THE SIMPLIFICATION OF HOLDING COMPANY SYSTEMS UNDER THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

by

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The title of these remarks I take from the heading of the famous Section 11 of the Public Utility Holding Company Act of 1935. That section is entitled "Simplification of Holding Company Systems". As used in the statute the term "simplification" comprehends not only the reduction of capital structures by the elimination of intermediate holding companies, the redistribution of inequitably distributed voting power and the like, but also the change of the utility holding company map of this country from its present arrangement to one where there shall be with few exceptions a collection of simple, corporately unconnected, integrated public utility systems.

My remarks* today deal with the problems of administration of this section as revealed in the actual work of the Securities and Exchange Commission. Purposely I refrain from any discussion as to the constitutional validity of this provision. Likewise I do not plan to discuss the merits of this section from a political or an economic viewpoint.

Preceding the enactment of this law, there occurred a bitter legislative battle, particularly on the issue of Section 11 *vel non*. Shortly after its enactment a number of the leading public utility holding companies instituted suits to test the constitutionality of the statute by seeking to enjoin its enforcement. The Securities and Exchange Commission on November 26, 1935, brought suit against the Electric Bond and Share Company to enjoin certain operations of the company because of its failure to register under the Act.

A number of holding companies registered with the Commission and the early precedents under the Act were developed in connection with the problems of these registered companies. Because most of the largest and most complicated holding company systems had sought court relief and thus avoided Commission control, fewer precedents have been made under the statute than would otherwise have been formulated.

Following the decision of the United States Supreme Court on March 28, 1938, in *Electric Bond & Share Company, et al.* v. *Securities and Exchange Commission*, which affirmed, on the facts therein contained, the validity of the registration provisions of the Public Utility Holding Company Act of 1935,

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questions arising from the operation of the Act as a whole took on a more immediate significance. The *Electric Bond and Share Company* case was instituted by the Commission itself for the purpose of accelerating a final determination, at least of the preliminary questions of law which were raised by the operation of the Act, viz., can Congress compel the registration of a holding company which has a corporate organization like that of the Electric Bond and Share Company and carries on the utility business in similar fashion. Pending the Supreme Court's decision in that case the Commission and the Attorney General adhered to a policy of withholding the sanctions of the Act and of limiting its administration to such companies as voluntarily had registered under the Act.

Although the decision in the *Electric Bond and Share Company* case is limited in scope in that it affirms the jurisdiction of the Commission only over such holding company systems as may fall within the facts of that case, and although it passes directly only upon the registration provisions of the Act, the response of the industry was a general movement on the part of all of the holding companies which were actually or potentially affected by the Act to register and to attempt to work out compliance with the other provisions, initially at least, through acceptance of the administrative functions of the Securities and Exchange Commission. 1/

The mechanism of regulation follows a now well-established pattern. The use of the mails and facilities of interstate commerce are prohibited to all but registered holding companies. Upon registration the companies are subjected to close supervision in their security transactions, acquisitions of assets, disposition of assets, service contracts, intercompany transactions, use of proxies, accounts and reports, and eventually to control over their corporate structure and geographical location.

The broad scope of the Act is indicated by the definitions in Section 2. A holding company is defined to mean any company which directly or indirectly owns, controls or holds with power to vote, ten per cent or more of the outstanding voting securities of a public utility company or of another holding company. A subsidiary company is defined to mean any company, ten per cent or more of the outstanding voting securities of which are directly or indirectly owned or controlled, or held with power to vote by a holding company. Thus a prima facie relationship calling for registration is made out where there exists an ownership of ten per cent or more of the voting securities of a gas or electric utility.

In order to provide for unusual situations the Commission is empowered, after hearing, to find that companies owning less than the stated percentage of voting securities are nevertheless subject to the Act if such companies actually exercise such a controlling influence over the management or policies of any public utility or holding company as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that such person be subject to the obligations, duties, and liabilities imposed by the Act upon holding companies. The basis for this sweeping authority was, of course, the extent to which through pyramiding there had grown up

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1/ By its regulation, Rule 4, any document filed with the Commission may contain "express reservation of and refusal to waive, any constitutional or legal rights". It has been uniformly held that registration involved no such waiver.

in the utility industry a serious separation of ownership from control. Thus far this extraordinary power has not been invoked.

It should be emphasized, however, that the Act does provide for the making of an application to the Securities and Exchange Commission for a declaration that the applicant, even though within the definition of the statute, is not a holding company or a subsidiary company. 2/ In the absence of contest as to the application of the Electric Bond and Share Company decision, 3/ it is clear that the Public Utility Holding Company Act of 1935 applies very generally to the gas and electric utility industry, and admits of an initial exemption from its provisions only as to such companies or systems that are predominately intrastate in character, 4/ predominately operating companies or are only incidentally holding companies, being primarily engaged or interested in one or more businesses other than the business of a public utility company.

Despite the heated debates and the public excitement during the passage of the 1935 statute, there existed a surprisingly large body of informed opinions within the utility industry favorable to Federal regulation of holding companies. Section 11 very early in the controversy was characterized as the "death sentence", thus bringing into the arena of debate emotionalism which tended to obscure a real understanding of the objectives of the law as a whole. 5/ That phase caught on so well in the popular and professional imagination that it still is used colloquially to identify the simplification section.

While the developments thus far under the administration of the Act by the Securities and Exchange Commission would seem to indicate that the implications of "the guillotine" were exaggerated, it is still true that the greatest attention to the Act, both on the part of the Commission and on the part of the affected companies, is being devoted to procedure under that section.

There can be no question that the purpose of the Act, as indicated not only in its final provisions, but also in the legislative deliverations leading

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2/ A well-conceived provision of the statute, Section 2 (a) (7) and (8), enables a company filing in good faith an application for an order declaring it not to be a holding company or an intermediate company or a subsidiary company to escape the obligation of such a status until the Commission acts on the application.

3/ In many cases the decision of the companies to register represented a practical judgment that the welfare of those companies was more likely to be advantaged by working out the problems involved in regulation co-operatively with the Commission rather than to risk the inevitable losses consequent upon protracted litigation.

4/ It should be pointed out that despite the broad scope of the 1935 law, there is a very substantial part of the electric and gas industry of this country outside the scope of Federal control, e.g., Consolidated Edison of New York, Boston Edison Co., Consolidated Gas Electric Light & Power Co. of Baltimore, Commonwealth Edison Co., Southern California Edison Co., Pacific Gas and Electric Co., etc.

5/ The importance of this section as furnishing a mechanism for eliminating unnecessary corporate complexities has been lost sight of in the conflict over the propriety of compulsory physical integration.

up to its enactment, is to arrest the further extension of the holding company device as it had developed in the gas and electric utility field, and to bring about a simplification of the corporate structures of existing holding company systems and a geographical integration of the operating territories within each system. This purpose is reflected in provisions of the statute other than those of Section 11. 6/ Thus Section 9 of the Act imposes drastic restrictions against the acquisition, without the approval of the Commission, by a registered holding company or any of its subsidiaries of any securities or utility assets or any other interest in any business.

Section 10 of the Act, in setting up the standards for the Commission's approval of the acquisition of securities and utility assets which are not exempted under other provisions or rules, expressly requires the Commission to deny the application to acquire where the acquisition tends toward interlocking or concentration of control, when the fees are excessive or the acquisition is not reasonably related to the earning capacity of the utility assets being acquired or the utility assets underlying the securities to be acquired, or where the acquisition unduly complicates the holding company system or is detrimental to the public interest. Even if all these elements are found favorable to the applicant, the Commission must refuse to approve a proposed acquisition if it is unlawful under Section 8 or is detrimental to the carrying out of Section 11. The Commission must also find in the case of the proposed acquisition of securities or utility assets of a public utility or holding company that it "will serve the public interest by tending toward economical and efficient development of an integrated public utility system." 7/

6/ This ultimate purpose of the Act is definitely stated in its "preamble", Section 1, and in particular in Section 1 (c), which reads as follows:

"(c) When abuses of the character above enumerated become persistent and widespread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, *in accordance with which policy all the provisions of this title shall be interpreted*, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title."

7/ Section 10 provides:

"(b) If the requirements of subsection (f) are satisfied, the Commission shall approve the acquisition unless the Commission finds that-

"(1) such acquisition will tend towards interlocking relations or the concentration of control of public-utility companies, of a kind or to an extent detrimental to the public interest or the interest of investors or consumers;

(cont.)

Section 7 of the Act similarly has a bearing on Section 11, for it establishes standards of simplified and conservative finance, which should of themselves tend towards the development of simplified capital and corporate structures. This section lays down very strict standards for public utility financing, not only with relation to the kind of security which may be issued, but also with reference to the kind of property which may constitute the lien, the purpose of the issue, its relationship to the existing financial structure of the holding company, etc. 8/

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7 (cont.)/ "(2) in case of the acquisition of securities or utility assets, the consideration, including all fees, commissions, and other remuneration, to whomsoever paid, to be given, directly or indirectly, in connection with such acquisition is not reasonable or does not bear a fair relation to the sums invested in or the earning capacity of the utility assets to be acquired or the utility assets underlying the securities to be acquired; or

"(3) such acquisition will unduly complicate the capital structure of the holding-company system of the applicant or will be detrimental to the public interest or the interest of investors or consumers or the proper functioning of such holding company system."

The same section further provides:

"(c) Notwithstanding the provisions of subsection (b), the Commission shall not approve -

"(1) an acquisition of securities or utility assets, or any other interest, which is unlawful under the provisions of Section 8 or is detrimental to the carrying out of the provisions of Section 11; or

"(2) the acquisition of securities or utility assets of a public utility or holding company unless the Commission finds that such acquisition will serve the public interest by tending towards the economical and efficient development of an integrated public-utility system. This paragraph shall not apply to the acquisition of securities or utility assets of a public-utility company operating exclusively outside the United States."

8/ Section 7 (c) states as follows:

"(c) The Commission shall not permit a declaration regarding the issue or sale of a security to become effective unless it finds that--

"(1) such security is (A) a common stock having a par value and being without preference as to dividends or distribution over, and having at least equal voting rights with, any outstanding security of the declarant; (B) a bond (i) secured by a first lien on physical property of the declarant, or (ii) secured by an obligation of a subsidiary company of the declarant secured by a first lien on physical property of such subsidiary company, or (iii) secured by any other assets of the type and character which the Commission by rules and regulations or order may prescribe as appropriate in the public interest or for the protection of investors; (C) a guaranty of, or assumption of liability on, a security of another company; or (D) a receiver's or trustee's certificate duly authorized by the appropriate court or courts; or

(cont.)

Section 12 likewise contains provisions which should ultimately have a material effect on the devlopment of simplified structures. These provisions place restrictions on inter-company transactions, dividends, acquisition of a company's own securities, and sale of assets and investments owned. Even if there were no mandate to achieve simplification the various restrictions affecting the financial operations of holding company systems would in time have great effect in achieving a certain degree of simplification. 9/

8/ (cont.) "(2) such security is to be issued or sold solely (A) for the purpose of refunding, extending, exchanging or discharging an outstanding security of the declarant and/or a predecessor company thereof or for the purpose of effecting a merger, consolidation, or other reorganizations; (B) for the purpose of financing the business of the declarant as a public-utility company; (C) for the purpose of financing the business of the declarant when the declarant is neither a holding company nor a public-utility company; and/or (D) for necessary and urgent corporate purposes of the declarant . . where the provisions of paragraph (1) would impose an unreasonable financial burden upon the declarant and are not necessary or appropriate in the public interest or for the protection of investors or consumers; or

"(3) such security is one the issuance of which was authorized by the company prior to January 1, 1935, and which the Commission by rules and regulations or order authorizes as necessary or appropriate in the public interest or for the protection of investors or consumers."

Section 7 (d) states as follows:

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

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

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

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

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

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

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

9/ Section 12 (a) - prohibits upstream loans.
Section 12 (b) - regulates intercompany loans.
Section 12 (c) - regulates acquisition of own securities and payment of dividends.
Section 12 (d) - regulates sale of assets and investments.
Sections 12 (f) and 12 (g) - regulate transactions between associates and affiliates.

Section 30 of the Act directs the Commission to make broad studies looking forward to economic and geographic integration.

These provisions would seem to reflect an intention on the part of Congress that while a concomitant purpose of the Act is to protect the investors and consumers in the utility industry, in security matters, the administration of the Act for those purposes should at least be consistent with the simplification and integration objectives as set up in Section 11.

The Commission has already had before it a number of cases involving acquisitions of securities or properties wherein it has considered and discussed the effect of the acquisition on Section 11 (see Appendices A, B, C, D, E, F and G.) It will be noted from a review of these Commission releases that the Commission was very careful in its treatment of the difficulties of Section 11. No clue as to the ultimate judgments under that section was furnished but the Commission's approach seemed sensible. In effect it has held that an acquisition of securities or of utility assets may be approved even if no direct move is made toward physical integration, at least in those instances where the degree of diversification was not by the acquisition increased. At an early date in the administration of this law the Commission made public an opinion of its General Counsel clarifying the degree to which Section 11 must be considered in reference to acquisitions occurring in connection with a reorganization of a holding company and announcing a liberal policy of interpretation. 10/

The duties of administration under Section 11 may be summarized as follows:

1 - The Commission is required to examine the corporate structure of every registered holding company and subsidiary company thereof to determine the extent to which the corporate structures of such systems may be simplified and the business thereof confined to an integrated public utility system.

2 - It is the duty of the Commission, *as soon as practicable after January 1, 1938,* 11/ to require that such steps as it shall recommend for simplification or integration shall be carried out. The section also provides that any registered holding company or subsidiary company at any time after

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10/ "But there is nothing in the terms of the Act which would prevent the Commission from sanctioning the acquisition by a reorganized company of several integrated systems in different localities or regions if the result of the acquisitions was merely to bind together under common control companies or properties previously under common control and no others, particularly if the acquisition by the new reorganized company would facilitate and protect investors in the ultimate segregation, divestment of control, reorganization or liquidation of the properties which may later be required under Section 11." - Opinion of the General Counsel December 23, 1935. Holding Company Act Release No. 54.

11/ This date is by no means a deadline. There is no sanction in the statute itself as to the vital question "when". The enormity of the task and the novelty of the legal and economic problems involved make haste in this matter undesirable and unattainable.

January 1, 1936, may submit its own plan for simplification and integration, upon which the Commission shall conduct hearings and make an order. The section also gives the Commission power to intervene in any reorganization proceeding to assure itself that such a reorganization shall be consistent with the purposes of Section 11, and further authorizes the Commission to invoke the jurisdiction of the Federal courts to enforce any of its orders under Section 11.

There is still a respectable opinion that a diversified system in the utility field may be shown to be more desirable than one which is territorially integrated. 12/ However this report deals with the law as we find it, which adopts the philosophy of integration and rejects the economics of diversification. It cannot be denied that the Act outlaws diversification as the final pattern of our private utilities. For purposes of this paper the relative merits of the two ideas need not be discussed.

There is little likelihood that the conflict centering around geographical integration will be resolved in the near future. A constructive and patient administration of the law by the Commission will do much to bring about orderly acceptance of this basic postulate of the law even in the absence of an early determination from the courts favorable to the law as written.

The other function under Section 11, viz. corporate simplification, has received more willing acceptance. No one can soundly maintain that corporate and capital structures ought not to be simplified - if it is demonstrable that existing complexities are either the vehicle of abuse, or merely unnecessary.

The last decade witnessed a rapid extension of the holding company technique in many fields. Stimulated in part by the tax laws permitting consolidated returns, a corporate maze developed, particularly in the public utility field, which made financial irregularities difficult to detect, state regulation ineffective and investment judgment fraught with peril. Disclosures by public agencies of how the holding company device had been used as a tool of financial oppression brought on the device itself much deserved public condemnation. The tax laws were amended to abolish consolidated returns and to impose an inter-corporate dividend tax. This latter provision has been enormously effective in simplifying the capital structures of innumerable companies in the business field generally as well as in the public utility field.

12/ That all the leaders of the holding company industry are not yet reconciled to the policy of geographic integration contained in Section 11 of the Act is indicated pretty clearly in the letter of the recently organized committee of the industry for co-operation with the Securities and Exchange Commission sent to Chairman Douglas on May 5th which stated in part:

> "In this connection, these executives also expressed their belief that the fundamental principle of diversity of investment which is represented here by both geographic location of operating properties and character of business served by them, is a very important factor and in the raising of additional capital, and that such principle should be preserved in the public interest."

The Securities and Exchange Commission is at the present time actively making the required studies under Section 11 involving both integration and simplification. Economic and geographic integration of utility companies is of necessity still a somewhat indefinite subject. Since the question of corporate and capital simplification is the more immediate and is, in fact, a prelude to a solution of the integration problem, a large part of the Commission's efforts is devoted to corporate simplification.

Progress under Section 11 in the near future then will probably be primarily along the lines of corporate and capital simplification. Progress, of course, will be made toward economic and geographic integration, but primarily in connection with simplification. That is, in connection with each working out of a simplification problem, integration must be considered, and as each case is settled certain principles with reference to economic and geographic integration will become established. This does not mean that the Commission can or will permit long delays in developing plans for geographical integration. The Chairman this morning served notice on utility executives that full compliance with the statute would be required. However, the problems are so difficult that years of effort may be necessary before substantial integration of the industry will be achieved.

This trend in the development of simplification and integration under Section 11 can be illustrated by the case of American Water Works & Electric Co. That holding company system had a problem considerably less difficult than those facing most of the other large holding company systems, because of the fact that its electric utility properties consist essentially of one large interconnected system located in one region, northern West Virginia, western Maryland and western Pennsylvania. The problem facing American Water Works & Electric Co. was essentially one of corporate and capital simplification, together with the question of whether its important interests in a number of water companies were "reasonably incidental or economically necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of" its system.

During 1937 American Water Works & Electric Co. filed a plan under Section 11 (e) of the Act, which provides for the filing of voluntary plans by companies. This plan provided essentially for simplification through the elimination of an intermediary holding company. Such an elimination in itself would not be particularly difficult, but in this case there were large issues of debentures and preferred stock of the intermediary holding company in the hands of the public which had to be redeemed. Hence, financing by American Water Works & Electric Co. was necessary to provide the funds to redeem these securities. However, the management of the company correctly advocated that before investors would purchase new securities of American Water Works & Electric Co. they would have to be assured that American Water Works & Electric Co. would not be subject to the "death sentence", or in other words that it would be for years to come a continuing enterprise in substantially the same form as now constituted.

Late in 1937 the Commission issued its findings, opinion and order in this case, approving the company's plan. In granting this approval it concluded that the electric operations of the system conformed to the standards

of an "integrated public-utility system", as defined in the Act, that the combination of minor gas properties with the electric properties under such circumstances constituted a single integrated system, and that the ownership of other businesses (primarily the water companies) were "reasonably incidental and economically appropriate". Thus, in this manner certain principles of economic and geographic integration were expressed in a case involving primarily corporate and capital simplification. This was an important, though in relation to the whole problem a limited precedent (a) on the question of geographic integration and (b) on the question of what other enterprise can be regarded as reasonably incidental to a holding company system. 13/

It is generally expected that future progress in the next few years in connection with economic and geographic integration will be made in this same case method. There is no indication as yet that the Commission looks upon the integration provisions of Section 11 as a Procrustean bed into which every holding company is to be forced abruptly. In fact, in the case of Peoples Light & Power Co. it stated definitely that the working out of the integration provisions of Section 11 must be "evolutionary rather than revolutionary". Thus, while the policy of the Commission must be, under the present provisions of the Act, that the mandate of Congress as to simplification will not be accomplished until holding companies in general, with certain exceptions, are done away with, it is universally recognized that such results cannot be preemptorily demanded or brought about merely by Commission fiat but only by patient and intelligent administrative supervision.

That this analysis is correct is further strengthened by the often-stated policy of the Securities and Exchange Commission in encouraging the filing of voluntary plans by the companies. For example, in the American Water Works & Electric Co. case 14/ the Commission stated:

> "In concluding this opinion, the Commission wishes to point out that two alternative methods of securing compliance with the simplification requirements of Section 11 are provided in the statute. One is by an order under Section 11 (b), which may be enforced through the courts, as provided in Section 11 (d); the other is by a voluntary plan of a registered holding company pursuant to the provisions of Section 11 (e), whereby the Commission is empowered to approve a voluntary plan devised to enable an applicant to comply with the requirements of Section 11 (b). *The Commission recognizes that it is highly desirable that the simplification requirements be effectuated by voluntary and co-operative proceedings under Sections 11 (e) rather than by involuntary proceedings under Sections*

13/ One of the most important questions likely to be raised in connection with judicial review of the statute will involve the question of delegation of legislative power, a question not regarded as a threat to Federal legislation until a few years ago. The very nature of the task imposed by Congress necessitated broad grants of power to the administrative agency not only for the attainment of the ends of the law, but to give that flexibility without which hardship on the industry might result. To the extent that the Commission spells out in a series of precedents its own conception of what the delegation meant, the constitutional dangers are likely to be minimized.

14/ See Securities and Exchange Commission Holding Company Act Release No. 949, dated December 30, 1937.

11 (b) and 11 (d). For this reason it is the policy of the Commission to render all appropriate assistance to the executives of a holding company system desiring to comply voluntarily with the simplification provisions of the Act. That policy has been followed in this case and has been facilitated by the constructive co-operation of the applicant's officers."

This point of view has since been reiterated time and again in public statements by the Commission.

Even a passing familiarity with problems involved in integration is sufficient to convince one that the objectives set by the statute are realizable only after many years of patient and competent effort on the part of the Commission and the industry. This effort to be successful within a reasonable time must not be made in an atmosphere of antagonisms and litigation, but rather in a constructive and friendly spirit. It is doubtful if a final order for the compulsory rearrangement of one of our large utility holding company systems could be achieved until after years of hearing before the Commission and litigation in the courts, where all the conflicting interests of the various security holders could be impartially adjudicated. Even if the action of the Commission involving compulsion were to be given a complete judicial approval, the final results in the larger aspect of a social problem will be far less advantageous if the solution is had through administrative and judicial compulsion than if it be brought about by orderly co-operative endeavor. This aspect of the problem is recognized by the Commission and must, of course, be recognized by the leaders of the industry. From the viewpoint of wasted effort, impaired security values, etc., the advantages of voluntary rearrangement far outweigh the advantages of "trial by battle".

The development of a co-operative technique in aid of administration, it seems to me, can be an immediate objective of the public utility holding company industry without in any way impairing or prejudicing its rights to have the major powers granted by Congress to the Commission tested as to their constitutional bases. It is not beyond the realm of accomplishment that the industry will work out a method whereby adjudications of these powers will proceed in orderly fashion while the administration of the law by the Commission will not be impeded.

There is practical unanimity on the part of all critics of the public utility industry in this country, whether friendly or otherwise, that a major cause of the evils which brought about the strict measure of governmental control now obtaining was the unbridled competition on the part of the holding company systems to acquire operating companies. This led to the artificial inflation of property values which was bound to affect the rates and inevitably distorted the security structures of these companies. Many of the evils from this competitive campaign were left to be worked out by the Commission under its extraordinary powers to eliminate writeups, etc. Strangely enough, in any voluntary rearrangement pursuant to the integration section of the Act the industry will find itself face to face with a modified form of this serious evil of the last decade. Assume a holding company system which because of its diversification just cannot integrate some parts of its properties into its own system. 15/ It must therefore sell or trade these properties.

15/ Mr. Floyd Odlum, President of Atlas Corporation, had described a system in which his company is the largest individual security holder and as violating "practically every basic provision of the Holding Company Act, the company's subsidiary properties being mostly 'utility islands' entirely surrounded by major systems, belonging to other major groups."

Assume further that a particularly attractive operating company may be integrated into one of three systems and in each case be in compliance with the integration standard as determined by the Commission. The holding company system owning the property can offer it to the highest bidder, and with three competitors the bidding is likely to be spirited. There is danger that the price may be beyond that which on sound principles can be justified. Of course the Commission can coerce the sale to one of the three competing systems by announcing in advance a complete pattern for rearranging all holding company systems of the country. However, such a task is tremendous, involves grave risks of administration, and probably as a practical matter cannot be done for years.

There is one step which the Commission can take to minimize the evil of which I speak. It can lay down fairly broad formulae of value, announcing at the same time a policy that it will not approve the acquisition or the sale if the terms substantially exceed these formulae. In this fashion the disposing company will not be able to play the potential acquiring companies one against the other so as to inflate the price. In this way the Commission can more easily in voluntary rearrangements work out its policies with reference to the refashioning of the utility map of this country. 16/

In recent months there have come from the pens of the Commission and its staff writings which indicate a marked unanimity of opinion regarding the appropriate policy which should be followed in certain types of recapitalizations. The typical situation involves a holding company on whose preferred stock there are accumulations of unpaid dividends for several years. In some of these cases the arrearages amount to as much as 30% to 50% of the preferred stock principal. In these situations the urgent need for reorganization has been frequently stressed. The Chairman wrote in the Wall Street Journal on June 8, 1938, "Many companies now find themselves with large arrearages on their preferred stock and swollen capital structures which block voluntary moves toward rehabilitation of the industry and compliance with the program of the Public Utility Holding Company Act."

Commissioner Frank in an address in Buffalo said, "These, then, are among the chief obstacles to utility reorganization - the desperate clinging by investors to . . . a mirage . . . the determined clutch of management upon the common stock . . . The continued existence of these exhausted claims upon non-existent earnings - these worthless stocks raise a problem of grave national importance."

Because each problem must be treated as a special one on its peculiar facts it is not strange that we find such generalizations as "The sensible way out is for common stockholders, encouraged by this Commission to abandon the pattern of the past and to devise plans which give to each class of stock its lawful and rightful desert". A similarly cautious generalization which recognizes how particularized must be the administrative treatment is seen in the following:

16/ A clear indication of Chairman Douglas' viewpoint on the importance of proceeding to the implementation of Section 11 is apparent from his remarks regarding the Utilities Power & Light Corporation reorganization. See New York Times July 21, 1938.

"This does not mean that the rights of common stockholders may be disregarded. The Commission has the same duty to protect the rights of the common stockholders that it owes to the preferred holders. It must fairly protect those legal rights but it cannot permit either class of stockholders to impair the rights of others."

Even though these statements are somewhat indefinite it would be a mistake not to appreciate that the Commission is broadly hinting that in many situations the common stock must be satisfied with but a small fraction of the new company, the balance to go to the preferred stockholders whose rights have been so long postponed. The Chairman has invited companies and security holders to file plans and has promised co-operation, indicating that where reasonable voluntary plans are filed the Commission will give every recognition to the common stockholders that fairness will permit. If these recapitalizations are not put into effect voluntarily, however, Chairman Douglas indicates that the Commission will take action on its own initiative to restore a balance to the capital structure and to give to the different classes their equitable deserts.

In undertaking to force recapitalization to eliminate large preferred dividend arrearages the Commission would probably proceed under Section 11 (b) (2), which provides essentially as follows:

"Sec. 11 (b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(2) To require by order - - - that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system."

Under this section of the Act the Commission could presumably issue an order directing a company having large preferred dividend arrearages and a common stock "under water" to redistribute the voting power so that control passed from the common to the preferred. Thereupon the preferred stock could prepare, file and put into effect with the approval of the Commission an equitable plan of recapitalization. Should such an order of the Commission be opposed by the common stockholders, a court test of Section 11 (b) (2) might result. In many cases the court might very well decide the issue in favor of the Commission on the ground that the common stock of the company was "under water" and hence the common shareholders could not be damaged in any legal sense. 17/ Or the court may sustain the Commission's powers even where the common stockholders holdings have value, since the statute makes no such distinction and apparently is not based upon bankruptcy powers alone.

17/ Compare the provisions of the Bankruptcy Act, Section 77B, U.S.C. Sec. 207, where upon the finding of insolvency, the rights of the stockholders are considerably curtailed.

Under Section 11 (d) of the Act the Commission is granted power to apply to a court to enforce compliance with an order issued under Section 11 (b).18/

It should perhaps also be pointed out here that the Commission has very substantial power to force simplification of holding company systems by virtue of the authority granted to it by Section 12 (c) of the Act over dividends. 19/ In the case of one large holding company which the speaker has in mind, the major part of the income consists of common dividends from an intermediary holding company. The balance sheet of the latter indicates definitely that the nature of its surplus is not known, and an order of the Commission preventing further payment of common dividends would shrink the income of the top holding company to a point such that it would be unable to meet its fixed charges.

This power of the Commission over the payment of dividends has been forcibly demonstrated by the Columbia Gas & Electric Corporation case (Holding Company Act Releases No. 1055 and 1152), in which the Commission refused to permit the payment of common dividends pending a determination of Columbia's surplus.

18/ Section 11 (d) reads as follows:

"The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity, may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization."

19/ Section 12 (c) of the Act reads as follows:

"It shall be unlawful for any registered holding company or subsidiary company thereof, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, to declare or pay any dividend on any security of such company or to acquire, retire, or redeem any security of such company, in contravention of such rules and regulations or orders as the Commission deems necessary or appropriate to protect the financial integrity of companies in holding-company systems, to safeguard the working capital of public-utility companies, to prevent the payment of dividends out of capital or unearned surplus, or to prevent the circumvention of the provisions of this title or the rules, regulations, or orders thereunder."

In the case of a company falling within the class of those needing recapitalization according to Chairman Douglas, it would seem to be a wise course for the management or the preferred shareholders to prepare and file a plan for the elimination of these arrearages. This plan presumably would be filed under Section 11 (e). Not only would there be the advantages of voluntary action plus an opportunity for trading during the course of the proceeding and before final Commission action, but the parties would have the advantage of making their own precedent. They would avoid the risk of later litigating whether their case came within or without the authority of a precedent made by a different company.

There is another distinct advantage to be gained by filing a plan under Section 11 (e) 20/ which has perhaps been overlooked by an industry somewhat intimidated by the task of complying with the provisions of the Act. The advantage is that of being able to obtain approval by a governmental agency of the proposed plan. It is noted that in the case of a number of reorganization plans filed with the Commission, the filings have taken the form of separate applications under Sections 7, 10, 11 (g), etc., rather than a composite petition under Section 11 (e) for specific approval of the plan as a whole. This procedure may be due to the applicant's feeling that the Commission is reluctant to be faced with the necessity of placing its stamp of approval on a plan to comply with the provisions of Section 11 (b). As a practical matter it would appear that this mechanism should be available for use in connection with reorganization plans which move forward towards compliance with Section 11 (b) even though the plan does not provide for complete compliance with that subsection. For example, it should be reasonable to assume that the Commission would specifically approve under Section 11 (e) a plan by a holding company to comply with Section 11 (b) (2) (or in part only) even though at the time no specific provision was made for compliance with the provisions of Section 11 (b) (1).

The advantage of an impartial report by a governmental agency exists under Section 11 (g) also. This subsection provides essentially that no person may solicit proxies in connection with a reorganization plan of a registered holding company or subsidiary unless the plan has been submitted to the Commission and solicitations are accompanied by the Commision's report on the plan. Heretofore in rorganizations it has been difficult to get investors to assent to plans, largely because they were seldom informed as to the course of action proper in their own interest. Now they can have a reasonably competent and impartial analysis of the plan to guide them. A report that the proposed plan is fair would greatly facilitate the reorganization of a company.

The device of a report has been used successfully in connection with reorganization or recapitalizations in the case of illinois Power & Light Corp., International Paper & Power Co., Commonwealth Gas & Electric Companies, Central Massachusetts Light & Power Company and Massachusetts Lighting Companies.

20/ The first part of Section 11 (e) reads in essence as follows:

"(e) - - - any registered holding company or any subsidiary - - - may - - - submit a plan for the divestment of control, securities, or other assets, or for any other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If - - - the Commission shall find such plan - - - necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; - - -"

Section 11 (e) also provides a mechanism for the enforcement by courts of plans approved by the Commission. 21/ To date there has not been any court action pursuant to this section. However, it offers a means of enforcing the provisions of a voluntary reorganization heretofore never available. Although no explicit language is used indicating that dissenting stockholders can be forced to accept new securities on a basis found fair and equitable by the Commission and upheld by the court, nevertheless such a power of compulsory substitution of fair equivalents is absolutely essential to the efficacy of Section 11.

Section 11 (e) raises a rather novel question of constitutional law. Can a Congress through a Federal administrative agency and a Federal court compel a security holder to accept terms different from those provided under the corporation law of the state in which the company being reorganized is incorporated. Fortunately from the viewpoint of time and my reputation as a prophet, this question lies outside the scope of my paper.

These provisions of Section 11 thus offer facilities which companies may advantageously use to facilitate simplification. However, while these mechanisms are undoubtedly of real help to the companies, more than advantageous machinery is necessary. It is important that the Commission approach its task with an eagerness to accept the responsibility of the statute in order to facilitate simplification. It must be willing to approve under Section 11 (e) plans constituting partial compliance with and looking towards ultimate complete compliance with Section 11 (b), and it must be willing to act boldly in making reports on plans under Section 11 (g). The Commission must be ready to seek practical solutions within the framework of the Act.

Successful administration of a modern statute is seldom a simple task. This law presents a variety of complexities never before faced by any tribunal of government. An immense amount of talent was required for drafting this statute. As much if not more talent will be needed to make it work.

In this connection, I should like to make two points. First of all, perfection in administration of this law must be regarded as unattainable. So much of it calls for judgments in areas where many can differ substantially and yet no one be demonstrably wrong that a general tolerance for the opinion of the industry is essential. The perfectionist in this field is bound to fail because of the size of the job and the limitations on human capacity. The most we should expect is sincerity and informed practical wisdom. In the second place, the administrators must not permit their knowledge or feeling about past malfeasances to obscure their thinking about the task at hand. The

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21/ The second part of Section 11 (e) in substance provides:

" - - - and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of Section 18, to enforce and carry out the terms and provisions of such a plan. If - - - the court - - - shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of Section 11, the court as a court of equity may - - - take exclusive jurisdiction and possession of the company - - - and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee - - - to hold or administer - - - in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed."

record of yesterday may call for wariness but not for vindictiveness. Any policy of vengeance toward individuals or companies will distort the whole administration. In fairness it should be observed that nothing in the record of the Commission indicates that personal justice is supplanting justice according to law.

A most reassuring indication of the co-operative attitude of the Commission was revealed by the action of Chairman Douglas in appearing before the Senate Committee on Finance and sponsoring a provision now found in the Revenue Act of 1938. If it were not for this tax exemption a serious deterrent to voluntary reorganizations would be continued. Under the 1938 Act practically every reorganization subject to the supervision of the Securities and Exchange Commission, whether involving the collapse of an intermediate holding company, the exchange of securities or property of existing systems, the distribution of securities by the top holding company in exchange for subsidiaries' securities, or the like, which may result in capital gains, is to be treated as exempt from the normal provisions of the revenue law. All praise to the Chairman for this effort. Regardless of how logical an argument can be made against a government that would compel reorganization on the one hand and appear unduly to tax the results of it on the other, on the issue of co-operation and good faith and progressive understanding of the current problems, Chairman Douglas is deserving of genuine commendation. Without his sponsorship the removal of this important obstacle to reorganization would have been unlikely.

Even though we have a combination of intelligent administration and on the part of the industry wholehearted cooperation, the program necessary to make the 1935 Act effective may be a failure unless economic conditions soon improve so as to render equity financing of utility properties practicable. Under present conditions, it is all too obvious that equity financing of utility properties has come to a point of near paralysis. This condition is attributable to a variety of circumstances unconnected with the administration of the Holding Company Act. However, as an effect it must be recognized. The present depressed state of utility markets does militate against reorganizations and refinancing which are essential to the fulfilment of the objectives of the statute. Without a substantial equity market for utility securities the possibility of reorganizing and integrating utility properties is considerably dimmed. Here again any serious comment leads me apart from the proper confines of the subject I have set myself to discuss. 22/

Perhaps there should be observed the problem of overlapping jurisdiction as between the Securities and Exchange Commission, the state commissions and the Federal Power Commission. This, while a minor point, involves a problem of effective government action and calls for the oft-repeated argument of coordination.

Problems of recapitalization have been rendered more difficult by a recent decision of the Supreme Court of Delaware, *Keller* v. *Wilson & Co.* To put it mildly, this case was a shock to the reorganization bar, particularly of the City of New York, some members of which regarded Delaware jurisprudence as incapable of compliance with the requirements of due process as that term was generally understood.

22/ Although American Water Works and Electric Company has completed a plan for simplification as of December 30, 1937, the unfavorable condition of the equity market for utilities has prevented effective consummation of the plan.

In past periods of adjusting capital structures to eliminate large preferred dividend arrearages, the method most generally used, in the absence of special statutory or other difficulties, was that of working out what was ostensibly an equitable trade between the common stockholders and the preferred, obtaining the requisite percentage of favorable votes from each class of stock, and issuing the new shares of preferred and common in exchange for the old shares in accordance with the plan. This relatively simple procedure, however, was voided by the abovementioned decision, wherein the court held that preferred dividend arrearages are in the nature of a vested property right and cannot be satisfied by the issuance of stock in exchange for them, even if a majority or larger percentage of preferred stock have voted to accept such an exchange.

As a result of this decision companies have been forced to seek other means of satisfying preferred dividend arrearages. One mechanism which has been devised is that of dividend arrears certificates, a new type of security which carries no interest or dividends but which must be retired before the common stock can receive any dividends. This mechanism appears to satisfy the requirements of the Wilson decision, but has the unfortunate effect of tending to complicate the capital structure of the company in question.

Perhaps the most notable use of this device was that in 1937 in the Illinois Power & Light Corp. (now Illinois Iowa Power Co.) reorganization, which was accomplished under the Public Utility Act of 1935. In that case preferred stockholders were given a half share of new preferred stock and some common stock for the principal of their old preferred stock, plus dividend arrears certificates in the amount of the arrears on their old preferred stock. These dividend arrears certificates entitle the holders to receive in cash the full amount of the dividend arrears before any dividends may be paid on the common stock. They are also convertible into common stock.

During the same year, 1937, another reorganization was effected under the Public Utility Act of 1935, that of International Paper & Power Corp. In this case, however, the large arrears on the preferred stock were satisfied by the issuance of common stock to preferred stockholders in settlement of the dividend arrears. This was an unusual situation, however, for International Paper & Power Corp. was a Massachusetts voluntary trust, which is in some respects more in the nature of a partnership than a corporation and the rights of its stockholders are determined wholly by the articles of association and not by the state corporation law. The articles of association of International Paper & Power Corp. are very broad in certain respects, and all preferred stockholders were bound by the vote of two-thirds of the stock present at the capital stockholders' meeting. Two-thirds of the preferred stock present voted to accept common stock in settlement of preferred dividend arrears, and consequently the minority had to accept the exchange.

It is possible to eliminate preferred dividend arrears without using dividend arrears certificates, however, by effecting a statutory consolidation, if circumstances permit, that is, if in connection with the proposed plan two companies are available which can be consolidated as a practical matter. In such a case the various stockholders of each company would be given new stock in the consolidated company in fair and equitable proportions and preferred dividend arrears would not have to be satisfied through issuance of dividend arrears certificates.

In such a consolidation, of course, in most states any dissenting preferred, or other, stockholder would be entitled to an appraisal of his holdings and to be paid off in cash. If a substantial proportion of the stockholders dissented, the reorganization by this method probably would be impractical, as the company might not have sufficient cash to pay off the dissenters.

There are two reasons why managements should not be afraid to proceed with a reorganization by a statutory consolidation. In the first place, the consolidation would not be binding until final action by the boards of directors declaring the consolidation effective. The boards of directors, of course, could reserve such action until they saw the number of dissenters. In the second place, such a reorganization of a registered holding company or subsidiary would have to be reviewed by the Commission under the Public Utility Act of 1935 and solicitations of consents would have to be accompanied by a report of the Commission. As has been observed, a finding by the Commission that the plan of reorganization is equitable would, invariably, bring to the support of the plan the necessary assents.

In this necessarily short review of the work of the Commission we can perceive the beginning of a section of our jurisprudence which will undoubtedly loom large in the legal institutions of tomorrow. One cannot emphasize too much the fact that never before has an agency of government attempted such a sweeping control over such a widespread industry. The number of cases which have passed through the administrative machinery is still relatively too small to permit of safe generalization, either in extravagant praise or sharp criticism. However, in all fairness it must be stated that the Commission has not regarded itself as an agency to reform traditional American legal concepts. It should be acknowledged that the administration has been characterized by a conservative rather than a bold and adventurous policy. In view of the novelty and magnitude of the task Congress has imposed upon this important agency of government, fairness would seem to require that any thorough-going critical analysis be postponed until such time as the Commission has had a longer time and a greater number of cases in its endeavor to apply the Congressional policies to this far-flung industry.

Because this problem is essentially dynamic, because it deals with an industry whose future is far from static, because of the sweeping commands of the statute and the widespread effect of its mandate, all judgments necessarily should be tentative. Consequently the continuation of a committee which will keep members of the Association informed of current developments is respectfully recommended.

Appendix A

MASSACHUSETTS UTILITIES ASSOCIATES and NEW ENGLAND GAS AND ELECTRIC ASSOCIATION 1/

This case presents a particularly interesting example of corporate simplification and geographic integration under the Public Utility Holding Company Act of 1935.

Massachusetts Utilities Associates (MUA), a subsidiary of New England Power Association, a registered holding company, controls a large number of small utility holding and operating companies in Massachusetts. Several of these subsidiaries, at the time of the filing of the applications, had outstanding minority interests in their common stocks. To simplify its system MUA desired to acquire these minority interests, some of which were owned by New England Gas and Electric Association (NEGEA).

NEGEA is a holding company owning control of a number of utility operating companies in New England, and is generally regarded as being a part of the Associated Gas & Electric System. Important among the utility operating companies controlled by NEGEA are New Bedford Gas & Edison Light Company and Cape & Vineyard Electric Company.

Territory in southeastern Massachusetts adjacent to the service areas of these two operating companies were served with electricity by Plymouth County Electric Company and with gas by Plymouth County Gas Light Company, both of which were subsidiaries of MUA. NEGEA desired to acquire these two companies to round out its service area in that region.

MUA applied to the SEC pursuant to Section 9 (a) (1) for approval of acquisition by it from NEGEA of the latter's holdings of minority stocks of subsidiaries of MUA.

NEGEA applied pursuant to Section 9 (a) (2), neither it nor Associated Gas & Electric Co. being a registered holding company at that time, for approval of acquisition from MUA of securities representing control of Plymouth County Electric Company and Plymouth County Gas Light Company.

The SEC approved these applications on March 19, 1937, MUA was thereby enabled to acquire minority interests in its subsidiaries which in turn at a later date permitted it to take steps towards the dissolution of some of its subsidiary sub-holding companies and the consequent simplification of its corporate structure. NEGEA was able to obtain control of some utility properties which fitted in closely with its important properties in southeastern Massachusetts.

Thus, though these two transactions were carried out solely through applications under Section 9 the result was simplification and integration as contemplated by Section 11.

1/ Securities and Exchange Commission - Holding Company Act Release No. 578 - March 24, 1937.

The consideration given to Section 11 by the Commission in approving these applications is well evidenced by the following extracts from its findings and opinion. In the case of the MUA application the Commission stated in part as follows:

"It appears to the satisfaction of this Commission that such State laws as may apply in respect to the proposed acquisition by MUA have been complied with, and that accordingly, the provisions of Section 10 (f) are satisfied; that such acquisition is not unlawful under Section 8 and that in this respect Section 10 (c) (1) is satisfied.

"Section 10 (b) and 10 (c) (1) of said Act provide, in effect, that under such circumstances the Commission shall approve the acquisition unless it finds that it will tend toward interlocking relations or concentration of control of a kind or to an extent detrimental to the public interest or the interest of investors or consumers; that such acquisition will unduly complicate the capital structure of the holding company system of the applicant or will be detrimental to the public interest or the interest of investors or consumers or the proper functioning of such holding company system, or detrimental to carrying out the provisions of Section 11; that the consideration to be paid is not reasonable or does not bear a fair relation to the sums invested in or the earning capacity of the utility assets underlying the securities to be acquired. Section 10 (c) (2) provides that the Commission shall not approve the acquisition unless it finds that it "will serve the public interest by tending towards the economical and efficient development of an integrated public utility system.

"As stated above, all of the issuers of the securities to be acquired by MUA are included among its present subsidiary companies. The electric utility companies of this group are all interconnected through the network of the New England Power Association's system. These companies serve areas in Massachusetts, which, when considered together with other direct and indirect subsidiary companies of New England Power Association, may be said to be confined "to a single area or region" and to be generally contiguous. The issuers of securities to be acquired by MUA also include two gas utility companies, the operations of which are within the general area served by other direct and indirect subsidiary companies of New England Power Association.

"The proposed acquisition would increase the interest of MUA in the voting securities of these companies, but since they are already controlled by MUA through the ownership of seventy percent or more of their voting securities, such acquisition would not, in fact, alter the existing control of such companies. Furthermore, such acquisition will facilitate the ultimate elimination of four subholding companies of MUA, which is contemplated as a step in the simplification of the New England Power Association System.

"As stated above, the consideration for such acquisition by MUA consists principally in the exchange of securities, together with a cash payment of $25,000. There is evidence that the transaction involves arm's length bargaining between parties who are not affiliates, and that after allowance for such fees and the cash consideration involved the relation between the earning capacity and sums invested in the assets underlying the securities to be exchanged, is not unreasonable.

"Under the circumstances we find no reasons for any adverse findings in any of the respects set out in Section 10 (b) of the Act, and find that the acquisition of said securities by MUA will serve the public interest by tending towards the economical and efficient development of an integrated public utility system."

With reference to the acquisition by NEGEA the Commission said in part as follows:

"Inquiry into compliance with the provisions of Section 10 (f), Section 10 (c) (1) and Section 8 (applicable by virtue of Section 10 (c) (1)) involves substantially similar consideration to those discussed above in connection with the proposed acquisition by Massachusetts Utilities Associated. Again, it appears to the satisfaction of this Commission that such state laws as may apply in respect to the proposed acquisition by applicant NEGEA have been complied with, and that, accordingly, the provisions of Section 10 (f) are satisfied; that said acquisition is not unlawful under Section 8 and that in this respect Section 10 (c) (1) is satisfied. As in that phase of the transaction considered with reference to the application of Massachusetts Utilities Associates, there is evidence that the transaction involves arm's length bargaining between parties who are not affiliates, and that after due allowance for fees and cash consideration involved, the earning capacity of, and sums invested in, the assets underlying the securities to be acquired by applicant NEGEA are not disproportionate to the consideration to be given. Again, there appears to be no reason for adverse findings in any of the respects set out in Section 10 (b) (2).

"The further questions arising under Sections 10 (b) (1), 10 (b) (3), and the requirement of 10 (c) (1) for inquiry as to whether the acquisition is detrimental to the carrying out of the provisions of Section 11, more specifically relate to the effect of the transaction upon applicant NEGEA and upon the Associated System.

"Section 10 (c) (2) provides that the Commission shall not approve the acquisition unless it finds that "it will serve the public interest by tending toward the economical and efficient development of an integrated public utility system".

"Section 2 (a) (29) gives separate definitions of 'integrated public utility system', as applied to electric utility companies and as applied to gas utility companies. However, we are principally concerned with its application to electric utility companies. Plymouth Gas Light Company, which distributes gas within part of the territory served by Plymouth County Electric Company, has gross earnings at the rate of approximately $70,000 a year, gross assets of a book value of $888,000 (as of December 31, 1935) and has no facilities for the manufacture of gas but purchases its entire requirements from Brockton Gas Light Company, a company not affiliated with any of the parties to the proposed exchange agreement. Under the circumstances, it seems appropriate to regard the acquisition of said securities of Plymouth Gas Light Company by applicant NEGEA as incidental to the acquisition of securities of the Plymouth County Electric Company, and to consider the proposed acquisition as an entirety without regard to whether the acquisition of said gas utility, as a separate transaction, would meet the requirements of Section 10 (c) (2).

"Plymouth County Electric Company distributes electricity within an area that is located between areas served by New Bedford Gas & Edison Light Company and Cape & Vineyard Electric Company, existing subsidiaries of applicant NEGEA. The transmission lines and distributing and generating facilities of these three electric utility companies are already physically interconnected. The area served by these three electric utility companies may appropriately be described as falling within the description "a single area or region", all of which is within the State of Massachusetts and which is not so large as to impair the advantage of localized management, efficient operation, and the effectiveness of regulation. Accordingly, the Commission finds that the acquisition by applicant NEGEA of said securities of Plymouth County Electric Company and the acquisition, as incident thereto and part of the same transaction, of said securities of Plymouth County Gas Light Company will serve the public interest by tending toward the economical and efficient development of an integrated public utility system.

"There remains for consideration the question of whether it is appropriate for the Commission to make adverse findings in the respects set forth in Section 10 (b) (1) or Section 10 (b) (3), or in respect of finding said acquisition detrimental to carrying out the provisions of Section 11. We have not deemed it appropriate to make any such adverse findings. In reaching this conclusion, we have been influenced, among other circumstances, by the fact that the transaction involves no additional investment by applicant NEGEA or by any of the companies of the Associated System, but is substantially an exchange of minority holdings in subsidiaries of another holding company system for the securities which applicant proposes to acquire; the fact that said minority holdings are now held by NEGEA through a wholly-owned subsidiary (Electric Associates, a Delaware corporation) while the securities of said Plymouth companies will be directly held by NEGEA; the fact that all of the public utility companies within the Associated System which operate in areas adjacent to that served by the two Plymouth companies are subsidiaries of applicant NEGEA, and that, therefore, no question arises as to the relative advantages, with reference to complying with Section 11, of grouping either of said Plymouth companies with any other companies of the Associated System. Including in a single holding company system said Plymouth companies and the electric utility subsidiaries of applicant NEGEA which serve adjacent areas, is an appropriate preliminary step toward ultimate compliance with the provisions of Section 11 by any companies of the Associated System (including applicant NEGEA) to which such provisions may become applicable, whether or not the ultimate result of such compliance will involve separation of either or both of said Plymouth companies from other companies of the Associated System."

From this case, as well as from some similar cases, an important observation may be drawn. The Commission, in considering the application by a member of a far-flung holding company system for approval of the acquisition by it of additional adjacent properties, has not found such acquisition to be detrimental to the carrying out of the provisions of Section 11. Rather this Commission has found that such acquisition of adjacent properties are appropriate preliminary steps toward ultimate compliance with the provisions of Section 11.

Appendix B

MASSACHUSETTS UTILITIES ASSOCIATES 1/

This case presents an example of substantial corporate simplification accomplished through the filing and approval of a voluntary plan under Section 11 (e).

Massachusetts Utilities Associates (MUA), a holding company subsidiary of New England Power Association, a registered holding company, joined with three of its own subsidiary holding companies, in the filing of three sets of applications and declarations pursuant to Sections 7, 11, 12 and 15 of the Act, the ultimate purpose of which was to effect liquidation of the three sub-holding companies under MUA, thereby substantially simplifying the corporate structure of MUA and New England Power Association. (During 1937 MUA had successfully taken a preliminary step looking towards this consolidation when it transferred its control of Plymouth County Electric Company and Plymouth County Gas Light Company to New England Gas and Electric Association in exchange for substantial minority interests in subsidiaries of MUA.)

The Commission found that the voluntary plan was necessary and was fair and equitable, as is required by Section 11 (e), and also approved the necessary declarations under Section 7 as well as the payment of liquidating dividends and the retirement of stocks under Section 12 and the necessary accounting entries under Section 15. In addition, it issued, pursuant to Section 11 (g), reports on the plan for liquidating each sub-holding company, which reports were issued by MUA in making solicitations in connection with the plan.

1/ Securities and Exchange Commission - Holding Company Act Release No. 961 - January 11, 1938.

Appendix C.

UNION ELECTRIC LIGHT AND POWER COMPANY OF ILLINOIS 1/ EAST ST. LOUIS LIGHT & POWER CO. 1/ 2/

This case is a relatively simple one, but illustrates well the progress that is being made by holding companies in simplifying their systems.

Union Electric Light and Power Company of Illinois and East St. Louis Light & Power Company, both subsidiaries of the North American Company, a registered holding company, filed applications under Section 6 (b) and Section 7, respectively, with reference to the issuance of securities in connection with a proposed merger of Union and three other operating subsidiaries in the same system into East St. Louis Light & Power Company. All of these companies were operating utilities serving East St. Louis and vicinity in southern Illinois, as well as supplying a large amount of power to the affiliated Union Electric Light and Power Company of Missouri. As a result of this merger the corporate structure of The North American Company system was simplified by one company taking the place of five.

The only applications filed with the SEC were those having to do with the issuance of securities (applications under Sections 6 (b) and 7), the acquisition of assets in connection with the merger being exempt under Section 9 (b) (1) of the Act.

That this case of simplification is typical of the progress that is being made is evident from the following quotation from the Annual Report for 1937 of The North American Company:

"Since the beginning of 1937 fourteen companies in the Missouri-Illinois-Iowa group have been eliminated. These were all subsidiaries of Union Electric Light and Power Company, the principal operating company in that group, the name of which was changed to Union Electric Company of Missouri. Five of its Illinois subsidiaries--Union Electric Light and Power Company of Illinois, Power Operating Company, Alton Light & Power Company, Alton Gas Company and East St. Louis Light & Power Company-- were merged under the name of Union Electric Company of Illinois. The consolidation of three subsidiaries operating principally in Iowa was accomplished through the acquisition by Keokuk Electric Company (now Iowa Union Electric Company) of the property and assets of Fort Madison Electric Company and Dallas City Light Company both of which were dissolved. Central Mississippi Valley Electric Properties, a subsidiary which has previously held the stocks of the three companies, was liquidating and all of the outstanding common stock of Iowa Union Electric Company is now held directly by Union Electric Company of Missouri. In addition, seven other subsidiaries largely inactive or whose operations had been curtailed were dissolved. In the Ohio group an inactive subsidiary of The Cleveland Electric Illuminating Company was dissolved during 1937."

1/ The present name of these companies, since merged, is Union Electric Company of Illinois.

2/ Securities and Exchange Commission Holding Company Act Release No. 675 - May 26, 1937.

Appendix D.

THE ASSOCIATED CORPORATION 1/

This case illustrates particularly well the consideration given by the Commission to the purposes of Section 11 in passing on a declaration under Section 7.

The Associated Corporation, a direct subsidiary of Associated Gas & Electric Corporation, and an indirect subsidiary of Associated Gas & Electric Company, both registered holding companies, filed a declaration pursuant to Section 7 of the Act regarding the issue of its $1,000,000 note to a bank, to refund a similar note dated February 11, 1938 and due July 11, 1938.

The Commission approved the issuance of this note, limiting it to three months, however, and commenting as follows with reference to its (The Commission's) consideration of Section 11:

"A much more serious question arises, however, as to whether the renewal of this note is consistent with the interest of the public investors in securities of the declarant's parent companies. If, as the record indicates, the continued existence of the declarant unduly and unnecessarily complicates the structure of the Associated Gas and Electric Company System, the provisions of Section 11 require its ultimate elimination. A brief survey of the history and activities of the declarant abundantly demonstrates the desirability of its liquidation."

1/ Securities and Exchange Commission - Holding Company Act Release No. 1159 - July 11, 1938.

Appendix E.

GULF STATES UTILITIES COMPANY, ET AL 1/

This case presents a good illustration of simplification of corporate structure through the consolidation of three operating companies to form one large operating company, as well as a good illustration of the consideration given by the Commission to Section 11 in passing upon applications under other sections.

Gulf States Utilities Company is an important operating subsidiary of Engineers Public Service Company, a registered holding company. It provides chiefly electric light and power service to southeastern Texas and southwestern Louisiana. Two smaller subsidiaries of Engineers, Baton Rouge Electric Company and Louisiana Steam Generating Corporation, operate in adjacent territory. The combination of these three companies into a single, large operating company would appear to be almost obviously desirable.

Gulf States, Baton Rouge, Louisiana Steam and Engineers filed a number of applications under Section 7, 10 and 11 (g) and Rules 12C-2 and 12D-1, all of which were considered together by the Commission. Why these were not filed as a voluntary plan under Section 11 (e) is not apparent, particularly as the Commission in its Findings and Opinion referred to the applications as "The Plan of Consolidation".

Essentially the "plan" provided for the donations by Engineers to Gulf States of the common stocks of Baton Rouge and Louisiana Steam and the subsequent liquidation of the latter two into Gulf States. With certain modifications the Commission approved the applications and it is to be expected that in due course the consolidation will be effected.

With reference to the application of Gulf States under Section 10 to acquire the securities of Baton Rouge and Louisiana Steam the Commission made the following statements indicative of its consideration of Section 11.

"Section 10 (c) of the Act provides in effect that the Commission shall not approve an acquisition of securities of utility assets or any other business which is unlawful under the provisions of Section 8 or is detrimental to the carrying out of the provisions of Section 11, or other acquisition of securities or utility assets of a public utility company unless the Commission finds that such acquisition will serve the public interest by tending towards the economic and efficient development of an integrated public-utility system. Counsel for the applicants and declarants have advised the Commission that there is no State law prohibiting the common ownership of gas and electric facilities in the same territory. It therefore appears that the provisions of Section 8 are inapplicable. With respect to the provisions of Section 11 it would appear that the merger of these three operating companies will not be detrimental to the carrying out of this section; in fact the Commission is of the opinion that the acquisition by Gulf States Utilities Company of the utility assets of Louisiana Steam Generating Corporation and Baton Rouge

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1/ Securities and Exchange Commission - Holding Company Act Release No. 1160 - July 11, 1938.

Electric Company will serve the public interest by tending towards the economic and efficient development of an integrated public utility system. It has already been stated that these three companies operate primarily as a unit. The testimony of applicants' and declarants' witnesses indicates that the merger of the three companies will aid future financing, save certain legal, managerial and overhead expenses, and eliminate certain complications arising by virtue of intercompany contracts. There was further testimony to the effect that upon the consummation of the merger a rate reduction would be put in effect resulting in an annual saving to consumers of approximately $100,000.

"The Commission has given serious consideration to the possibility that consummation of the proposed merger may make it more difficult to separate from the Engineers Public Service Company's holding company system any properties the retention of which will be found inconsistent with the requirements of Section 11. However, the record does not indicate that there is a substantial risk of such embarrassment resulting from the merger. The mortgage of Gulf States Utilities Company contains a partial release clause. On the other hand, if it becomes necessary or desirable to add to such properties by purchase of adjacent properties, such additions will not be made more difficult by the fact of this merger.

"Further question arises as to whether the acquisition by Engineers Public Service Company of stock in the new bus company will be detrimental to the carrying out of the provisions of Section 11 which permits the retention of interests in non-utility businesses only upon a showing that such retention is reasonably incidental or economically necessary to the system's public-utility operations. Applicant has urged that the retention in the system of its bus business may be justified because this business represents a continuation of the electric railway services formerly rendered by Baton Rouge Electric Company and that it might prove harmful from a public relations standpoint to abandon all transportation services in this community. Applicant also urges that the segregation of the bus properties in a new company tends to make more salable applicant's investment therein, should at some future time the Commission or the applicant determine that applicant should divest itself of this business. In any event, it does not appear that such segregation will interpose any great difficulties to the divestment of the applicant's investment in this business. However, it is not necessary to pass upon this argument at this time since the proposed acquisition of stock in the new bus company by Engineers Public Service Company will only result in a change in the form of ownership of this existing interest in the bus business.

"The ruling of the Commission, in approving these acquisitions, should not be construed as an approval of the permanent retention of this business or of the other minor non-utility enterprises conducted by Gulf States Utilities Company or Baton Rouge Electric Company.

"However, Louisiana Steam Generating Corporation does engage in one major non-utility enterprise, that of the sale of steam, which is interrelated to its generation of electric energy and can be said to be reasonably incidental to the economic operation of a public utility system. Taking the record as a whole, there is nothing in the acquisition and present retention by Gulf States Utilities Company of these non-utility businesses which will be detrimental to the carrying out of the terms of Section 11."

It seems appropriate to point out in connection with this case the obstacle to rapid simplification and integration of holding company systems that exists because of overlapping jurisdictions, in this case between the Securities and Exchange Commission and the Federal Power Commission. Because with reference to certain transactions it seems clear that the FPC has jurisdiction and with reference to others, may have jurisdiction, these companies have found it necessary in effect to submit their plan to the FPC as well as the SEC. While in the end it is reasonable to expect that they will obtain FPC approval as well as that of the SEC, the task of presenting and handling the case practically in duplicate results in substantial delay and expense. In this particular case the duplication might have been eliminated through the passage of rules by the SEC under Section 12 (f), which would have had the effect of confining federal jurisdiction to the SEC, in accordance with the provisions of Section 318 of Title II of the Public Utility Act of 1935.

Appendix F

SOUTHERN NATURAL GAS COMPANY 1/

This case illustrates consideration given by the Commission to Section 11 in passing on an application under Section 9. Furthermore, it gives an interesting sidelight on the attitude of the Commission towards the application of Section 11 with respect to utility companies not part of the system of a registered holding company.

Southern Natural Gas Company is primarily a pipe line company which transports natural gas from Louisiana to sell at wholesale to customers in Mississippi, Alabama and Georgia. At the time of filing this application it also owned (and still owns) the securities of Alabama Natural Gas Corporation, a gas distribution company (a "utility" under the Act) in Alabama.

Southern Natural Gas Company desired to acquire all the securities of two small gas companies in Alabama from Consolidated Electric & Gas Company, and to sell to the latter certain securities of Georgia Natural Gas Company, other securities of which Consolidated already owned.

Southern Natural Gas Company at the time of filing this application was not a registered holding company nor a subsidiary of a registered holding company. 2/ However, since it already was an affiliate of Alabama Natural Gas Corporation, its acquisition of 5% or more of the voting securities of either of the small gas companies in Alabama it proposed to acquire would bring into operation the provisions of Section 9 (a) (2). Accordingly, it made application under Section 9 (a) (2) to acquire the securities of the two small gas companies in Alabama.

The Commission approved the application, and in its findings and opinion stated in part as follows:

"Section 10 (c) provides, in effect, that notwithstanding the provisions of Section 10 (b), the Commission shall not approve (1) any acquisition of securities which is unlawful under the provisions of Section 8 or detrimental to the carrying out of the provisions of Section 11, or (2) the acquisition of securities of a public utility or holding company unless the Commission finds that such acquisition will serve the public interest by tending toward the economical and efficient development of an integrated public utility system."
.....

The Commission further observed that:

"It also appears that the contemplated acquisition should not be disapproved under Section 10 (c). The underlying properties are gas properties solely. Neither the applicant nor any company in its holding company system owns or operates any electric utility assets. Hence the acquisitions are not unlawful under Section 8. There seems no reason to suppose that the acquisitions will be detrimental to the carrying out of the provisions of Section 11, and, in view of the circumstances hereinbefore stated, particularly the location of the properties and the expected reduction in expenses of the applicant and of the companies whose securities are to be acquired, the Commission finds that the proposed acquisitions will tend towards the economical and efficient development of an integrated public utility system."

1/ Securities and Exchange Commission - Holding Company Act Release No. 682 - June 4, 1937

2/ Federal Water Service Company, parent of Southern Natural Gas Company, has since become a registered holding company.

It may be observed that Southern Natural Gas Company was not at the time a registered holding company nor part of the system of a registered holding company. (The fact that it has since become registered is not material.) Section 11 applies only to registered holding companies and their subsidiaries. Hence, it could not apply to Southern Natural Gas Company at that time except indirectly, that is, by consideration of whether the proposed acquisition was of properties which might more properly fit in with those of some registered holding company system. In this case, the Commission considered the location of the properties to be acquired in relation to the properties of the acquirer, and then made the finding that the proposed acquisitions would tend towards the economical and efficient development of an integrated public utility system and would not be detrimental to the carrying out of the provisions of Section 11. In the case of Commonwealth Edison Company (Release No. 808) as well as that of Utility Service Company (Release No. 507), the Commission likewise gave consideration to the location of the properties and made similar findings.

Appendix G

ILLINOIS POWER & LIGHT CORPORATION 1/ 2/

Here we see an excellent example of the use of a report by the SEC on a reorganization plan under Section 11 (g).

Illinois Power & Light Corporation (IP&L) is a large holding and operating utility company, providing electric, gas and other services directly to a substantial part of Illinois and controlling subsidiaries supplying electric and gas service to Des Moines and vicinity in Iowa. In addition, it owns the securities of the important Illinois Terminal Railroad Company. It is a subsidiary of North American Light & Power Company which is controlled by the North American Company, both of which are registered holding companies.

Because of adverse business conditions, early bond maturities and other factors dividends on IP&L's preferred stock were discontinued in 1932, and by 1937 the accumulations on the approximately $50,000,000 of preferred stock amounted to nearly $12,000,000. Early in 1937 IP&L filed with the SEC applications in connection with a plan of recapitalization under which it proposed to eliminate these large preferred dividend arrearages and place itself in a position to refund its bonds, a large proportion of which bore high coupon rates. In accordance with Section 11 (g) the Commission issued its report on the plan, which was used by the company in its solicitation to obtain the required two-thirds consent of stockholders to make effective the necessary charter amendment under Illinois law. Under the plan the preferred stockholders received new 5% stock equal in amount to one half of their original holdings, dividend arrears certificates in the amount of the unpaid accumulated dividends and approximately 62% of the common stock of the company as recapitalized. After the required consents by stockholders had been obtained, the Commission issued its order making effective the declaration with reference to the issuance of the new securities and also issued an order under Section 12 (c) of the Act authorizing the company to charge against paid-in surplus any payments it might make on the dividend arrears certificates.

This report under Section 11 (g) was the first of its kind, and it is pertinent to note that in this recapitalization involving some 25,000 stockholders, the necessary two-thirds consent was obtained in a little over one month, which was a substantially shorter period than usual.

1/ Securities and Exchange Commission - Holding Company Act Release No. 582, March 25, 1937, and No. 633, May 3, 1937.

2/ The name of this company has since been changed to Illinois Iowa Power Company.