111

ADDRESS

of

JOSEPH L. WEINER

Director of the Public Utilities Division

Securities and Exchange Commission

Before the

PRACTISING LAW INSTITUTE

New York City

8:00 P.M., E.S.T., Monday, October 14, 1940

SECTION 11 OF THE HOLDING COMPANY ACT
SOME LEGAL AND ADMINISTRATIVE PROBLEMS

Before plunging into the substance of the subject matter for this evening, I ought to make two exculpatory statements which, fortunately, are consistent with the spirit of the Trust Indenture Act. The first is the traditional and quite proper notice that any expressions of opinion which you may hear from me tonight are exclusively my own. The second is that I shall not attempt to discuss either the wisdom of the legislation or its constitutionality.

Having thus, I hope, absolved myself from any major responsibility, I feel free to say that I am very glad to have been asked to address a group of lawyers interested in corporate law, on the subject of Section 11 of the Holding Company Act. In the first place, it is consoling to find that there are a goodly number of lawyers who at least are willing to assume, as a hypothesis, that Section 11 is part of the law. All too frequently our experience has been the contrary. Moreover, in the exceptional cases, Section 11, and indeed the entire Act, have generally been relegated to some such field as "public utility law" and thereby quite effectively removed from the interest of lawyers generally. I think, myself, that Section 11 is of great interest in the field of corporate law, and that in the eventual evolution of the law of the land it is not unlikely that Section 11 may have its more significant impact in the field of corporate law.

I assume that you are all acquainted, at least in a general way, with the objectives, if not with the text, of Section 11. At the very least, you are aware that it has been designated on the one hand as a "death sentence" for utility holding companies, and on the other hand as a life giver to utility operating companies. But, for this evening's discussion, that general designation is inadequate and I am, therefore, compelled to outline, as briefly as is feasible, the provisions of Section 11. The actual text, in view of the significance of the statute, is not excessively long. On the other hand it is quite long as compared, say, with the most famous corporate statute ever enacted by the federal government, to-wit, the Sherman Anti-Trust Act.

Before outlining Section 11 itself, I want to refer you to Section 1 of the Act, the policy-declaring section. That section declares it to be the policy of the law to eliminate the evils of unregulated holding companies. The preamble makes it clear that Congress believed that more than regulation was necessary. In the words of the law itself, it was declared to be the policy of the Act (I quote from Section 1 (c) of the Act):

> "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 the Act.

Turning to Section 11, the standards to which holding companies must conform are found, so far as that section is concerned, generally in Section 11 (a), and more particularly in 11 (b). Section 11 (a) makes it the duty of the Commission to examine the corporate structure of "every

registered holding company and subsidiary company thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system."

As you can see, this provision is somewhat introductory. I shall discuss later its legal and adminstrative significance.

Section 11 (b) is divided into two parts. Section 11 (b) (1) makes it the duty of the Commission, as soon as practicable after January 1, 1938, to require by order that each registered holding company, and each subsidiary company thereof, "shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system," provided that under certain specified conditions the Commission must permit a registered holding company to control one or more additional integrated public utility systems.

This portion of Section 11 (b) is frequently referred to as the physical or geographical simplification of holding company systems, as contrasted with Section 11 (b) (2) which is usually referred to as the corporate simplification of holding company systems. It occurs to me that it might be better to describe the first as property simplification and the second as financial simplification.

I turn to Section 11 (b) (2). That subdivision makes it the duty of the Commission, as soon as practicable after January 1, 1938, 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 insure 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." In addition, there is a requirement that in carrying out this provision the Commission shall take such action as it finds necessary to prohibit holding companies of the third degree, that is, the Commission is to eliminate a holding company which has a subsidiary, which in turn has a subsidiary which is a holding company. In popular terms, this means that an operating company may at most have a grandfather, and because of the prohibition of any greater degree of remoteness, this clause has come to be known as the great-grandfather clause.

I propose to postpone to a later point consideration of the other subdivisions of Section 11, and to pause here for some comment on the place of Section 11 in the field of corporate law.

The closest analogy to Section 11 (b) (1), that is, the geographical, physical, or property simplification -- call it what you will -- is probably found in the Sherman Act itself. There is, however, this striking difference: The Sherman Act contained merely a prohibition making a monopoly or an agreement to restrain trade unlawful and appropriately left its enforcement to the Department of Justice. In the Holding Company Act, failure to conform to the standards of Section 11 is nowhere made unlawful. Indeed, even failure to comply with an order of the Commission, directing the action or steps to be taken to achieve conformity, is expressly excluded from the penal provisions of the Act. 1/ Section 11 differs also from other regulatory statutes which, as a rule, are designed to shape future conduct on the basis of existing facts. For example, the usual public service commission law seeks to control future security issues, future rates, future entries in accounts, and such other matter as a particular commission in its wisdom deems appropriate. Section 11, on the other hand, seeks to undo what had been done, even more than it seeks to control future conduct, and, although the Holding Company Act contains provisions for supervision of financing, loans, dividends, servicing, and other features of the activities of both holding and operating companies, it is clear from the legislative history that these other provisions are regarded primarily, first, as an aid to the accomplishment of Section 11 and, second, as a means of protection pending accomplishment of Section 11, and only secondarily as an independent affirmative form of regulation. For the unique thing about the Holding Company Act as a regulatory device is that fundamentally it is a self-liquidating project. To a very large and probably a major degree, its enforcement will result in the continual shrinking of the activities subject to the jurisdiction conferred by the Act. The usual regulatory statute attempts to preserve an existing course of conduct by subjecting it to a continued and usually ever-increasing scrutiny and supervision. The Holding Company Act, on the other hand, seeks to accomplish its objective by a reshaping of the course of conduct itself, with a continual relaxation and probably final elimination of scrutiny and supervision.

Even within the comparatively limited time within which the enforcement of Section 11 has proceeded, there have been several examples of this effect. I may mention three of them.

Indianapolis Power & Light Company 2/ is an operating utility serving Indianapolis. It was a subsidiary of Utilities Power & Light Corporation, a holding company which controlled utility properties scattered throughout the United States and Canada in places as far distant from each other as Nebraska, Connecticut and Nova Scotia. As a subsidiary of Utilities Power & Light Corporation the Indianapolis company was subject to regulation under the Holding Company Act. The holding company was in reorganization in the bankruptcy court under Section 77B. With the approval of the bankruptcy court the Trustee in bankruptcy, through underwriters, sold all the common stock of Indianapolis Power & Light Company. Incidentally, this common stock found a ready market and was sold at a price very advantageous to the holding company system.

1/ Section 29 of the Act.

2/ Holding Company Act Release No. 2001.

The effect of the sale of the Indianapolis stock was to terminate the relationship of Indianapolis Power & Light Company with the holding company system. As a result, the Indianapolis company now operates as an independent operating utility, and is no longer subject to regulation under the Act.

Another and different illustration of the contrasting character of the Commission's jurisdiction under the Act is afforded by the case of Houston Natural Gas Corporation. Houston Natural Gas Corporation 3/ was a Delaware Corporation owning the stock of four Texas utility companies operating in Texas. The holding company was required, because of its incorporation in another state, to register under the Act. The company therefore registered and shortly thereafter worked out a plan by which all of its properties were transferred to the holding company, which in turn conveyed them to a new Texas corporation. Appropriate exchanges of securities are being made and upon their completion the Delaware company will be dissolved. The effect of this procedure was to transform a Delaware holding company into an operating Texas utility company, which is no longer a holding company subject to the jurisdiction of the Act. Incidentally, it is interesting to note that after the registration of Houston Natural Gas Corporation, the only matter brought before the Commission under the Holding Company Act was this very transaction which ended the company's status as a holding company.

A third illustration of the way in which the Commission's jurisdiction under the Act is self-liquidating is furnished by the case of San Diego Consolidated Gas & Electric Company. 4/ This company conducts electric and gas utility operations in San Diego, California. It is a subsidiary of Standard Gas and Electric Company, a large holding company system operating properties centered primarily in Wisconsin and Minnesota, but scattered through other states from Pennsylvania to Oregon. The directors of Standard Gas and Electric Company recognized the need for the disposal of some of their properties in order to comply with the requirements of Section 11 (b) (1); they also realized the need for reducing the company's debt structure in order to bring about compliance with Section 11 (b) (2). Accordingly, as a step toward complying with Section 11, Standard Gas and Electric Company offered debenture holders of that company the privilege of exchanging their debentures for common stock of San Diego Consolidated Gas & Electric Company. The effect of this transaction, if consummated, will be similar to the first two cases mentioned in that it will remove the San Diego utility company entirely from the jurisdiction of the Holding Company Act; it goes further, however, in that it will represent a substantial step toward compliance by the Standard Gas and Electric Company with Section 11, both by geographical and corporate simplification.

It would extend my discussion unduly to discuss other statutes which might be compared in their effects to Section 11 (b) (1). Among such laws might be mentioned the Transportation Act of 1920, which directed the Interstate Commerce Commission to prepare a general plan for the consolidation of railroad systems. I shall, therefore, proceed next to a consideration of precedents in corporate law for the corporate or financial simplification requirements of Section 11 (b) (2)

3/ Holding Company Act Release No. 2072.

4/ Holding Company Act Release No. 2262.

In the mainstream of American corporate law, Section 11 (b) (2), that is, corporate or financial simplification, is part of an evolution that has even more ancient origin. Needless to say, I am referring to the corporate foreclosure, the equity reorganization, and the recent statutory substitutes for all of these. The principal difference between Section 11 (b) (2) and, let us say, Chapter X of the Bankruptcy Act, is that the latter has its incidence solely on the event of insolvency. Those of you who have participated in the reorganization of holding companies -- reorganization in the strict sense of the term -- know the intricate problems which arise due to the transactions that have taken place between the holding company and its subsidiaries, or among the subsidiaries themselves. The Bar is still struggling with the implications of the so-called Deep Rock case, 5/ despite the attempted clarification in *Pepper* vs. *Litton*. 6/ When you come, as we frequently do, to the application of these doctrines to solvent corporations, the complexities are enormously multiplied. And I may add that in considering these questions it is comforting to indulge the hope that in this field at least the enforcement of Section 11 will prevent their recurrence.

You will recall, of course, that Section 221 of the Bankruptcy Act requires that a plan of reorganization must be "feasible", and Section 216 contains specific requirements with respect to the charter provisions of the reorganized or successor corporation. For example, it is expressly provided that no non-voting stock may be issued, and that voting power must be fairly and equitably distributed among all classes of stock. Preferred stock must be given adequate representation on the board of directors in the event of default in payment of dividends. 7/ The charter of any company reorganized under Chapter X must include provisions which are fair and equitable with respect to the terms of different classes of securities, with respect to the issuance, acquisition, purchase, retirement or redemption of securities, and concerning the declaration and payment of dividends. 8/ The same section also requires that all large corporations submit adequate annual reports to their security holders.

In connection with the requirement that a plan be "feasible", you will recall also the pungent remark of the judge 9/ who said that it was not the object of the reorganization statute to send forth into the world corporate cripples to be a menace to investors and to persons who deal with them. Here then, you have in miniature the concept underlying Section 11 (b) (2).

5/ *Taylor et al*, v. *Standard Gas & Electric Company et al.*, 306 U. S. 307 (1939).

6/ 308 U. S. 295 (1939).

7/ Section 216 (12).

8/ Section 216 (12) (b).

9/ *Price et al* v. *Spokane Silver & Lead Co.*, 97 F. (2d) 237, 247 (C.C.A. 8th 1938).

But, as you are well aware, there is lacking in American law any general counterpart to the reorganization statute, applicable to solvent corporations. Legal ingenuity has not, of course, been completely balked by the absence of direct statutory enactment. Recapitalizations of corporations with unsound and unwieldy corporate structures are taking place every day by the devices of charter amendment, mergers, transfers of assets, and the like. The difficulties and pitfalls of such proceedings may be recalled briefly by reference to a series of cases decided by the courts of Delaware.

In *Keller* vs. *Wilson & Co.*, 10/ it was held that cumulative, unpaid, and undeclared dividends on preferred stock are not subject to elimination by action of the stockholders under Section 26 of Delaware's General Corporation Law, where the preferred stock was issued prior to the enactment of that section. A year later, in *Consolidated Film Industries* vs. *Johnson*, 11/ it was held that even as to corporations organized after its enactment, Section 26, while effectively creating means to bar the accumulation of future dividends, could not be used to affect dividends already accrued. Recently, in *Federal United Corp.* vs. *Havender*, 12/ it was held that such dividends can properly be eliminated in a merger under Sections 59 and 59 (a). In that case the merger was with an insignificant and wholly owned subsidiary. Although it was not alleged that the plan was a device to circumvent the decisions construing Section 26, the lower court had held the plan to be illegal and attached the consequences of the *Wilson* and the *Consolidated Film* cases. I shall not attempt to discuss the implications of the higher court reversal. Others have done so at length in the various law journals. It is sufficient for my purpose that the problem is by no means solved.

I venture to say that it is unlikely that this state of affairs will continue indefinitely, at least with respect to large corporations having outstanding securities in the hands of the public. In the field of the public utility holding company the change is here, and I offer by way of illustration the recapitalization of Community Power and Light Company.13/

Community is a Delaware corporation having its principal executive offices in New York City. It is a holding company as defined by the Holding Company Act and is registered as such. It owns all of the outstanding voting securities of four public utility companies and 60% of the outstanding voting securities of General Public Utilities, Inc., which is both an operating company and a holding company. If we disregard its subsidiaries, Community's corporate structure consisted of $14,000,000 of bonds, preferred stock of a stated value of $6,896,000, but with arrears of dividends in excess of $3,000,000, so-called "assignments and agreements" of the face amount of $370,000, and 10,000 shares of common stock without par value, but with a stated value of $250 per share.

10/ 190 Atl. 115 (Del. 1936).

11/ 197 Atl. 489.

12/ 11 Atl. (2d) 331 (Del. 1940).

13/ Holding Company Act Release No. 1803.

It hardly needs to be said that this corporate structure was the result of adverse financial history. In fact, it was primarily the result of the financial and other mismanagement of still other holding companies which previously had controlled Community and which have since been liquidated through receivership and bankruptcy. Without recounting the financial circumstances of Community, which made this structure unduly and unnecessarily complicated and resulted in an inequitable distribution of voting power, I proceed directly to the plan proposed by the company to simplify its corporate structure.

In the first place, the plan provided for certain minor modifications of the so-called "assignments and agreements" with a view to their prompt retirement by payment in cash. Secondly, and of major importance, the plan provided for the elimination of the two classes of stock and the substitution therefor of a new single class of common stock of a par value of $10 each, and entitled to one vote per share. Each share of preferred stock, together with all accumulated unpaid dividends, was entitled to receive 5 shares of the new common stock, or an aggregate of 344,810 shares. Each share of the common stock was entitled to 1-4/5 shares of new common stock, or an aggregate of 18,000 shares. In effect, therefore, the preferred stockholders were given 95% of the total equity available for stockholders, and the common stockholders were given 5%. The plan made no provision for cash payment to dissenters and, on the contrary, stated that dissenters would be required to accept the securities offered in the plan. It was provided that the plan was not to become effective unless it was approved by the holders of 2/3 of the preferred and a majority of the common.

I will not recite, at this time, the procedural steps taken for the consummation of the plan, but I do want to call attention to the fact that this plan was approved by the Commission and a Federal court 14/ under Section 11 (e), and its successful consummation represents a development in corporate law which is worthy of your most careful consideration.

The other provisions of Section 11, with the exception of 11 (g), complete the structural pattern for the enforcement of the standards set forth in Section 11 (a) and 11 (b). It may be easier to follow them if I take them up in somewhat different order from that in which they appear in the statute.

First, I invite your attention to Section 11 (e). That section permits any registered holding company or any subsidiary thereof to submit a plan to the Commission -

> "... for the divestment of control, securities, or other assets, or for 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, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, 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; and the Commission, at the request of the company, may

---

14/ *In re Community Power and Light Company*, 33 F. Supp. 901 (D. Ct. S.D.N.Y. 1940).

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 plan. If, upon any such application, the court, after notice and opportunity for hearing, 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, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction 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 and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed."

Considering the first part of the subsection only, it is apparent that its purpose is to permit voluntary action for the accomplishment of what the Commission may require by order pursuant to section 11 (b). In fact, a considerable number of section 11 (e) plans have been approved by the Commission. In each case the action proposed by the plan was not the entire action which the Commission would have required under enforcement of section 11 (b), but the Commission has held 15/ that the statute permits compliance by means of a series of steps and has therefore approved such action as was proposed without prejudice to the taking of later action either by the company or by the Commission for the carrying further of the requirements of section 11 (b).

With respect to the mechanics provided by section 11 (e), it is apparent how the precedents provided by the Anti-Trust Law and the reorganization statutes have been made use of. The voluntary plan submitted to the Commission corresponds to the plans submitted to a federal court sitting in equity for the carrying out of a decree charging a violation of the anti-trust laws. Perhaps the most interesting case in that connection is *Continental Insurance Company* v. *Reading*, 259 U.S. 156. You will find that case referred to in the Congressional discussions preceding the enactment of the Holding Company Act, 16/ and hence the analogy is by no means accidental.

The provision for application to a court to enforce such a plan, and the mechanics provided therefor, perhaps resemble more closely the provisions for the consummation of a reorganization plan under Chapter X of the Bankruptcy Act. Indeed, we were so impressed by the analogy that in the one case where we had occasion to invoke this provision, we followed the pattern of reorganization as closely as might be. That occasion was in connection with the Community Power and Light Company plan which I described earlier. In accordance with the provisions of 11 (e) the Company requested the Commission to apply to a court to enforce and carry out the terms and provisions of the plan. That application was made to the District Court for the Southern District of New York. The proceeding was in every way similar to reorganization proceedings under the Bankruptcy Act. It was entitled as an application of

---

15/ *Peoples Light and Power Company*, 2 S.E.C. 829, 836 (1937); cf. also *The North American Company*, 4 S.E.C. 434, 458 (1939).

16/ Report of Senate Committee on Interstate Commerce, 74th Cong., 1st Session, Report No. 621, page 33.

the Commission to enforce and carry out a plan of simplification of the Company, and the Court was requested to take jurisdiction over the Company's assets to the extent necessary to enforce the plan. Upon the filing of the application, the Court entered a temporary restraining order similar to that entered in reorganization proceedings under the Bankruptcy Act. Notice of the pendency of the proceeding was given to security holders affected by the plan, both by mail and publication. The notice stated that an opportunity would be afforded to be heard on the plan before the Court at a given time and place. After all the intermediate proceedings had been taken, the Court entered a final decree approving the plan and directing its execution, which bears strong resemblance to the parallel decree issued in reorganization proceedings under the Bankruptcy Act.

The proceedings for enforcement of an 11 (b) order are modeled on the same pattern. They are set forth in subsections (c) and (d) of Section 11. Under the terms of subsection (c), an 11 (b) order must be complied with within one year from the date of the order except that the Commission is authorized to grant additional time, not to exceed one year. In the absence of such compliance the Commission may, pursuant to subsection (d), apply to a court to enforce the decree. Upon such an application the court is authorized, to the extent deemed necessary to enforce the Commission's order, to take exclusive jurisdiction over the Company and its assets, wherever located. The same provision gives the court jurisdiction to appoint a trustee, and the court may appoint the Commission as sole trustee to administer the assets under the court's direction. The trustee is given power to dispose of assets and such disposition may be made in accordance with a reorganization plan which shall have been approved by the Commission. The Commission may itself propose a plan.

Subsection (f) contains provisions regarding the appointment of trustees, in Federal court proceedings, whether under Section 11 or otherwise. It also requires Commission approval for all reorganization plans and confers authority on the Commission to regulate reorganization fees. Subsection (g) governs the solicitation of proxies and consents for reorganization plans and provides for the making of reports by the Commission regarding such plans. This completes the provisions of Section 11.

The Holding Company Act shares with all other statutes the need for interpretation, and out of that need arises what are commonly called legal problems. Insofar as these problems relate to procedure for enforcement of Section 11, I shall refer to them later when I discuss the problems of administration. I want to consider here, briefly, the problems of so-called substance, merely to indicate the nature of the problems which arise and the considerations which seem appropriate in their resolution.

Just as the procedural problems affect merely the propriety and character of the steps taken toward reaching the eventual result, so the substantive problems largely resolve themselves into whether a particular holding company system ultimately may be permitted to keep a larger or smaller portion of its properties or companies, or as to whether, and the extent to which, particular security structures are unsound and unduly complex, or particular voting arrangements unfairly distribute voting power.

I do not mean to intimate that these problems are not of great significance or that many of them can be resolved without the most careful study. Take, for example, that portion of Section 11 (b) (1) which directs the Commission to require by order that each holding company and each subsidiary thereof shall take such action as the Commission shall find necessary to limit its operations to a single integrated system. May the Commission direct a system to acquire utility property not presently owned by it? I am not sure, but I doubt it. Or, take the great-grandfather clause, to which I referred earlier. You will recall that the Commission is directed to require by order that each registered holding company and each subsidiary 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. This is then followed by the express prohibition of great-grandfather companies. Immediately the question arises as to whether the prohibition is also a limitation, namely, whether the Commission may find that a grandfather company is an undue or unnecessary complexity and direct its elimination. I believe that it is reasonably clear that the Commission may do so.

In these problems of interpretation, the stated objectives of the statute are almost as significant as the text itself. Indeed, recent decisions of the Supreme Court, 17/ and much earlier precedent, indicate that even with language apparently unambiguous, legislative history may supply an otherwise unexpected construction and legislative objectives can overcome any defects of draftsmanship. Consequently, in considering these problems, the committee reports are invaluable and the balance of the legislative history an indispensable tool.

With these few remarks, I leave the subject of what I have called substantive interpretation. I do it with less reluctance because a number of the substantive questions were recently discussed by Commissioner Healy at the last Annual Convention of the American Bar Association.

It is now high time that I turn to the methods and procedural means for carrying out the substantive requirements of Section 11, if I am to avoid default on my earlier statements that I intended to make some comments on this subject. You are all familiar with the so called Brandeis brief. If I may coin a phrase, I will ask you to indulge me in a Brandeis exposition.

There are at the present time 147 registered holding companies which for convenience we have classified as comprising 57 separate holding company systems although that classification is not exactly on statutory grounds. Including subsidiaries, these systems comprise approximately 1500 corporations. The aggregate consolidated assets as carried on the books of the companies approximate some fourteen billion dollars. The single largest system has aggregate assets in excess of two billion dollars, operates utility properties in 32 states and in a vast number of foreign countries, and

---

17/ See, for example, United States v. Dickerson, 310 U. S. 554 (1940) and Securities and Exchange Commission v. United States Realty & Improvement Company, 310 U. S. 434 (1940). Cf. also Norwegian Nitrogen Products Co. v. United States, 288 U. S. 294.

has hundreds of thousands of security holders. Other systems have corporate structures with layers extending to as many as nine stages between the operating company and top holding company. Not infrequently companies in a system own securities of other companies of different grades or characters in between which may be sandwiched securities owned by the public. In several systems, there are companies each of which owns securities of the others, sometimes holding securities in amounts sufficient to constitute control. In the case of two corporations, for example, the outstanding securities are so distributed that each is a holding company required to register under the Act by reason of its holdings in the other company.

It seems obvious that the choice of an administrative agency to apply the Congressional standards was dictated by the very nature of the problem which I have just briefly outlined. Conceivably, Congress could have specified the statutory standards in detail, making it, for example, illegal after a lapse of a stated period of time for any company to have more than one parent company, or for any company to operate utility properties in more than one or any other specified number of states, or extending over a distance greater than a specified number of miles. Such a statute could have been enforced by the simple process of indictment or injunction. On the other hand, Congress might itself have considered each of these systems in turn and specified the precise action to be taken in order to meet Congressional objectives. The reasons for the rejection of the suggested alternatives and the choice of the method provided in the Act seem apparent, but these reasons, I suggest, must be constantly borne in mind in the actual administration of the statute. I believe indeed that in this instance at least, Congress indicated in the statute itself the method which it contemplated for the effectuation of Section 11.

In order to understand the nature of the action which the Commission is required to take, it is important to read together subsections (a) and (b) of Section 11. As I have said, subsection (b) makes it the duty of the Commission to require action after notice and opportunity for hearing. The Commission's place in such a scheme is obviously different from that of a court. The Commission cannot wait for someone to request it to act; it cannot delegate to anyone else the duty of taking the initiative to enforce the Act. The law places this duty on the Commission itself.

I do not wish to place any considerable emphasis on the phrase "opportunity for hearing" but I believe that the word "opportunity" is in this connection not without significance. Ordinarily in the course of a judicial proceeding, the expression "opportunity for hearing" would not be descriptive. The trial of an action is not an opportunity for hearing. It is a hearing. I am therefore tempted to conclude that if the expression was used advisedly — and in the light of the craftsmanship of the statute it would be presumptuous to suppose otherwise — it is contemplated that a considerable activity would take place prior to the opportunity for hearing so that if, for example, the opportunity for hearing was not availed of, the Commission would nevertheless be in a position to enter an order requiring such action as the Commission should deem necessary to enforce the standards of Section 11. Plainly this is inconsistent with judicial procedure except in cases of default. Even a judgment by default can grant only relief demanded in a complaint, and there is usually required a modicum of proof if only through the means of a verified complaint and the sanction of penal provisions against perjury.

In this context, subsection (a) is an interesting subject for study. You will find in Section 18 of the Act a general investigatory power conferred upon the Commission applicable to a wide range of subject matter which, like similar powers conferred in other statutes, may be invoked at the discretion of the Commission. Despite this general provision, Section 11 (a) contains a further investigatory power, and unlike the discretionary power of Section 18, the investigation here is also made a duty. That duty is to examine the corporate structure of every registered holding company and each subsidiary thereof and the relationships among them "to determine" the extent to which simplification of various kinds is possible. There is no specific indication as to how that determination is to be expressed, and accordingly it may be said that despite its emphatic language, Section 11 (a) is only exhortatory or directory. On the other hand, it may and has been argued that Section 11 (a) requires a preliminary determination by the Commission as to the nature of the holding company system and the action required to be taken to conform to the standards of Section 11, which preliminary determination is then to be made the basis for the opportunity for hearing accorded by Section 11 (b). Odd as it may seem to some of you, this argument was pressed not by Commission counsel but by attorneys for a holding company system. The actual course of the development may be of interest here.

Beginning in February of this year, the Commission issued a series of notices providing for hearings with respect to Section 11 (b) (1). There were nine such notices directed to nine of the principal holding company systems. The notices were quite general in character; each contained a description of the properties of the various holding companies and concluded with the general allegation that each of the holding companies owned more than one integrated system. Parenthetically, you will note that none of the notices in effect alleged non-compliance with the statutory standards of Section 11 because they did not negative the existence of the conditions under which the company might retain more than one system. The notices invited answers.

In several instances, answers were filed criticising the notice as inadequate in one way or another and characterizing as faulty the procedure as represented by the notice. The answer of the United Gas Improvement Company urged that the notice was defective and that the hearing was not the hearing contemplated by Section 11 (b) (1) of the statute, on the ground that prior to such hearing the company was entitled to receive from the Commission advice as to the Commission's contemplated determinations under Section 11 (a), and as to what action the Commission found necessary under Section 11 (b) (1) to limit the company's operations as required by that section. The company claimed that it was not required to proceed to a hearing until it had received a specification of the respects in which its system did not comply with the standards of the Act. The Commission concluded that the notice as sent and the procedure followed were sufficient as statutory compliance but nevertheless agreed to give the company the kind of statement requested. 18/ At about the same time, several other companies made the same or a similar contention and in each instance, the Commission reached the same conclusion.

Whether one takes the view that the notices as sent were defective or not is primarily a matter of emphasis but whether the proceeding should be conducted as originally instituted, or as modified as a result of the oral argument, involves an important question as to the nature of the administrative process.

18/ Holding Company Act Release No. 2065. But note special concurrence
(Continued)

This situation is not without precedent. I shall not undertake to discuss the numerous instances in which problems of this character have arisen, but merely refer you to a few instances as suggestive of the approach and of possible solutions. Perhaps the most striking analogy to the procedure urged by the United Gas Improvement Company is to be found in the provision of Section 19 (a) of the Interstate Commerce Act 19/ directing the Interstate Commerce Commission to "investigate, ascertain and report the value of all property owned or used by every common carrier subject to the provisions of this chapter." After having completed a tentative valuation the Commission was directed to give notices thereof to the carrier and allow 30 days for filing a protest. If no protest was filed the valuation was to become final. If a protest was filed the Commission was directed to hold a hearing before issuing an order making the tentative valuation final. The statute further declares that final valuations are to be "prima facie evidence of the value of the property under all proceedings under this chapter . . . ."

In *United States* v. *Los Angeles R. R.*, 273 U. S. 299, the railroad brought suit "to enjoin and cancel an order of the Interstate Commerce Commission purporting to determine the 'final value' of its property" under what is now Section 19a of the Interstate Commerce Act. In the course of the opinion holding that the suit could not be maintained, Mr. Justice Brandeis made the following remarks:

> "The mere fact that Congress has in terms made 'all final valuations . . . and the classifications thereof . . . prima facie evidence of the value of the property in all proceedings under the Act to Regulate Commerce . . . ' is, obviously, not a violation of the due process clause justifying proceedings to annul the order. That to make the Commission's conclusions prima facie evidence in judicial proceedings is not a denial of due process, was settled by Meeker v. Lehigh Valley R. R. Co., 236 U. S., 412, 430,431 . . .
>
> "Nor does the fact that 'all final valuations . . . and, the classifications thereof' are made prima facie evidence prevent the report from being solely an exercise of the function of investigation. Data collected by the Commission as a part of its function of investigation, constitute ordinarily evidence sufficient to support an order, if the data are duly made part of the record in the case in which the order is entered." (273 U. S. at 311, 312).

In *United States* v. *Interstate Commerce Commission*, 264 U. S. 64 (1924), a carrier, after having filed a "protest" against the Commission's valuation, filed a petition for mandamus to require the Commission to allow it to examine the "underlying data, contracts, reports, compilations and records of the Bureau of Valuation so far as in any way related to valuation of the relator's property". In affirming a judgment dismissing the petition, the Court through Mr. Justice Holmes, said:

---

18 cont'd/ of Commissioner Healy, and cf. views of Commissioner Healy set forth in his memorandum of April 1, 1940, and those of the other members of the Commission in memorandum dated June 24, 1940, made public June 27, 1940, in connection with proposed adoption of Rule U-8.

19/49 U.S.C. sec. 19 (a).

"The relator's claim has for its broadest basis the fact that the valuation when made final by the Commission will be *prima facie* evidence in various judicial proceedings in which the value of the property is material to the decision of the case. But the legislature may make one fact *prima facie* evidence of another if the inference is not 'so unreasonable as to be a purely arbitrary mandate'. . . *If Congress had given no hearing before the Commission but still had made its conclusion prima facie evidence of value, it would be hard to say that any constitutional rights of the railroads had been infringed.*" 20/

A less circuituous arrangement was involved in *Lindsey* v. *Public Utilities Commission*, 111 Ohio St. 6, 144 N.E. 729 (1934). In the course of a hearing with respect to telephone rates, a report of the telphone expert of the Ohio Commission was filed showing that the engineers of the Commission made a detailed valuation and found the reproduction value of the property of the telephone company to be a certain amount. The statute, after authorizing the Commission to hold a hearing for the purpose of ascertaining the value of the properties of public utilities, provided that this provision should not prevent the Commission from making any preliminary examination or investigation, or from inquiring into such matters in any other investigation or hearing. The Commission was empowered to resort to any other source of information available. In response to the contention that the Commission's reliance upon the report of the telephone expert was reversible error, the court said:

"A mere reading of these sections in connection with the various other sections of the act confirms the power of the Commission to avail itself of the services of the engineers, experts, and other assistants which it is specially empowered by the Legislature to employ, and it acts within its authorized powers in sending its experts to make an independent investigation as to value, operating expense, and revenue, and is authorized to give to the report of such experts such weight in establishing value, or any other issue, as the experience, learning, thoroughness, integrity and dependability of the experts, or other assistants, in the judgment of the commission, justify.

"The plaintiffs in error, however, were entitled to examine such report of the engineers and to cross-examine such engineers upon any or all matters contained in such report. The report, being in the nature of evidence in the case, is, like any other evidence, subject to analysis and impeachment, and had an application to examine the report been made and refused, or an application been made to cross-examine the engineers and refused, this

---

20/ 264 U. S. at p. 77. But Mr. Justice Holmes did add that:

"...we think that, in such way as may be found practicable, the relator should be enabled to examine and meet the preliminary data upon which the conclusions are founded and to that end should be given further information in advance of the hearing, sufficient to enable it to point out errors, if any there be." (264 U. S. at 79).

court would regard such refusal as reversible error." 21/

The problems of administrative procedure become more accute when consideration is given to certain of the standards by which an integrated utility system is to be judged. As we find in Section 2 (a) (29), an integrated electric utility system is one

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

Judging from the legislative history one of the most important policies embodied in the Act is the provision at the end of the section, which limits an integrated system to one which is not so large as to impair the advantages of localized management, efficient operation and the effectiveness of regulation. Consider for a moment the problem of localized management. It may well be possible, although extremely time consuming and expensive, to determine through the ordinary processes of examination and cross examination of witnesses whether or not a particular company has now or has had in the past what is considered localized management. That, however, is not the standard of the Act, as will be apparent to you from a moment's consideration.

Suppose, for example, that the present operations of the company are such that its own officers have no autonomy by reason of the instructions issued by the holding company management. One might well conclude from these facts that there is no localized management. Suppose, on the other hand, that the particular holding company management has great faith in the delegation of authority. By certain standards the resulting relationship might be described as localized management. But that such a test would be irrelevant for the operation of the Holding Company Act becomes obvious when one considers that with such a standard as a guide the change from an integrated system to a non-integrated one and back again might be kaleidoscopic.

Consequently the statute is framed, not in terms of whether a particular system has localized management, but rather in terms of whether by reason of size there is likely to be an impairment of the advantages of localized management. The result is, then, that the experience of a particular company may be at best a poor index to a determination of the question posed by the statute, and that the solution is to be found, not primarily or perhaps at all, in the answers of the particular managers,

---

21/ 144 N. E. 729 at 733. See also City of Bucyrus v. Department of Health of Ohio, 120 Ohio St. 426, 166 N. E. 370, 371 (1929); In re New England Power Corporation, 156 Atl. 390, 392-3 (Vt. 1931); Wichita Gas and Light Power Co. v. Court of Industrial Relations, 113 Kan. 217, 214 P. 797 (1923); City of Atlanta v. Georgia Ry. & Power Co., 149 Ga. 411, 100 S. E. 442 (1919).

on the witness stand, however truthful, but in the experience of the industry as a whole in the light of the objectives of the Act. That, it seems to me, indicates both the reasons for the choice of an administrative agency and a worthwhile consideration as to the method by which its work shall be accomplished.

I believe that these considerations deserve the most careful study, in the light of their bearing on Section 11, and to the end that its standards may be enforced as efficiently and economically and by the means of as informed judgments as the Commission and those regulated by it are capable of producing. The judicial process in the narrow procedural sense has as a starting point in each trial a fixed premise, that is, a rule of law. Competition by each party for decision in his favor pivots around that rule, and proof is adduced within rather well defined channels created by the pleadings and by the rules of evidence. In instances where there occurs a more or less exact balance between the adversaries on establishment of the ultimate facts, the court is saved from a dilemma by the employment of ingenious formulas which have been evolved for just such occasions. Among such formulas are those of prima facie evidence and the burden of proof.

Such procedural devices are essential to the ordinary flow of judicial decisions. Without them, the judge would often have to confess helplessness. But it seems to me that in administrative proceedings such as those contemplated by Section 11 of the Holding Company Act, these devices have little if any place. It is the duty of the Commission not to decide between litigants but to apply standards on the basis of a knowledge of the facts and a judgment of their consequences. To that end the Commission takes charge of a limited subject matter. It is armed with a staff of assistants. It has the power to conduct investigations and issue subpoenas. It has the power and the duty to inform itself, with respect to the subject matter as to which it acts, by any feasible method, to the end that it may fairly, justly and efficiently carry out the tasks entrusted to it by Congress.

---oOo---