Michigan Law Review

Volume 36 | Issue 8

1938

PUBLIC UTILITY HOLDING COMPANY ACT - CORPORATE SIMPLIFICATION AND GEOGRAPHIC INTEGRATION UNDER SECTION II

Brackley Shaw
University of Michigan Law School

PUBLIC UTILITY HOLDING COMPANY ACT — CORPORATE SIMPLIFICATION AND GEOGRAPHIC INTEGRATION UNDER SECTION 11 — Section 11 of the Public Utility Holding Company Act of 1935,[1]

[1] 48 Stat. L. 803 (1935), 15 U. S. C. (Supp. 1937), § 79 k(b): "It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

"(1) To require by order, after notice and opportunity for hearing, 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-

the so-called "death sentence" clause, carries the specifications for achieving two of the government's main objectives in passing the act: corporate simplification and geographical integration of the large utility holding company systems.

I.

Whereas the original bill proposed to Congress would have required the dissolution of all public utility holding companies immediately after January 1, 1940,[2] the act which was finally passed is considerably less of a death sentence, inasmuch as it allows the retention

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, however*, That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system; (B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and (C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

"The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one or more integrated public-utility systems the retention of an interest in any business (other than the business of a public-utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems.

"(2) To require by order, after notice and opportunity for hearing, 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. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any other company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public utility company."

[2] S. Hearings on S. 1725, 74th Cong., 1st sess. (1935), p. 20, § 11(b)(4).

of two tiers of holding companies, thus condemning to death only the uneconomic superstructure above that degree. The evils inherent in such corporate pyramiding were sought to be eliminated by section 11(b)(2), which provides that

> "The Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company."[3]

One of the greatest dangers growing out of this pyramiding process, in and of itself, is the large degree of control of a system of operating companies which can be obtained with a relatively insignificant investment in the voting stock of the top holding company. In at least one case this was carried so far that an investment in the top holding company equal to two-hundredths of one per cent of the total capitalization of the bottom operating company was sufficient to control it.[4] A second danger inherent in the pyramiding process lies in the highly speculative character of the securities of the top holding companies. Charts have been prepared by the Federal Trade Commission illustrating how, even with a relatively conservatively financed holding company system, the common stock of the top holding company could pay dividends of eighty-seven per cent when the bottom operating company was earning only seven per cent on its investment and how, if the income of the operating company dropped to five per cent, there would be insufficient income to pay all the dividends of the second degree holding company, and no income at all for the third and fourth degree companies.[5] Similar charts illustrate the possibility of a fifth degree holding company paying nearly three hundred per cent when the operating company is earning eight per cent and being unable to pay

[3] 15 U. S. C. (Supp. 1937), § 79 k(b)(2).

[4] This was true of the Insull system, where control of the North State Beach Development Company was filtered up through nine tiers of holding companies and eventual control lodged in the Insull interests and Halsey-Stuart and Company. The West Florida Power Company was controlled by the same interests through an investment of .05 of one per cent. Federal Trade Commission Report on Utility Corporations, S. Doc. 92, 74th Cong. 1st sess. (1935) [referred to herinafter as Utility Corporations], part 72A, pp. 160-161.

[5] 72A UTILITY CORPORATIONS, p. 157. The chart is reproduced herewith. It will be noted that the financial set-up of this hypothetical system is relatively conservative, as no bonds or debentures have been issued by the holding companies and all of the common stock in each company is owned by the company immediately above it.

any dividends at all when the earnings of the operating company drop to five per cent.[6]

With control and earnings so nearly completely divorced from ownership, it is practically inevitable that there should be pressure brought to bear by those holding control to maintain the earnings of the operating companies at a high level without regard to the true best interests of the subsidiaries. Section 11 is founded on the principle that this situation is not in the public interest, from the point of view of either the investor or the consumer.

One means by which control has been concentrated in a few hands to the detriment of the holders of securities in the constituent companies has been through unfair distribution of voting power among the securities of these companies, so that those having the voting power represent only a relatively small proportion of the total outstanding securities of the company. The common practice is to issue large amounts of bonds or debentures and non-voting preferred stock.[7]

Company and its Securities		*Income and its Division*			
Structure	*Capital*	7%	%	5%	%
Operating Company					
50% bonds, 5%	$ 500,000	$25,000	5	$25,000	5
25% preferred stock, 6%	250,000	15,000	6	15,000	6
25% common stock	250,000	30,000	12	10,000	4
Total	$1,000,000	$70,000		$50,000	
First Degree Holding Company					
Income accrued		$30,000		$10,000	
50% preferred stock, 7%	125,000	8,750	7	8,750	7
50% common stock	125,000	21,250	17	1,250	1
Second Degree Holding Company					
Income Accrued		21,250		1,250	
50% preferred stock, 7%	62,500	4,375	7	1,250	2
50% common stock	62,500	16,875	27	———	–
Third Degree Holding Company					
Income Accrued		16,875		———	
50% preferred stock, 7%	31,250	2,187.50	7	———	–
50% common stock	31,250	14,687.50	47	———	–
Fourth Degree Holding Company					
Income Accrued		14,687.50		———	
50% preferred stock, 7%	15,625	1,093.75	7	———	–
50% common stock	15,625	13,503.75	87	———	–

[6] 72A UTILITY CORPORATIONS, p. 162. In one line in the Associated Gas and Electric System there were 10 tiers of holding companies between the bottom operating company and the top holding company. Ibid., p. 159.

[7] 72A UTILITY CORPORATIONS, pp. 136-137. In the security structure of the Central Public Service Corporation there are three classes of preferred stock and two classes of common stock. Only one class of common stock has voting power and all of this class is held by a holding company. Ibid., p. 137. At least two corporations have issued cheap management shares which give control of the corporation to the holders

Section 11 attempts to render such situations impossible by making it the duty of the Securities and Exchange Commission

> "to require . . . 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 the continued existence of any company in the holding company system does not . . . unfairly or inequitably distribute voting power among security holders of such holding company system." [8]

Finally, section 11 seeks to do away with the unbelievable complexity of some of the present holding company structures. In several of the systems no one who was not a financial expert, much less the average investor, could tell what the owner of a security in one of the top holding companies really owned.[9] And even the expert would be unable to give a wholly correct answer without knowing to what extent an apparent minority interest was bolstered into actual control by a friendly management, interlocking directorates, or a wide distribution of the remaining stock among the public. By section 11(b)(2) the commission is empowered to order that each holding company and subsidiary shall take steps 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." [10]

2.

A spread of the power of a holding company system over many of the states of this country and several foreign countries, as is the case at present with at least one system,[11] is made impossible by section

with a disproportionate investment. An extreme example is provided by the Cities Service Company, which in 1929 sold 1,000,000 shares of a special issue of stock to Henry L. Doherty & Co., another holding company, for $1 per share. Each of these shares conferred one vote as against one-twentieth of a vote per share carried by the company's no-par common stock, which had a stated value of $5 per share and which was selling in the market at the time for $30 per share. Ibid., p. 142. The annual report of the company for 1937 states, however, that none of this stock is outstanding at the present time.

[8] 15 U. S. C. (Supp. 1937), § 79 k (b) (2).

[9] See charts of the corporate structure of the North American Company and the United Corporation. 72A UTILITY CORPORATIONS, pp. 108, 114.

[10] 15 U. S. C. (Supp. 1937), § 79 k (b) (2).

[11] Electric Bond & Share Company controls operating companies from Florida to Washington and from Wisconsin to Texas. 72A UTILITY CORPORATIONS, p. 88. It operates in 31 states (ibid., p. 56) and 13 foreign countries—statement of S. R. Inch, president of Electric Bond & Share Company, in S. HEARINGS ON S. 1725, 74th Cong. 1st sess. (1935), p. 1024 at 1031. Middle West Utilities operated in 29 states before its collapse. 72A UTILITY CORPORATIONS, p. 56.

11(a)(1), which makes it the duty of the commission to limit the operations of a holding company system 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 system, except that the commission may allow the retention of additional integrated public utility systems in some circumstances if "all of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country."[12]

That this territorial expansion of the operations of the holding companies is an evil is stoutly denied by the representatives of the utility industry, who contend that ownership of securities from operating companies widely scattered over the country makes for "diversification of risk," safeguarding the investor in the holding company securities.[13] It would seem, however, that true diversification of risk consists in owning different classes of securities in many various kinds of companies. As the securities in the holding company portfolio are nearly all common stock equities in public utility operating or subholding companies, it may be seen that the diversification is purely geographic. The claim that this constitutes diversification of risk safeguarding the investor rests on the possibility of a depression in one part of the country while other parts are prosperous.[14] Commissioner Splawn contends that rather than being true examples of diversification of risk, the large utility systems are really "empires of scatteration."[15]

3.

Thus the broad outlines of a plan for regulating the public utility holding companies have been laid down by the act. But, because of the large discretion granted to the Securities and Exchange Commission in applying the act, many questions of vital importance to the utilities are left unanswered by it.

What is a "single integrated public utility system"? Although

[12] 49 Stat. L. 803, § 11 (b) (1) (B) (1935), 15 U. S. C. (Supp. 1937), § 79 k (b) (1) (B).

[13] See statement of S. R. Inch, president of Electric Bond & Share Company, S. HEARINGS ON S. 1725, 74th Cong., 1st sess. (1935), p. 1024 at 1030.

[14] See statement of Dr. Walter M. Splawn, member of the Interstate Commerce Commission, special counsel retained by the Committee on Interstate and Foreign Commerce of the House of Representatives to investigate public utility holding companies. S. HEARINGS ON S. 1725, 74th Cong., 1st sess. (1935), p. 85; H. HEARINGS ON H. R. 5423, 74th Cong. 1st sess. (1935), p. 2187 at 2194.

[15] Splawn in House hearing, supra note 14, p. 2194.

a definition of the phrase is provided in the act,[16] the definition itself needs interpreting before the utilities will know what systems are within the law. What constitute businesses "reasonably incidental, or economically necessary or appropriate to the operation of such integrated public-utility system"? What is a fair, equitable distribution of voting power among the security holders of the system? How large is a system "so large as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation"? While many abuses are clearly ruled out by these descriptive phrases, it is much more difficult to draw the exact line between permissible and prohibited practices.

Unquestionably the most vital question facing the holding companies which come within the act is what the attitude of the commission toward its duties in enforcing the act will be. Will it construe these provisions strictly against the companies, or liberally in their favor? Will it allow a holding company system to dismantle its house piecemeal, or will it insist that once the company has come within the range of commission action it must tear down its entire superstructure on the spot?

4.

Faint outlines of the answers to these questions are blocked in by three recent Securities and Exchange Commission releases under the Public Utility Holding Company Act. All three consist of opinions, findings, and orders of the commission on voluntary applications for reorganization made by utility holding companies under section 11(e) of the act. This provides that instead of investigation by the com-

[16] 15 U. S. C. (Supp. 1937), § 79 b (a) (29): " 'Integrated public-utility system' means—(A) As applied to electric utility companies, a system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation; and (B) As applied to gas utility companies, a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operation to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation: *Provided*, That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region."

mission followed by a reorganization order with which the utility is bound to comply, the utility may "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)."[17] A brief resume of these releases follows.

In the Matter of American Water Works & Electric Co., Inc.[18] The American Water Works & Electric Company is a fifth degree holding company which controls, in addition to some eighty-nine water companies and other non-utilities which are not within the terms of the act, a fourth degree utility holding company, the West Penn Electric Company. The West Penn Electric Company, in turn, controls a transportation holding company, a third degree utility holding company, and a second degree utility holding company. With consolidated assets of approximately $385,000,000, the electric operations of the system extend over portions of the states of Pennsylvania, West Virginia, Ohio, Maryland, and Virginia, in an area roughly three hundred miles north and south and three hundred miles east and west. Although the generating, transmission, and distribution facilities of the system are for the most part interconnected, in one area served by the company the power furnished is purchased from a non-affiliated company, and there are several small generating and distributing systems located within the service area of the company. It appeared, however, that these small systems are being rapidly tied into the company's main transmission system, and that this work will be completed as soon as the demand for electricity warrants. The company also carries on relatively inconsequential gas operations in the states of West Virginia, Pennsylvania, and Maryland. Sixty per cent of the business of the company is represented by its utility operations. The company has various other business interests. It owns directly forty-five water companies which have been a substantial and stable source of revenue

[17] 15 U. S. C. (Supp. 1937), § 79 k (e). In Release No. 952 under the Holding Company Act, January 1, 1938, the commission promulgated Rule 11F-1 which provides that any person proposing to submit a plan of reorganization to a federal court for a registered holding company or subsidiary must first file with the commission an application for approval of the plan. Such application may be combined with an application for a commission report under sections 11(g) and 12(e) on solicitation of proxies. CCH SECURITIES ACT SERVICE, ¶ 8396. The purpose of this release was to clarify Release No. 54, which was an opinion of the General Counsel that reorganization plans for registered holding companies need not be submitted to the commission for approval where a trustee or receiver had been appointed by a federal court before registration. CCH SECURITIES ACT SERVICE, ¶ 8071.01.

[18] Securities and Exchange Commission, Holding Company Act Release No. 949 (Dec. 30, 1937), CCH SECURITIES ACT SERVICE, ¶ 30,018.

to the company. It carries on some electric railway, bus and bridge business, for the most part in the same territory as its gas and electric service, the bus service having been acquired in some cases because electric railway lines became unprofitable and permission to abandon them could only be obtained by agreeing to institute bus service. Other interests of the company include two coal mining properties, the total output of which is sold to generating companies at cost; an appliance business; some ten thousand acres of agricultural land in the Sacramento Valley inherited from a predecessor corporation which the company is anxious to get rid of and is gradually selling off; an office building in Pittsburgh used by a subsidiary for its offices, and an office building in New York not used in the company's business. Some forty more water companies are controlled by the company through its control of the American Communities Company, a holding company with a highly complicated system and an unfair distribution of voting power among the security holders of some of its operating subsidiaries.

The plan of reorganization submitted by the American Water Works & Electric Company contemplates the dissolution of some intermediate holding companies and the acquisition of their assets by other companies in the system. The net result would be that the company would be a second degree holding company controlling three combined utility holding and operating companies, each of which controlled several operating companies. As no plan of refinancing the system or for the sale of new securities was filed with the plan for reorganization, the commission did not pass on the financing of the reorganization in this release.

The findings of the commission were that the electric operations of the company's subsidiaries constitute an integrated public utility system, inasmuch as the systems at present not connected with company's main transmission lines are "capable of physical interconnection" within section 2 (a)(29) of the act, and the company is planning such interconnection. The commission found that the company's combined gas and electric system constitutes a single integrated system because "all of the electric properties are integrated and all of the properties, both gas and electric, are in fairly close geographic proximity and are so related that substantial economies may be effectuated by their coordination under common control."[19] The commission found that the directly owned water companies are sufficiently related to the management of the company's gas and electric subsidiaries, and the coal and appliance businesses are so intimately related to the operations of the gas and electric utilities, as to be reasonably incidental and economically appropriate to the operation of the integrated public utility system. The

[19] Ibid., ¶ 30,018 at p. 7555.

commission also found that the electric railway, bus transportation, and bridge businesses of the company are necessary and appropriate in the public interest and not presently detrimental to the proper functioning of the public utility system, on the basis that they are inheritances from an earlier age, that they are relatively minor, and that the company would have difficulty in disposing of them on a forced sale. It prohibits future expansion of these businesses, however. As to the agricultural property in California and the office building in New York, the commission found that they are not reasonably incidental or economically appropriate, but gives the company a reasonable period of time in which to dispose of them. The commission reserved its judgment on retention by the company of its interest in the American Communities Company pending an attempt by the company to eliminate the Communities Company as an intermediate holding company and to reorganize or re-capitalize its system.

The commission also found that the preferred stocks in most of the corporations of the system have no voting power until dividends have been passed, and then only a vote share for share with the common, which in some cases will leave the common in control even after default in dividends. This the commission regards as not fair and equitable and requires a change in the voting power of the preferred stock in the event of continued dividend defaults. The commission found that there had been revaluations of the properties of the utilities in the past and reserved jurisdiction to approve or disapprove of a plan to be submitted by the company to adjust these revaluations.

In the Matter of Massachusetts Utilities Associates.[20] Massachusetts Utilities Associates is a subsidiary of the New England Power Association, which is controlled by International Hydro-Electric System, which, in turn, is a subsidiary of International Paper & Power Company. It is a second degree holding company owning substantially all of the stock of three subsidiary first degree holding companies, each of which controls several operating utilities. All of these utilities operate in the state of Massachusetts.

The proposed plans of reorganization provided for the dissolution of the three first degree holding companies and the issuance to the outstanding shareholders, other than Massachusetts Utilities Associates, of stock in that company or, at their option, of cash liquidating dividends set by the boards of trustees of the three companies. On

[20] Securities and Exchange Commission, Holding Company Act Release No. 961 (Jan. 11, 1938). This is a report on three separate applications. The full title of the release is In the Matter of Massachusetts Lighting Companies and Massachusetts Utilities Associates, Central Massachusetts Light & Power Company and Massachusetts Utilities Associates, Commonwealth Gas & Electric Companies and Massachusetts Utilities Associates.

final liquidation Massachusetts Utilities Associates would take over the assets of the three companies. The commission found that the plans submitted were necessary for effectuating the purpose of the act for the reason that they would eliminate an extra tier of intermediate holding companies. The commission also found that the plans were fair and equitable to the Massachusetts Utilities Associates and its shareholders and to the shareholders of the three sub-holding companies, pointing out that the elimination of the three companies will result in savings in legal and tax expenses and improve the cash position of the parent company. The commission refused, however, to sanction the proposal that the parent company carry on its books the securities and assets to be acquired from the three companies at substantially the same amount as the shares of such companies are now carried on its books, and reserved jurisdiction over the question of the proper value to be placed on these assets in the hands of the holding company.

In the Matter of Genesee Valley Gas Co.[21] In this application the applicant was an intermediate holding company with two tiers of holding companies above it and various operating companies below it. The proposed plan of reorganization applied only to the company's internal financial organization and was disapproved of by the commission because, among other reasons, it necessitated a transfer from depreciation reserve to earned surplus on the part of one of the company's subsidiaries in violation of the uniform system of accounts for gas corporations prescribed by the Public Service Commission of New York, and because new stock proposed to be issued by the company would raise its capitalization above the value of its assets. The principal interest of this release for the purposes of this comment lie in the concluding remarks of the commission:

> "Although it is not essential to the conclusions which we have reached in this case, it, nevertheless, appears desirable that we should point out a distinct limitation in the scope of the present plan, namely, the absence of provisions for eliminating applicant's existing holding company system. Admittedly, the effort toward simplification of applicant's capital structure is a step in the right direction. Nevertheless, the crucial factors underlying the system (and which have made necessary the present reorganization) urge something more than a mere palliative; removal of three uneconomic structures from the back of an income producing unit might well be considered as the first requirement of an effective therapeutic.
>
> "Again, while not essential to our opinion in this case, it may

[21] Securities and Exchange Commission, Holding Company Act Release No. 981 (Jan. 24, 1938), CCH SECURITIES ACT SERVICE, ¶ 30,024.

not be amiss to observe that a thorough-going plan of reorganization, one more nearly consonant with the declared objectives of the Act, would have contained provisions (in addition to the elimination of the present holding company structure) for the merger of applicant's New York State operating subsidiaries into a single operating unit. In this manner would concrete expression have been given to the operating realities which in fact now prevail."[22]

The answers to some of the questions set out earlier begin to appear. What is a "single integrated public utility system"? The partial answer to this question provided by the above releases is that a system taking in parts of five states and extending for three hundred miles in either direction may be such, even though parts of it are not connected with its main transmission lines, if they are capable of such connection, if the company has plans for such connection, and if there are not facilities of non-affiliated companies intervening. Furthermore, a system controlling sixteen public utility operating companies may be such a system when all of the companies are located within one state.

What are businesses "reasonably incidental, or economically necessary or appropriate to the operation of such integrated public-utility system"? The *American Water Works & Electric Company* release provides a good insight into the commission's interpretation of this phrase. A system of directly owned non-utilities, as defined by the act,[23] in this case water companies, whose management is related to that of the utilities and which provides a stable and substantial income to the utility holding company is such a business. So is a coal mine all of the products of which are used by the members of the system, and an appliance company whose products help to increase the consumption of the utility's product. The retention of bus transportation and bridge businesses is permissible by an electric utility system if they were acquired by historical accident, are only a minor part of the system's operations and could only be disposed of at a loss. But an office building not used in the business of the system, or agricultural lands in a distant state, even though acquired by inheritance from earlier companies, are not such businesses and provision must be made for disposing of them before the commission will approve the reorganization. An office building which is used in the business is a permissible business, however. The commission also indicates quite clearly that a controlling interest in a complicated holding company set-up of non-utilities is not a permissible interest for a utility holding company system to retain in its present form, and that the system must be unscrambled and the

[22] Ibid., ¶ 30,024 at p. 7570.

[23] 15 U. S. C. (Supp. 1937), § 79 b (a) (5): " 'Public-utility company' means an electric utility company or a gas utility company."

ownership by the utility holding company made more direct before it will sanction the business as one reasonably incidental or economically necessary or appropriate.

What is a fair, equitable distribution of voting power among the security holders of the system? At least it may be said that a situation in which the preferred stockholders are entitled to vote only in the event of default in the payment of dividends and even then may not have a controlling voice is not such a distribution of voting power. Provision must be made in such case to give the preferred stock the controlling vote in the operation of the company. It is suggested in the *American Water Works & Electric Company* release that the commission does not approve of non-voting preferred stock at any time, but will not require this company to make all of its preferred stocks voting because of the long history of dividend payments. That may be a warning of what is to come.

What is a system so large as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation? The answer to this question must be very similar to the first one. A system controlling fifteen operating utility subsidiaries, eighty-nine water companies, and various transportation, bridge, coal, and appliance companies may not be such, even though it extends over five states and covers three hundred miles in either direction. Neither is a system controlling sixteen operating public utilities which are all in the same state.

We come now to the question of the attitude of the commission toward its duties in enforcing the act. It readily appears from a reading of these releases that the commission is not disposed to be harsh or arbitrary in enforcing the provisions of section 11. In almost every case it has given the utility the benefit of the doubt in approving of the retention of non-utility businesses, and in those few cases where the holding company was required to dispose of businesses, a reasonable time has been given in which to do so. As to the sale of the office building and the agricultural land in California in the case of the American Water Works & Electric Company, the commission says, "Realizing, however, that a forced sale of these properties immediately might result in an unreasonable loss to applicant's stockholders, the Commission is willing to permit retention of the interests in these businesses for a reasonable period of time."[24] Likewise in the requirement that the company extend a greater voting power to its preferred stock, the company is given a reasonable time in which to effectuate the change. The commission concludes its opinion in this release with these remarks:

[24] Securities and Exchange Commission, Holding Company Act Release No. 949 (Dec. 30, 1937), CCH SECURITIES ACT SERVICE, ¶ 30,018, at p. 7555.

"The Commission recognizes that it is highly desirable that the simplification requirements be effectuated by voluntary and cooperative proceedings under Section 11(e) rather than by involuntary proceedings under Sections 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." [25]

The last question in the foregoing catechism is quite completely answered by the three releases referred to. May the holding company system dismantle its house piecemeal, or, once it has come within range of commission action, must it tear down its entire superstructure on the spot? There are three tiers of holding companies above Massachusetts Utilities Associates, which is itself a holding company, yet the commission did not refuse its approval to the plan of reorganization presented for this reason and, in fact, held that the proposed plans were necessary for the purpose of effectuating sub-section (b) of section 11 "for the reason that they will eliminate an extra tier of intermediate holding companies." [26] In another release the commission has recognized that "as a practical matter it will often be necessary to accomplish the ultimate objectives of the Act by a series of steps rather by one direct and final step." [27] That the commission will probably not approve mere internal plans of reorganization within one holding company which do not have the effect of reducing the holding company structure to some extent at least, however, is amply shown by the excerpt from the release in *In the Matter of Genesee Valley Gas Co.*[28]

One further interesting conclusion may be drawn from these three releases. That is that the commission will not give its sanction to a reorganization plan which perpetuates "write-ups" of utility company assets which have occurred in the past. Such write-ups have provided a means whereby a holding company could acquire control of utility operating companies at practically no cost to the holding company through the device of buying the assets of the operating company, selling bonds and preferred stock of a new corporation formed to operate the business to the extent of the cost of the assets, then writing up the value of the assets to the extent of the value of the common stock which was issued to the holding company with practically no

[25] Ibid., ¶ 30,018 at p. 7557.

[26] Securities and Exchange Commission, Holding Company Act Release No. 961 at p. 6 (Jan. 11, 1938).

[27] In the Matter of People's Light & Power Co., Securities and Exchange Commission Holding Company Act Release No. 885, p. 7 (Nov. 15, 1937).

[28] Quoted above at note 22.

expenditure on its part.[29] This conclusion may be inferred both from the refusal of the commission to give its final approval to the plan of reorganization of the American Water Works & Electric Company until various "revaluations" of the utility properties made in the past have been adjusted, and from the refusal of the commission to sanction the suggestion that the Massachusetts Utilities Associates carry on its books the assets of the dissolved intermediate holding companies at the same figure that it had formerly carried the stock of these companies.

The more or less sweeping generalizations which have been drawn from these three Holding Company Act releases in this comment are, of course, for the most part mere conjecture. They are, however, founded on actual decisions of the commission and form some guide for judging what the action of the commission in the future is apt to be.

It is clear that, however lenient the commission may be, it is bound by the express terms of the act to break up into much smaller organizations some of Commissioner Splawn's "empires of scatteration."[30] The Electric Bond & Share Company, for instance, and many another top holding company, can by no stretch of the imagination be said to be a "single integrated public utility system," nor will it come within the terms of the act even if it be granted the power to control additional integrated public utility systems "located in one State, or in adjoining States, or in a contiguous foreign country." Patently, also, many of the holding company systems will be forced to eliminate several intermediate holding companies, and will have to revise their capital structure to eliminate writeups and to equalize voting power. The utilities may find some comfort in the disposition of the commission to be generous to those holding company systems which form their own plans of reorganization and voluntarily submit them for approval,

[29] For instance, the Southeastern Power and Light Company owned utility properties for which it had paid $5,900,000. These properties were sold to the Mississippi Power Company for $19,000,000 in bonds, preferred stock and common stock of the Mississippi Company. The Southeastern Company then sold to the public bonds and preferred stock of the Mississippi Company to within $105,000 of the cost of the property to it and retained the entire issue of outstanding voting stock of the Mississippi Company. 72A UTILITY CORPORATIONS, p. 328.

[30] See note 15, supra. Although T. P. Swift wrote in the NEW YORK TIMES, § 2, p. 2:2 (May 1, 1938): "To date, however, the SEC has shown no desire to force acceptance of that portion of Section 11 calling for geographic integration of a system, but, on the other hand, has openly declared that it will seek every possible means to bring about corporate simplification," it should be pointed out that up until the present time the commission has had no reasonable opportunity to enforce this provision. All of the companies on whose reorganization plans the commission has passed can reasonably be called geographically integrated, and the commission has not yet passed on a plan concerning a large, scattered system.

and in the fact that they will be given an opportunity to tear down their structures by easy stages. It will not be necessary for the company to throw on the market all at once sufficient new securities to finance the reorganization of the entire system, as the commission has sanctioned the process of reorganizing by taking up each sub-holding company system in turn and eliminating therefrom a few intermediate holding companies.

It appears that the "death sentence" is really not a death sentence at all, but rather a reducing program for increasing the health of the utility industry by causing it to get rid of a lot of excess weight.

Brackley Shaw