

UTILITY REGULATION AND THE DEFENSE EFFORT

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It is with pleasure that I take this opportunity to discuss with you some of the aspects of utility regulation under present conditions of industrial mobilization. The jurisdiction of the Securities and Exchange Commission is not that of an emergency agency established to meet a specific and limited task in the defense organization. Rather it has been the responsibility for restoring to America the financial integrity and stability of its utility industry, a vital element in the overall pattern of industrial mobilization. In order to give some necessary background for our topic today, as approached from the S.E.C point of view, I want to briefly discuss how this objective of financial integrity and stability has been achieved and how our present supervision of financing activity is related to the growth problems of both electric and gas utility systems.

The S.E.C. was created by the Congress in 1934. It is an independent regulatory body of five members appointed by the President with the advice and consent of the Senate. Not more than three of its members may be of the same political party. The Commissioners hold staggered terms of five years.

At present, six statutes are administered by the Commission relating principally to the field of securities and finance. ^{1/} It also serves as advisor to the Federal courts in corporate reorganization proceedings under Chapter X of the National Bankruptcy Act. In general, it has been our task under the securities laws to provide a measure of protection for investors and the general public in their security transactions. We have

^{1/} Securities Act of 1933, Securities Exchange Act of 1934, Public Utility Holding Company Act of 1935, Trust Indenture Act of 1939, Investment Company Act of 1940 and Investment Advisers Act of 1940.

had the job of reestablishing public confidence in the nation's free security markets, which had been so bitterly shaken in the late '20s. The results of this work have been evidenced in recent years in a consistent broadening of stockholders' interest in the equity securities of many progressive American corporations.

In the field of public utility regulation, however, the Commission has been given more extensive powers and responsibilities which go well beyond the principles of adequate disclosure and prevention of fraud. A brief review of the development of the utility industry will serve to explain how the Commission has come to occupy its present regulatory position in this area.

DEVELOPMENT OF THE UTILITY INDUSTRY

It is only within the past 40 years that the utility industry has developed from a group of small isolated gas and electric enterprises into a vast network of power and fuel supply facilities. Within that time, it has become a fundamental element in the pattern of American economic, community and home life.

In its earliest stages, utility operation was limited to a few city areas which afforded to the pioneer companies a concentrated consumer market for their untried product. As subsequent demand increased, several thousand small enterprises undertook to provide local consumers with the benefits of electric lighting and the convenience of gas fuel. However, with the invention of improved generating facilities, transformers and long distance transmission lines, the economy of large-scale operation

soon became evident and the industry entered upon a period of large-scale combination and consolidation. For example, during the period from 1922 to 1932 when electric sales were increasing rapidly, the number of electric operating companies actually declined by more than 55 percent.^{2/} In the gas industry the development of natural gas facilities resulted in the linking of many distribution companies with long distance pipe line systems.

The movement toward consolidation and combination of properties also had another result. Many independent companies were brought under common control by use of the holding company device, which developed in several ways. The earliest holding companies, Electric Bond and Share Company and The United Gas Improvement Company, came into being through the efforts of manufacturers of electric and gas equipment to find a market for their products. The utility industry found it difficult in those days to obtain investment capital and equipment manufacturers often could sell their products only by accepting payment in the form of securities. These securities were converted into cash by organizing holding companies to hold them and selling holding company securities to the public.

These early operations were very profitable and attracted a number of promoter and speculator groups who set up holding companies and sought to out-bid each other in the race to acquire operating properties. The development was also encouraged by investment bankers who derived a substantial-and often excessive-compensation from the marketing of holding company securities.

^{2/} From information in Report of FTC to Senate of the U. S. Utility Corporations, Part 72-A, p. 24.

These holding company systems grew very fast. The Associated Gas and Electric system grew from approximately \$4 million of assets in 1922 to \$835 million in 1930. Middle West Utilities Company, a major part of the Insull empire, had a similar expansion. By 1929, 80 percent of the electric energy generated by private companies was controlled by 15 holding company systems. In 1932, 11 holding company systems controlled 80 percent of the total mileage of natural gas pipe lines.

With this tremendous concentration of power came a flood of abuses. The interstate character of the holding company systems and the complicated corporate structures which had been devised proved to be powerful obstacles to the state regulatory agencies which were, in most instances, unable to deal effectively with the problem. Investigations by the Federal Trade Commission and the House Committee on Interstate and Foreign Commerce revealed that many of the systems were financially weakened by top-heavy pyramided capital structures, sometimes with four or five holding company tiers superimposed upon the operating properties. They found much evidence of absentee management, excessive property write-ups, huge dividend arrearages and a general loss of public confidence in utility securities and utility management.

Against this background the Congress determined that corrective action was required, and passed the Public Utility Holding Company Act in August 1935 and delegated to the S.E.C. the responsibility of its administration. The statute is in part a specialized anti-trust law, aiming in section 11 at the complete decentralization and reorganization of major segments of the power industry; and in part, it is a regulatory statute

covering the financial and corporate practices of companies subject to its provisions. Upon its passage most of the electric and gas utilities came under Commission jurisdiction and our agency was faced with the task of virtually reconstituting the structure of the industry.

The story of the years of enforcement since 1935 can not be retold in this brief report. We are still engaged in carrying forward the latter steps of integration and simplification in a number of systems. But the huge sprawling holding company aggregations which came under Commission jurisdiction in 1935 have disappeared from the national scene. The spectre of top-heavy capital structures, defaulted debt securities and large preferred stock arrearages exists no longer. More than 60 percent of electric and gas industry is free from all holding company control, and those companies that continue as a part of larger systems remain subject to the jurisdiction of the Commission. The independent operating electric and gas utilities and the simplified holding company systems reflect improved capital structures, increased operating efficiency, lower capital cost and a proven ability to serve the nation with the increasing amounts of power and fuel which it so urgently requires.

ROLE OF THE SECURITIES AND EXCHANGE COMMISSION

In the past years of the Commission's administration of the Holding Company Act, the greatest portion of its effort has been devoted to the problems of enforcing section 11. As I mentioned earlier, this is the section which has resulted in a complete overhauling of the holding company systems.

Let us narrow the scope somewhat to see how this has occurred and what have been the results. To summarize briefly, section 11 provides both integration and simplification requirements. It requires that holding companies be limited to one (or in certain situations, two) integrated system and only such other businesses as are directly and closely related thereto. By definition, an integrated system is one which is capable of economic operation as a single coordinated system, confined to one single area and not so large as to impair the advantages of localized management, efficient operation and effectiveness of regulation. It also requires action to insure that the corporate structure or the continued existence of any company in the system does not unduly or unnecessarily complicate the structure or unfairly or inequitably distribute voting power among security holders of the system.

Primarily as a result of action taken to enforce these provisions, holding companies in the period since 1940 have been either drastically scaled down in size or completely liquidated.^{3/} Of a total of 2175 companies which have at one time been subject to Commission jurisdiction under the Holding Company Act only 444 remained in this status at June 30, 1951. Of the balance, many have been eliminated through merger, consolidation or dissolution. A total of 753 companies with assets of over \$10 billion dollars have been divested by holding company systems and are no longer subject to Commission jurisdiction, since they are now

^{3/} Because of delay in registration by many systems pending a decision on the constitutionality of the registration provisions of the statute, little enforcement action occurred prior to 1940.

operating as independent or exempt companies, freed from holding company control and restored to local ownership and effective state regulation.

Before many of the utility companies could be freed from holding company control, however, they had to be thoroughly reorganized. The Commission also had to bring about a more equitable distribution of voting power among security holders, and an elimination of inflationary items from property accounts. Often, proper ratios of debt to equity were achieved only by obtaining a substantial contribution of capital by the parent holding company. In addition, charter provisions were strengthened, bond indentures were revised to include new protective provisions for the security holders. Finally, the common equity of the operating utilities took on an attractiveness which stimulated increasing market interest as each new divestment was made by the holding company systems.

Contrasted with the very limited number of utility common stocks available to the investor prior to 1945, there are now well over 150 gas and electric operating company commons which are actively traded on the security markets of the nation. The companies which these stocks represent are for the most part no longer connected with holding company systems and are not subject to the provisions of the Holding Company Act.

There remain under Commission jurisdiction, however, some 40 utility holding company systems with assets (after deduction of valuation reserves) of about \$10 billion dollars. About half of the group are still faced with problems of compliance with section 11. Some will eventually liquidate; others, by divesting themselves of remaining utility properties, may qualify for exemption from provisions of the statute.

The other group of some 20 holding companies will probably continue as registered systems and are expected to meet the standards of section 11 as geographically integrated systems within limited areas, possessing sound and simplified financial structures. The operation of these continuing systems is in a sense a test of the integration principle of the statute and a test of the appropriateness of the holding company device under regulatory control of the S.E.C.

Among the 20-odd continuing systems there are three general types. The first is the electric holding company system which usually consists of one holding company above a number of interconnected electric operating companies. In this category are such systems as American Gas & Electric Company which operates in an area extending northwest from Tennessee to Michigan; Central & South West Corporation serving portions of Texas, Oklahoma, Louisiana and Arkansas; and The Southern Company serving most of Alabama and Georgia and portions of Florida and Mississippi. The second type is the natural gas holding company system which frequently controls natural gas transmission as well as distribution properties. Systems of this type include Columbia Gas System, Inc. serving portions of a seven-state area from Kentucky to New York; American Natural Gas Co. which transmits gas from the Texas area and distributes in the Michigan-Wisconsin area; and Consolidated Natural Gas Company serving sections in West Virginia, Ohio and Pennsylvania. The third type is the operating holding company. In these instances the holding company derives a substantial proportion of its income from its own utility operations but also retains one or more subsidiary operating companies. Delaware Power &

Light Company, Ohio Edison Company and Union Electric Company of Missouri are examples of this type.

Thus, in spite of the contraction of holding company systems and the divestment of many operating properties the Commission continues to be faced with the responsibilities and regulatory problems of a large segment of the industry. This regulatory jurisdiction embraces the issue and sale of securities by holding companies and their subsidiaries, also acquisitions of securities or utility assets by holding companies, dividend payments, inter-company loans and the solicitation of proxies. System servicing and accounting procedures are also subject to Commission supervision. But the influence of the Commission extends beyond the companies remaining under its jurisdiction, for our requirements tend to set the standard for the industry as a whole.

COORDINATE REGULATORY JURISDICTION

In the regulation of the private utility industry the Securities and Exchange Commission shares responsibility with more than 40 state commissions, the Federal Power Commission, and, with the development of our intensive defense program, with a new group of emergency control authorities.

We, at the Commission, have always recognized that responsibility for the regulation of the day-to-day operations of the local operating utilities must remain the job of the state commissions. The primary objective of utility regulation is to assure adequate service at lowest

reasonable cost to the consumer. Under the monopoly conditions in which utilities operate the state agencies provide necessary protection and an assurance that operating standards will be maintained. Additionally, many state commissions exercise jurisdiction of security issuance, accounting procedures and other phases of utility operations.

The purpose of the Holding Company Act was, in large measure, to free operating companies from absentee control and thus permit more effective regulation by the states. The protection of state regulation is specifically provided for in several sections of the Holding Company Act, and certain security issues and security and asset acquisitions are exempted from areas of Commission jurisdiction when they have been approved by a state commission. The Holding Company Act was never intended to supersede state regulation, but rather to supplement and reinforce it.

The Federal Power Commission has many duties under federal statutes. It handles the licensing of hydro-electric projects on lands or streams subject to congressional jurisdiction, grants certificates of public convenience and necessity for construction, acquisition and operation of natural gas facilities, regulates electric and gas rates in matters involving interstate operations and makes original cost studies. It handles certain applications to issue securities or to dispose of or merge operating facilities. It also conducts studies on power resources and requirements of the country and on river basin and water power development.

In matters where jurisdiction may converge, there are frequent and helpful exchanges of information between the two Federal agencies. In many ways the work is complementary, as it is between this Commission and the state agencies. Both the F.P.C. and the local commissions, however, have a more direct interest in the character of utility service and utility rates. The S.E.C. is primarily concerned with the maintenance of financial stability and integrity, and in that field our jurisdiction is paramount.

Within the past two years, however, the deteriorating international situation has brought new factors into the regulatory pattern. It has become necessary to establish new Federal controls to aid in achieving an effective mobilization of national resources.

The Defense Electric Power Administration which represents the electric power industry in the mobilization program has the responsibility for determining the adequacy of electrical facilities to meet power requirements of the direct military, defense industry and the civilian economy. It is the claimant agency for necessary materials to supplement the program. The Petroleum Administration for Defense does a somewhat similar job for the oil and natural gas industries. The final allocation of critical materials among the various industries is the task of the Defense Production Administration.

DEPA and PAD do more than just act as claimant agencies, however. They also have the power to curtail certain types of electric or gas service where shortages make this step necessary. They clearly cut across areas of jurisdiction normally controlled by other agencies. They can discriminate to meet emergency requirements where other authorities might

be prevented by statute from doing so. However, the recent Bow amendment to the Defense Production Act provides that no ruling, regulation or order under that act restricting the use of natural gas shall apply to any state in which a public regulatory agency has authority to restrict the use of natural gas and certifies to the President that it is exercising that authority "to the extent necessary to accomplish the objectives of this act."

Regulatory agencies are also concerned with the effect of a provision of the Internal Revenue Code which permits the grant, under certain conditions, of certificates of necessity for certain construction approved by the certifying authority. This authority is held by the Defense Production Administration. These certificates permit an accelerated amortization of plant facilities built to meet defense needs, for purposes of computing taxable corporate income. This has the effect of reducing the company's initial income tax liability and increasing profits during an initial five year period. It raises some knotty problems, however, from the regulator's viewpoint since this adjustment of net income can have an important effect upon rates, earnings coverage for the equity security holders and future financing programs.

Of most direct concern to this Commission, however, is the financial impact of this tremendous expansion program for defense in both the electric and gas industry coming as it does upon the heels of a five year period of rapid post-war growth which of itself was unsurpassed in the history of utility development. I have made considerable point of the Commission's efforts to restore the financial health of the industry. The job now is to preserve these gains.

Utility companies and utility systems have a very compelling obligation to provide service adequately and promptly where it is needed. When the switch is flicked, the power must be there to illuminate the bulb; when the handle is turned, the gas stove is expected to ignite. Electricity and gas have become more and more an integral necessity of our daily living, and as our civilian use has grown, so has our dependency. I personally do not believe there is as much a cushion of fat in civilian consumption of power as there was, say, ten years ago, when substantial amounts of power could be pared from civilian use through brown-outs. I have the feeling that a bigger percentage of our enlarged capacity is fixed and essential, either to industry or to the civilian population. Let me give you an example from close to home. We hardly associate electricity with house heating in this part of the country - gas and oil are much more economical. Yet, last year when an explosion put the electric substation in my neighborhood out of order, just about everyone had to go without heat until the station went back on the line - for while the furnace may burn fuel, the blower system and the thermostat require electricity. They don't require very much, it is true, but they cannot do without that bit.

So, I feel when we plan for the nation's growth, and particularly as we plan for our defense needs, we must plan enough; and we cannot afford to depend on taking away from existing consumers without a serious dislocation of the civilian economy.

As the utilities grow to meet the nation's demand for power and fuel, there is a constant need for large quantities of new capital investment which must be added in proper proportions of debt and equity.

CONSTRUCTION AND FINANCING

It is sometimes difficult to put into words the full concept of growth as it has occurred in the utility industry in the last five or six years. Electric utilities now serve more than 46 million customers in the United States, a 29 percent increase over 1946. Energy sales have jumped from 191 billion kilowatt hours to 317 billion, up 66 per cent, and generating capacity has increased about 50 percent during the same period. At the same time the margin of reserve capacity to peak load requirements remains so low as to be a cause for concern, particularly in certain critical areas.

A survey recently completed by the publication "Electrical World" indicates that almost 29 million kilowatts of generating capacity are expected to be added in the period 1952 to 1954, about 70 percent to be built by private utility companies. In terms of dollars of construction expenditures the outlay of the private and certain public systems, past and projected, is as follows:

Annual Capital Expenditures for New Construction, Private, Municipal, State and Power District Systems*

1946	\$ 718,169,000
1947	1,372,145,000
1948	2,078,088,000
1949	2,517,614,000
1950	2,347,171,000
1951	2,443,324,000
1952	3,001,803,000 (planned)

* Source: Electrical World Surveys

Of the total construction expenditures reported above, about 88 percent of the 1951 and 1952 totals represent private utility outlays.

4/ Data from Electrical World Statistical issue, Jan. 28, 1952.

The effect of defense power requirements has been to compress construction programs in the critical areas into shorter periods of time. In other areas where such needs can be met with present capacity or with limited additions, some individual company programs may be partially deferred. The sum total, however, is an accelerated pace graphically illustrated by the more than \$3 billion of expenditures planned for this year. Up until Korea, the industry expected to have completed its post-war expansion program during 1950-1951. Now it finds it must equal or exceed in 1951-1953 the growth of the first five post-war years. ,

The same step-up in construction is reflected in the natural gas industry. In a recent issue of the publication "Scientific American", Prof. Parsons of the University of California, pointed out that in terms of energy units the 6 trillion cubic feet of natural gas used in this country in 1950 was equivalent to four times the amount of hydro-electric power generated. Natural gas accounted for nearly one-fifth of the nation's total energy consumption from all commercial sources. We now have more than 315,000 miles of natural gas pipelines in the country or more than the total mileage of all railroad lines. When service to New England is completed every part of the country except the Pacific Northwest will be accessible to the gas transmission network.

Construction expenditures by the natural gas industry are shown in the following table:

Total Natural Gas Utility Construction Expenditures *

1946	¢ 236,800,000
1947	623,600,000 <u>1/</u>
1948	629,200,000
1949	848,100,000
1950	1,095,700,000
1951	1,433,800,000 (forecast)

1/ Includes \$143,127,000 cost of Big Inch and Little Big Inch pipelines purchased for conversion to transmission of gas.

* Source: - Gas Facts

While in both the electric and natural gas industry sizeable amounts of funds for investment in new plant are generated from internal sources, including retained earnings and depreciation reserves, the major portion of such funds must be obtained through financing operations.

During 1949, the electric and gas industry (and including private water companies) sold \$2.3 billion of bonds, preferred stock and common stock, of which \$1.8 billion was invested in new plant and equipment, the remainder being refinancing of existing obligations. In 1950, they sold \$2.6 billion of securities, and invested \$1.7 billion in new plant. During 1951, which has witnessed a sharp contraction in refinancing activity, total volume has declined somewhat to about \$2.3 billion but new money offerings have increased and have passed the \$2 billion mark.

The impact of the Korean situation which has sustained and heightened the growth problems of the utilities has, of course, been felt by the holding company systems under Commission jurisdiction. A number of them operate in areas where defense activities (which also have a direct effect upon residential and commercial demand) are under intensive development.

Set forth in the following table is a list of the ten largest systems which we term "continuing" in the sense that they are expected to remain as integral operating units under Commission jurisdiction. The dollar volume of their post-war and future expansion programs, which is only a part of the industry under our jurisdiction, provides an indication of the amount of financing activity that has come before us for consideration.

Approximate Expenditures for Construction
by Ten Registered Holding Company Systems

	5 Years <u>1946 - 1951</u>	2 Years <u>1952 - 1953 (Forecast)</u>	
American Gas & Electric Company	\$388,000,000	\$201,400,000	
American Natural Gas Company	229,200,000*	---	**
Columbia Gas System, Inc.	276,200,000	75,000,000	(1952 only)
Consolidated Natural Gas Company	212,800,000	---	**
General Public Utilities Corporation	231,000,000	151,000,000	
Middle South Utilities, Inc.	268,000,000	138,700,000	
New England Electric System	168,000,000	38,000,000	(1952 only)
The Southern Company	332,100,000	214,000,000	
Union Electric Co. of Missouri	168,500,000	82,700,000	
West Penn Electric Company	186,700,000	94,800,000	

* Organized in 1947.

** Data not yet available.

The accelerated rate of system construction programming is emphasized by the estimates for 1952 and 1953. Material restrictions and material and labor shortages may cause a few deferments in the completion of scheduled installations but, even within the past 6 to 9 months, the scope of many of these programs has been increased. Companies have actually been forced to raise their sights in spite of a tight material situation.

FINANCING THE HOLDING COMPANY SYSTEMS

In general, the corporate structures of the holding company systems which have evolved from the simplification process of section 11 follow one of two different patterns. A few systems are organized in such manner that all securities of the underlying operating companies including both debt and equity segments are owned by the parent holding company. In these situations all capital investment flows into the system through the parent company which may have outstanding long term debentures, representing a general claim on system properties, and common stock. In these systems the parent company's capital structure, with allowance for surplus retained at the subsidiary level, essentially reflects the capitalization of the system. This is a comparatively simple type of structure.

Most holding companies, however, have a somewhat more complex financial structure. In these systems, the debt and preferred stock of the operating companies are publicly held and only the common stock segment is owned, usually wholly owned, by the parent holding company. Since the assets of the holding company consist almost entirely of its common stock investments in its subsidiaries, the Commission generally adheres to the principle that the holding company should have only common stock in its own capital structure. ^{5/} The purpose of this rule is to prevent any recreation of multiple tiers of debt securities, a situation which the Holding Company Act was specifically enacted to eliminate.

^{5/} However, several holding company systems of this type were permitted to emerge from section 11 reorganizations with outstanding debt in the parent company's capital structure. This is ultimately to be eliminated.

Under ordinary circumstances this arrangement affords satisfactory results with the parent holding company adding to its investment in its subsidiaries through retention of earnings and through periodic new common stock investment. The scope of recent construction, however, has begun to place a strain on the maintenance of this standard. The individual operating subsidiaries have been called upon to add quickly large amounts of new generating capacity, new transmission and new distribution facilities. Additional bond financing is generally the initial source of funds. It provides the proportion of lowest cost capital without which present utility expansion could not be a realization. In addition, however, amounts of common equity must also be invested to preserve the balanced ratios of debt and equity in the subsidiaries.

This new equity must come from the parent holding company which has no more important function than that of supplying needed funds to its subsidiaries. While this responsibility is recognized by holding company managements, there is often an inclination to postpone the sale of their common stock because of the dilutionary effect upon earnings available for present shareholders. In addition, when expansion programs must be compressed into shorter periods of time and the new capital investment rate is stepped up, the lag between the time funds are invested and the time when increased power output is reflected in higher earnings income becomes of major significance. No management welcomes the prospect of selling common stock under circumstances which result in materially lower earnings per share, even if only for an interim period.

While the Commission still believes firmly in the principle that holding companies should remain on an all common stock basis, ours is not a blind adherence to a rigid rule. We recognize that there must be added a degree of flexibility which will enable us to deal realistically with problems arising out of the mobilization situation. These financing programs are under constant study and in several recent cases, the Commission has permitted the holding company to undertake short term bank borrowing to provide cash for additional equity investment in the operating subsidiaries with the specific understanding that such notes would be retired within a few months with the proceeds of common stock financing. Under such circumstances a temporary condition is permitted in a number of systems where debt securities will be outstanding both at the operating company and the parent company level. I emphasize, however, that the condition is regarded as temporary. Just recently one holding company system approached the Commission with a proposal to sell convertible debentures at the parent company level though its subsidiaries already had outstanding substantial amounts of mortgage debt. The company urged this proposal because such securities appeared to offer a method which it hoped would ultimately add to the common stock of the holding company (through conversions) and which would not materially dilute income available to the present stockholders. There is a substantial difference, however, between the character of short term bank borrowings and long term debentures. It is not simply a matter of flexibility. It would mean the reestablishment of long term debt at the holding company level and a serious recomplication of the system structure. For that reason, and because we could not see that a particular

hardship would result from conforming to our usual standard, the Commission has denied the company's request to issue the convertibles as part of the company's current financing program.

The Commission also exercises a degree of flexibility in its determination of capital ratios appropriate for various holding company systems. No two systems reflect the same ratios and, while we urge that financial programming be undertaken with a long range improvement factor in mind, particular circumstances may necessitate some deviation from normal standards. However, the justification for such deviation must not be frivolous or capricious.

The preparedness program of the nation has brought other problems to the Commission necessitating a flexibility in administration. One of the most unusual of these is related to the program of atomic energy development. In December 1950, The Atomic Energy Commission announced plans for the construction of a new plant to produce uranium 235 by the gaseous diffusion process at Paducah, Kentucky. A major requirement of the new plant was an adequate supply of electric power. After some negotiations, a group of five utility companies proposed to organize a new company, Electric Energy, Inc., which would construct and operate a 500,000 kilowatt generating station and related transmission lines capable of supplying half of the project's requirements. The remaining power requirements were to be supplied by TVA.

The organizing companies immediately filed an application with the S.E.C. seeking to acquire common shares in the proposed enterprise. Four of the five acquiring companies were registered holding companies, though two had an exemption from most of the provisions of the Holding Company Act.

The application was unique because, although it was a private venture, its purpose was the cooperative building of a project dedicated to serve a vital installation of the United States government with the government guaranteeing to supply a substantial part of the cost of the project.

The proposal presented some serious problems under the acquisition standards of the Holding Company Act because, while it was clear that the new plant could be integrated with the operations of the nearby companies, there was some question of how it might fit with some of the others should it ever be available for ordinary use; nor do we have any other instance of a power plant being owned jointly by several unassociated companies. Furthermore, the total common stock investment of \$3,500,000 was to be accompanied by debt borrowing of up to \$100,000,000. The applicants had entered into an arrangement with the Atomic Energy Commission which was later formalized by a 25 year contract to supply firm capacity to the Paducah project. The rates to be charged the Federal Government and its additional guarantees assured the servicing of debt and its amortization over the life of the contract as well as a return on the common stock.

Ordinarily, a determination as to whether such an acquisition could meet the integration standards of section 10 of the Holding Company Act would have required the development of a comprehensive record which might have taken some time. Under emergency conditions, however, the Commission postponed definitive consideration of the problem and permitted interim acquisition of the Electric Energy stock by the five companies, subject to a fresh look when the emergency is over. The unusual financing

arrangement, departing sharply from usual utility practice, was allowed only because the mortgage debt enjoyed substantial protection under the government's power purchase contract.

In permitting acquisition of the Electric Energy common stock and the subsequent issuance of its mortgage bonds, the Commission modified its usual procedure to meet a specific need. Flexibility of administration was clearly justified in this instance. On the other hand, we have to be careful to distinguish the circumstances of such a program from other instances where applicants seek to justify the creation of top heavy, unsafe capital structures through the organization of separate generating companies or through lease-back arrangements on the basis of alleged defense requirements but no real necessity.

The achievement of realistic, flexible regulatory administration calls for a combination of sympathetic understanding of problems faced by the operating companies under mobilization conditions, careful analysis of the impact of Commission action upon the national interest and the interest of investors, consumers and the general public, and finally a firm conviction in the appropriateness of the principles of financial stability which we enforce through the medium of the Public Utility Holding Company Act.

Enforcement of this statute has brought about a restoration of sound financial structure in the electric and gas industry, without which the present heavy expansion program by private companies would probably not have been feasible. Now we must deal successfully with the task of maintaining financial stability in that segment of the industry which we shall continue to regulate.