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THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

In the tangle caused by increased federal regulation of American industry, the overall scope of such regulation is often forgotten in examining the minutia of a particular area of concentration. As new regulatory schemes are added to the old, there is a tendency to consider the old as only of historical importance. The regulatory teeth of the older statute, which may still have a sharp bite, are neglected. One statute which has been treated in this cavalier fashion is the Public Utility Holding Company Act of 1935.¹ Many consider the act of only academic interest since the regulatory pattern of the act makes the Securities and Exchange Commission's functions self-liquidating.² However, the belief that the process of elimination of 1935-vintage holding companies has been completed is erroneous. True, there are fewer cases now brought by the SEC to curb the size of holding companies than there were in the years immediately following passage of the act, but the act is still a powerful weapon for federal regulation of the utilities industry.

I. THE RISE AND FALL OF PUBLIC UTILITY HOLDING COMPANIES

In order to understand the Public Utility Holding Company Act of 1935, particularly section 11(b)(1),³ it is necessary to examine the historical pattern of utility holding companies in the United States and the economic chaos that resulted from their activities culminating in the passage of the act to control and regulate their conduct.

After the development of electrical power as a source of cheap and efficient light and heat, private companies were formed to distribute this energy to the public. During the post-World War I period and the nineteen-twenties, the utilities industry, like many others, grew tremendously, both physically and in economic importance. The pyramid principle of the holding company was applied to the electric and gas utilities industry. A holding company would control operating companies by buying enough stock in each one to control its management. Thus, one company, through stock control, would manage many operating companies scattered throughout the country. The pyramid effect was further heightened when the second level was expanded to a third or fourth degree. The top level of the holding company would control the management of the lower levels by stock ownership, and thus control the management of the operating companies.

The result was that while all the holding companies' securities holdings in the operating companies constituted a very small fraction of the total independent public investment in them,⁴ this small amount was sufficient to direct their development, growth, and economic policies. Several men created fan-

¹ 49 Stat. 803 (1935), 15 U.S.C. § 79a (1964).

² Loss, *Securities Regulation* 137 (1961).

³ 49 Stat. 820 (1935), 15 U.S.C. § 79k(b)(1) (1964).

⁴ 79 Cong. Rec. 8926 (1935) (radio speech of Senator Wheeler, June 9, 1935); Report of the National Power Policy Committee, H.R. Rep. No. 1318, 74th Cong., 1st Sess. 49 (1935).

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tastic fortunes manipulating utility stock in this fashion while playing the piper to the general investing public. Samuel Insull of Chicago, known as the "uncrowned king of Illinois,"⁵ alone controlled four of these large holding combines.⁶ The "crown prince of corporate jazz was Howard C. Hopson of the Associated Gas and Electric Company system. He succeeded and exceeded . . . Insull in holding company legerdemain."⁷ Some of the manipulative devices utilized by these financeers were: fictitious stock subscriptions; inflated appraisal of operating companies' properties leading to write-ups (or stock watering) of assets; inflation of the holding company's income statements by writing the earnings and surplus of the subsidiaries on the holding company books, thus making the subsidiaries' capital the holding company's earnings; and improvident purchase of operating companies by paying excessive prices for these properties—a price which is used on the balance sheet to reduce income taxes.⁸ These sly practices led Will Rogers to define a holding company as "something where you hand an accomplice the goods while the policeman searches you."⁹

For the general mass of unsophisticated investors during the 1920's, the public utility companies were considered blue chip securities and, because the investor could own a portion of many utilities with one relatively small investment, the public utility holding company represented the most gilt-edged of these blue-chips.¹⁰ By 1932 thirteen large holding company groups controlled over seventy-five per cent of the operating utility industry, and three of these groups alone controlled forty per cent of the entire operating industry.¹¹ But eventually this delicate house of cards had to collapse of its own weight, and the Great Depression was the catalyst which marked the economic collapse of the big utility holding companies. In 1929 common stocks of the twenty-five largest holding companies had a market value of \$16,787,563,147—"an amount practically equal to the public debt of the United States at that time."¹² Comparison of the market value of some of these stocks at the height of the boom in 1929 with their value in early 1933 demonstrates the degree of

⁵ Ritchie, *Integration of Public Utility Holding Companies* 1 (1954).

⁶ *Id.* at 2. They were Middle West Utilities Co., Midland United Co., People's Gas, Light and Coke Co., and Commonwealth Edison Co.

⁷ *Id.* at 3.

⁸ See 79 Cong. Rec. 10321 (1935). See generally 79 Cong. Rec. 10317-18 (1935) (FTC report to the House Committee on Interstate and Foreign Commerce, April 9, 1935).

⁹ Quoted by Senator Wheeler in an address made April 2, 1935. 79 Cong. Rec. 4902 (1935).

¹⁰ This is evidenced by the innumerable times the proponents and opponents, when discussing the Public Utility Act, referred to the "widows and orphans" caught in the collapse of the utility stock market boom. See, e.g., 79 Cong. Rec. 8926 (1935) (remarks of Senator Wheeler). Of course, both sides used these same "widows and orphans" to support their varying positions, but it is obvious the late "parents and husbands" considered them prudent investments when they invested in these stocks.

¹¹ The three groups were Electric Bond and Share, United Corporation and Insull's companies. 79 Cong. Rec., 4902 (1935); H.R. Rep. No. 1318, *supra* note 4, at 49; Report of the National Power Policy Committee on Public Utility Holding Companies, S. Rep. No. 621, 74th Cong., 1st Sess. 55 (1935).

¹² 79 Cong. Rec. 10319 (1935) (remarks of Representative Rayburn).

their economic collapse. For example, ten shares of Middle West Utilities worth \$500 in 1929 were valued at \$1.25 in 1933.¹³

The wounded public utility investor turned to the federal government for help, and so too did the injured operating companies. Aside from the economic abuses perpetuated by these holding companies, there were weaknesses apparent in their practical day-to-day organization. The "operating properties of the holding companies were not grouped in economically nor geographically contiguous units . . . in defiance of all principles of engineering efficiency."¹⁴ Management directions came from home offices which were often located great distances from the problems of the local operating company.¹⁵ The holding company systems also owned or operated subsidiaries in speculative, non-utility enterprises.¹⁶

II. THE LEGISLATURE'S RESPONSE

On March 12, 1933, less than two weeks after his inauguration, President Roosevelt, in a message to Congress, expressed his concern over the public utilities situation and outlined what measures of regulation he envisaged:

Except where it is absolutely necessary to the continued functioning of a geographically integrated operating utility system, the utility holding company with its present powers must go. If we could re-make our financial history in the light of experience, certainly we would have none of this holding company business. It is a device which does not belong to our American traditions of law and business. . . . And it offers too well demonstrated temptation to, and facility for, abuse to be tolerated as a recognized business institution. That temptation and that facility are inherent in its very nature. It is a corporate invention which can give a few corporate insiders unwarranted and intolerable powers over other people's money. In its destruction of local control and its substitution of absentee management, it has built up in the public-utility field what has just been called a system of private socialism which is inimical to the welfare of a free people.

I am against private socialism of concentrated private power as thoroughly as I am against governmental socialism. The one is equally as dangerous as the other: and destruction of private socialism is utterly essential to avoid governmental socialism.¹⁷

The President's firm committal to regulation of the public utility holding company systems was the prelude to an impassioned and tempestuous con-

¹³ Other examples of the sharp decline in market prices are: ten shares of American Gas and Electric Company, valued at \$2,038.75 in 1929, dropped in value to \$210 in 1933; ten shares of Commonwealth and Southern Company, valued at \$320 in 1929, were worth only \$18.75 in 1933; ten shares of Stone and Webster common stock, worth \$1,133.75 in 1929, were valued at \$62.50 in 1933. 79 Cong. Rec. 10319 (1935).

¹⁴ Ritchie, *op. cit.* supra note 5, at 13.

¹⁵ *Id.* at 14.

¹⁶ *Ibid.*

¹⁷ Message of President Franklin D. Roosevelt to Congress, March 12, 1935, H.R. Rep. No. 1318, supra note 4, at 1-3 (1935).

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gressional debate on the proposed legislative action. "The object . . . of the bill was to reform scattered and loosely knit [public utility holding company systems] into unified operations. . . ."¹⁸ Because the electrical and gas utility industries are to an extent natural monopolies, the statute was envisaged as a peculiar sort of antimonopoly law in that it was designed to restore the effectiveness of state and federal regulation rather than the effectiveness of competition in a free market. To accomplish this objective, Congress stated that "the national public interest, the interest of investors . . . and the interests of consumers . . . may be adversely affected"¹⁹ by (1) lack of information, (2) restraint on the subsidiaries' independent bargaining power, (3) obstruction of state regulation of the subsidiaries by the actions of the holding company, (4) uneconomical management of the holding company because of its excessive growth, and (5) lack of efficiency, economy and adequate service caused by the holding companies, for whatever reason.²⁰ Section 1(c) of the act declared that when these abuses injure consumers, investors or the public, the policy of the act was to "be interpreted, to meet the problems and eliminate the evil . . . [which] burden interstate commerce . . . [to be effectuated by compelling] the simplification of public-utility holding company systems, and to provide . . . for the elimination of [such] companies. . . ."²¹

A holding company is defined as any company which controls ten per cent of the voting stock of a public utility company²² or any person who exercises such a controlling interest in a holding company or utility company as to necessitate his being brought under the act.²³ But the heart of the act lay in section 11 which made it the express duty of the SEC to carry out the mandate to simplify and eliminate uneconomical holding companies.²⁴ This section, popularly called the "death sentence" clause,²⁵ was the focal point of high emotion and bitter controversy²⁶ during the months in which the bill

¹⁸ Ritchie, *op. cit.* supra note 5, at 17, citing Ramsey, *Pyramids of Power* 281-82 (1937).

¹⁹ 49 Stat. 803 (1935), 15 U.S.C. § 79a(b) (1964).

²⁰ 49 Stat. 803 (1935), 15 U.S.C. § 79a(b)(1)-(5) (1964).

²¹ 49 Stat. 804 (1935), 15 U.S.C. § 79a(c) (1964).

²² 49 Stat. 806 (1935), 15 U.S.C. § 79b(a)(7)(A) (1964).

²³ 49 Stat. 806 (1935), 15 U.S.C. § 79b(a)(7)(B) (1964). "Public-utility company" is defined as an electric or gas utility company. 49 Stat. 806 (1935), 15 U.S.C. § 79b(a)(5) (1964).

²⁴ 49 Stat. 820 (1935), 15 U.S.C. § 79k (1964).

²⁵ S. Rep. No. 621, supra note 11, at 11.

²⁶ Tempers and language ran very high. Congressman Rankin of Mississippi, speaking about the compromise act, stated that ". . . it isn't extreme enough. I want to wring the hands of the racketeers from the throats of the American people who pay these exorbitant burdens for the electric light. . . ." 79 Cong. Rec. 14623 (1935). Senator Norris (speaking on holding companies), ". . . [they] were conceived in sin, . . . managed in total disregard of the public good. . . . They are parasites upon our civilization. . . ." 79 Cong. Rec. 10848 (1935); Congressman Cooper (opponent of the bill), ". . . the provisions of the Wheeler bill . . . will mean nationalization of the electric utility industry. . . . [I]t does not mean regulation, but it does mean destruction. . . ." 79 Cong. Rec. 10328 (1935). One writer has characterized the legislative battle as ". . . a bitter struggle on the 'Hill' against as strong a lobby as ever moved into Washington, D.C." Douglas, *Foreword to Symposium on the Securities and Exchange Commission*, 28 Geo. Wash. L. Rev. 1, 2 (1959).

was discussed by the House and Senate. The bill was introduced in the House February 6, 1935, by Sam Rayburn,²⁷ but the Senate-House Conference Report was not adopted by those bodies until August 24, 1935.²⁸ As finally enacted, the section shows signs of the struggle. Under the House bill,²⁹ the Commission was directed to require each holding company system to operate as one integrated public utility holding system.³⁰ The burden of proof was on the Commission; the test they were to apply was a nebulous standard of retention of properties if it was consistent with the public interest.³¹ The Senate bill³² adhered more closely to the recommendations of the President and the National Power Policy Committee.³³ Section 11(a) of the Senate bill made it the Commission's duty to examine the corporate structure of each of the holding company systems in order to determine what complexities of corporate structure could be removed and whether these properties were geographically and economically integrated.³⁴ Section 11(b) empowered the Commission to issue a divestment order, enforceable in the federal courts, requiring a holding company or a subsidiary to divest itself of any property which was not geographically or economically an integrated portion of a public utility system.³⁵ The second part of this section gave the Commission power to require each holding company or its subsidiary to reorganize or dissolve whenever the Commission found that the continued existence of the corporate structure threatened the company's geographical or economic integration.³⁶

The present act represents a compromise between the Senate's strong anti-holding company legislation and the House's milder, less precise tone.

²⁷ 79 Cong. Rec. 1624 (1935).

²⁸ 79 Cong. Rec. 14473, 14626 (1935).

²⁹ Which had a rough haul too. The original bill was replaced by a substitute bill in the House Committee on Interstate and Foreign Commerce and, as amended, was reported favorably. H.R. Rep. No. 1318, *supra* note 4. The strong minority views of the committee members were presented by Congressman E. C. Eicher. He felt the bill as reported to the House (H.R. 5423) was irreconcilably inconsistent with the Senate bill (S. 2796). He felt section 11 had been "thoroughly emasculated" and the form of the bill as reported out included a "constitutionally dangerous, indefinite delegation of power to a regulatory commission." H.R. Rep. No. 1318, *supra* note 4, at 45. This minority position of the House Committee was prophetic of the majority of the House and Senate members' views at a later stage of the legislative struggle.

³⁰ Gas and electric systems were eventually defined separately in the act. In general, an integrated utility must be confined to one geographical area and be capable of economical operation and physical interconnection. 49 Stat. 810 (1935), 15 U.S.C. §§ 79b(a)(29)(A), (B) (1964).

³¹ H.R. Rep. No. 1318, *supra* note 4; H.R. Rep. No. 1903, 74th Cong., 1st Sess. (1935). In view of the Supreme Court decision on the National Recovery Act, this was considered by many to be an unconstitutional standard. See *Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935).

³² It, too, had difficulties. The Senate Committee on Interstate Commerce so changed the original bill (S. 1725) that a new bill was introduced (S. 2796). See S. Rep. No. 621, *supra* note 11, at 4.

³³ *Id.* at 4, 60.

³⁴ *Id.* at 32. The subsection as enacted contained essentially the same words. 49 Stat. 820 (1935), 15 U.S.C. § 79k(a) (1964).

³⁵ S. Rep. No. 621, *supra* note 11, at 32.

³⁶ 49 Stat. 820 (1935), 15 U.S.C. § 79k(a), (b) (1964).

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A vocal minority in each chamber objected to revisions in the act which were passed.³⁷ The Senate bill was diluted by adding to section 11(b)(1) the "ABC" clauses which permit the retention of more than one integrated public utility system if the Commission 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.³⁸

The "public interest" standard of the House bill, which the Chairman of the SEC had publicly castigated,³⁹ was replaced by a more precise standard: that the Commission limit the operations of a holding company to "such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system. . . ."⁴⁰ Though there was much bitterness in both the Senate and the House over the compromise bill,⁴¹ the legislation was eventually passed, and the responsibility for controlling the utility holding companies was handed to the SEC.

III. LITIGATION UNDER SECTION 11(b)(1): *New England Elec. Sys. v. SEC*

A typical example of the struggles the SEC must overcome in order to enforce the congressional mandate is shown by the litigational background of *New England Elec. Sys. v. SEC*.⁴² In 1940 the Commission instituted a proceeding under section 11(b)(2) of the act to simplify the corporate structure⁴³ of the International Hydro-Electric System, a large public utility holding company, which included six subholding companies. The Commission found that no economic justification for the continued existence of the holding company existed,⁴⁴ and worked out a plan whereby one of the subholding companies was terminated and, Minerva-like, the New England Electric System (NEES) sprang from the assets of the other five subholding com-

³⁷ For example, Congressman Huddleston, of the House Conference Committee, reported back to Congress that although he had signed the conference report which sent the compromise bill out to the two houses because he was "constrained by the instructions given by the House," he had "no intention whatever of voting for" the conference bill. 79 Cong. Rec. 14623 (1935).

³⁸ 49 Stat. 820 (1935), 15 U.S.C. §§ 79k(b)(1)(A), (B), (C) (1964).

³⁹ Letter of Joseph P. Kennedy, Chairman of the Securities and Exchange Commission: "I cannot be too vehement . . . this section . . . is most unfortunate." 79 Cong. Rec. 10838 (1935).

⁴⁰ 49 Stat. 820 (1935), 15 U.S.C. § 79k(b)(1) (1964).

⁴¹ See, e.g., 79 Cong. Rec. 14470 (1935) (remarks of Senator Norris).

⁴² *New England Elec. Sys. v. SEC*, 346 F.2d 399 (1st Cir. 1965).

⁴³ 49 Stat. 821 (1935), 15 U.S.C. § 79k(b)(2) (1935).

⁴⁴ See *Protective Comm. v. SEC*, 184 F.2d 646 (2d Cir. 1950).

panies.⁴⁵ Interestingly, some of the stockholders affected by this proposal tried to have the Commission settle the integration and retention-of-properties issues of section 11(b)(1) before its plan to create NEES could be enforced. But the court of appeals held that it was not necessary for the Commission to proceed under section 11(b)(1) before proceeding under section 11(b)(2), because consummation of the simplification plan would in no way prejudice subsequent proceedings under section 11(b)(1).⁴⁶

The NEES holding company controls seven electric utility subsidiaries (which serve 824,000 retail customers in New Hampshire, Massachusetts, Rhode Island and Connecticut) and eight gas utility companies (which serve 237,000 retail customers in Massachusetts only).⁴⁷ About seventy-five per cent of the gas franchises are also part of the franchise area served by NEES' electric operating subsidiaries, and seventy-eight per cent of its gas customers are also served by the electric companies.⁴⁸ In August 1957, the SEC instituted proceedings under section 11(b)(1) to determine the extent to which NEES could lawfully retain control over its electric and gas properties, since it had been stated consistently that a "single integrated system" may not include a combination of both an integrated electric system and integrated gas properties.⁴⁹ The Commission found, initially, that NEES' electric utility assets comprised an integrated electric utility system, meeting the standards of section 2(a)(29)(A) of the act,⁵⁰ and the company elected to retain these assets as its "principal system."⁵¹ The Commission then sought to determine whether the gas utilities⁵² could be retained as an "additional" integrated utility system under section 11(b)(1). The retention of "additional systems" is permitted by the "ABC" clauses of section 11(b)(1),⁵³ and the burden of proof is placed on the holding company to show that its systems come within the section's exceptions.⁵⁴ Since these requirements are cumulative, all must be fulfilled before the retention of an additional system may be approved.⁵⁵ Furthermore, the Commission has also observed that the ABC clauses envisage additional systems which are junior in importance to the

⁴⁵ See *Lahti v. New England Power Ass'n*, 160 F.2d 845 (1st Cir. 1947).

⁴⁶ *Id.* at 850. In reality, the stockholders acquired, among other assets, the liability of a later suit by the Commission which could eliminate all their assets.

⁴⁷ Holding Company Act Release No. 15035, at 1256-57 (March 19, 1964).

⁴⁸ *Id.* at 1257.

⁴⁹ *Philadelphia Co.*, 28 S.E.C. 35 (1948), *aff'd*, 177 F.2d 720 (D.C. Cir. 1949); *Columbia Gas & Elec. Corp.*, 17 S.E.C. 494 (1944); *United Gas Improvement Co.*, 9 S.E.C. 7 (1941).

⁵⁰ *New England Elec. Sys.*, 38 S.E.C. 193 (1958).

⁵¹ This is the short name for the nucleus of properties which constitute the "single integrated public utility system" of § 11(b)(1). See *Engineers Pub. Serv. Co.*, 12 S.E.C. 41 (1942). The term was used by Congress before the act became law, although it doesn't appear by that name in the act. H.R. Rep. No. 1903, *supra* note 31, at 71.

⁵² Which all the parties agreed to consider as an "integrated gas utility system," 49 Stat. 810 (1935), 15 U.S.C. § 79b(a)(29)(B) (1964); Holding Company Act Release No. 15035, *supra* note 47, at 1256.

⁵³ 49 Stat. 820 (1935), 15 U.S.C. § 79k(b)(1)(B) (1964).

⁵⁴ *United Gas Improvement Co. v. SEC*, 138 F.2d 1010, 1021 (3d Cir. 1943).

⁵⁵ *Philadelphia Co. v. SEC*, *supra* note 49; *North American Co. v. SEC*, 133 F.2d 148, 152 (2d Cir. 1943), *aff'd on constitutional issues*, 327 U.S. 686 (1946).

principal system of the holding company, and thus are dependent upon the continuation of joint control with the single system.⁵⁶

In *New England Elec. Sys. v. SEC*,⁵⁷ NEES brought a petition to review and set aside an SEC divestment order entered pursuant to regulations promulgated under section 11(b)(1). The SEC order had directed the holding company to divest itself of its eight gas subsidiaries. The Commission found that the holding company (NEES) had failed to meet its burden of showing that the gas utilities could not be operated as an independent system without the loss of substantial economies unless continued control was retained by the holding company, thus bringing itself within clause (A), the exception to section 11(b)(1). NEES had attempted to prove that the gas utility properties came within the exception by producing expert evidence tending to show that administrative losses, personnel losses, and intensive local competition satisfied the standards required by the Commission to prove loss of substantial economies. The court of appeals, setting aside the Commission's order and remanding the case for further action, held that the Commission's standard for the test of substantial economies, used in considering whether a public utility comes within the exceptions to section 11(b)(1)(A), is incorrect. The court ruled that the Commission must look to the entire act in determining its policy, and not merely a single section, and, accordingly, in deciding whether NEES has sustained its burden of proof, the Commission must make specific findings as to lessened competition, and must weigh more carefully the expert evidence presented to it.

In this case the issues revolved solely around clause (A), since NEES met the requirements of clauses (B) and (C).⁵⁸ Thus NEES bore the burden of affirmatively proving that operation of the gas utilities as independent systems would cause the loss of "substantial economies."⁵⁹ The Commission found that, "on the basis . . . of the entire record . . . [NEES] has [not] met their burden of showing that the test of clause (A) for the retention of the gas properties under the control of NEES is satisfied."⁶⁰ The court took issue with that finding, particularly with reference to the Commission's test for weighing whether the standards of the clause (A) exception had been met.⁶¹

To understand the differences between the court and the Commission, it is necessary to examine both the judicial and administrative interpretations of clause (A). An additional system must qualify under all of the ABC clauses in order to be retained, and the simplest way to dispose of these questions has been by application of the comparatively simple geographical

⁵⁶ See *Cities Service Co.*, 15 S.E.C. 962 (1944).

⁵⁷ *New England Elec. Sys. v. SEC*, supra note 42.

⁵⁸ "Since all the NEES gas subsidiaries are located within Massachusetts, the standard of Clause B is met." Holding Company Act Release No. 15035, supra note 47, at 1260. The Commission affirmed the hearing examiner's finding that the size of the combined gas and electric operations is not so large as to raise any substantial question under the standards of clause C with respect to the advantages of localized management, efficient operation, and the effectiveness of regulation. *Id.* at 1260-61.

⁵⁹ 49 Stat. 820 (1935), 15 U.S.C. § 79k(b)(1)(A) (1964).

⁶⁰ Holding Company Act Release No. 15035, supra note 47, at 1279.

⁶¹ *New England Elec. Sys. v. SEC*, supra note 42.

limitation test of clause (B).⁶² The *North American Co.* case⁶³ was the first situation in which the SEC laid down definitive rules on the interpretation to be given clause (A). The first Commission ruling was based on the concept that clause (A)'s "substantial economies" refers to economies which may be secured by the systems themselves, rather than to economies which may be secured by the holding company.⁶⁴ The second ruling is "that 'substantial economies' means important economies and not merely something more than nominal."⁶⁵ The next case to deal with the problems of clause (A) was *Engineers Pub. Serv. Co.*⁶⁶ In holding, as it had in *North American*, that the standard of clause (A) had not been met, the Commission stated:

. . . [S]ince this requirement . . . is an exception to a clearly expressed general policy, it must be strictly construed. . . . [W]e must require clear and convincing evidence of a loss of economies which would seriously impair the effective operations of the systems involved in order to permit the retention of an additional system.⁶⁷

On appeal, the majority of the Second Circuit upheld the Commission's ruling.⁶⁸ They referred to the "important economies" test of *North American*, stating, "the required importance must relate to the healthful continuing business and service of the freed utility."⁶⁹ Later the Commission declared, "Congress intended . . . that the loss, anticipated for all systems outweigh the benefits of independence. . . ."⁷⁰ Again, in *Philadelphia Co. v. SEC*, the Commission stated that, in their opinion, "economies are not 'substantial' unless their loss 'would cause a serious economic impairment of the system such as to render it incapable of independent economical operation.'"⁷¹ But in *Louisiana Pub. Serv. Comm'n v. SEC*,⁷² the court of appeals (examining *Engineers* and *Philadelphia*) read this last statement and denied that substantial economies must be so construed: "[T]he formula proposed by the Commission is not one that is to be inflexibly used in the application of clause A of the saving section."⁷³ The court criticised the Commission's interpretation of "substantial economies" because it believed the language on its face was so clear that it precluded reference to the legislative history.⁷⁴ It then held that the Commission must consider the economies to be lost by the holding company as well,⁷⁵ although such considerations are contrary

⁶² See comment, 59 Yale L.J. 1088, 1103-04 (1950).

⁶³ 11 S.E.C. 194 (1942).

⁶⁴ H.R. Rep. No. 1903, supra note 31, at 71.

⁶⁵ *North American Co. v. SEC*, supra note 55, at 152.

⁶⁶ 12 S.E.C. 41 (1942).

⁶⁷ *Id.* at 60-61.

⁶⁸ *Engineers Pub. Serv. Co. v. SEC*, 138 F.2d 936 (D.C. Cir. 1943).

⁶⁹ *Id.* at 944.

⁷⁰ *Cities Service Power & Light Co.*, 14 S.E.C. 28, 47 (1943).

⁷¹ See *Philadelphia Co. v. SEC*, supra note 49, at 725.

⁷² 235 F.2d 167 (5th Cir. 1956), vacated as moot on jurisdictional grounds, 353 U.S. 368 (1957).

⁷³ *Louisiana Pub. Serv. Comm'n v. SEC*, supra note 72, at 173.

⁷⁴ *Id.* at 172.

⁷⁵ *Id.* at 173.

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to one of the first rulings laid down by the Commission,⁷⁶ and to judicial precedent.⁷⁷

The court in the *NEES* case found the standard applied by the Commission in the hearings below to be one voiced in the *Middle South Util.*⁷⁸ case: divestment of the additional properties will not be ordered unless it is shown that such orders will cause the serious economic impairment of the systems and (the court supplied this meaning⁷⁹) "the gas properties could not operate effectively and efficiently under separate ownership."⁸⁰ The court questioned the interpretation "that a loss is not 'substantial' unless it would render impossible 'economical or efficient operation,'"⁸¹ and discounted the weight the Commission should give to the oft-quoted remarks of Senator Wheeler that

. . . the furthest concession [the Senate conferees] could make would be to permit the Commission to allow a holding company to control more than one integrated system if the additional systems were . . . so small that they were incapable of independent economical operation . . .⁸²

because they were made after the Senate vote on the act. But Senator Wheeler, as the sponsor of the Senate bill and the Chairman of the Senate conferees, was speaking prior to the adoption by the Senate of the conference report⁸³ and thus prior to the final vote. These remarks have been widely quoted as indicative of the congressional interpretation of clause (A).⁸⁴

The court states that retention where there was "real economic need"⁸⁵ is to be given a general meaning: "a real economic need to *avoid* any truly sizable financial loss notwithstanding the utility's ability to absorb it and remain efficient in some absolute sense."⁸⁶ (Emphasis added.) This is in contrast to the more stringent meaning the Commission gives the same language: "real economic need to prevent a loss that would preclude efficient or effective operation."⁸⁷ The court supports its opinion by a very careful examination of the language of the various sections of the act. It rejects the Commission's position that the phrase "substantial economies" in clause (A) "is fundamentally different from"⁸⁸ the "substantial economies" effectuated

⁷⁶ See p. 723 supra.

⁷⁷ "Not even the wisdom of judicial notice is necessary to know that the Act was not passed to protect the holding company systems. It was the public interest and the interest of investors and consumers" that was to be protected. *Matter of United Corp.*, 232 F.2d 601, 607 (3d Cir. 1956).

⁷⁸ 35 S.E.C. 1 (1953).

⁷⁹ *New England Elec. Sys. v. SEC*, supra note 42, at 402.

⁸⁰ *Ibid.*

⁸¹ *Id.* at 403.

⁸² 79 Cong. Rec. 14479 (1935).

⁸³ 79 Cong. Rec. 14626 (1935).

⁸⁴ See *Engineers Pub. Serv. Co. v. SEC*, supra note 68.

⁸⁵ *New England Elec. Sys. v. SEC*, supra note 42, at 403.

⁸⁶ *Ibid.*

⁸⁷ *Ibid.*

⁸⁸ *Id.* at 405.

by section 2(a)(29)(B)⁸⁹ because such a view "is opposed to the common principle that the same words in different portions of an act are presumed to have the same meaning"⁹⁰ unless it is affirmatively proved to be otherwise. The court also found

the Commission's interpretation of clause A opposed to the initial statement of the purposes of the Act . . . the tenor of which was that holding companies had been found uneconomical to investors and to the public. . . . [S]ystems which do not offend in this respect . . . should be continued instead of broken up. . . .⁹¹

This argument, however, can be criticised in two respects: (1) Interpretation of congressional intent and (2) the function of administrative law. Congress intended to break up holding companies because their size was a primary causal factor in perpetration of the abuses. "The very essence of a commonsense scheme of public regulation is, therefore, that the corporations to be regulated should not be permitted to reach a size and power and a complication where a Federal regulatory body can't be a match for them."⁹² This congressional policy is effectuated by a regulatory commission: if the Commission determines that a holding company system "offends" in respect of "economies" to the public and investors, it is not sufficient for the court to declare that their standard is wrong because the system doesn't "offend in this respect."⁹³

Whether economy is achieved by centralized control is always a doubtful question and one peculiarly fitted for decision by an administrative agency staffed by experts. On such an issue a court cannot review or reweigh the evidence.⁹⁴

The court also questioned the Commission's findings on the evidence presented. NEES submitted a study made by Ebasco Services, Inc., management consultants with extensive experience in the utilities field,⁹⁵ which showed that severance would bring an increase in operating costs of \$1,098,000⁹⁶ to the severed utilities. The Commission, however, questioned \$415,600 of this figure—the increase in cost attributable to customer accounting—because the Ebasco estimate was not based on managing the gas utilities as one combined system after severance, whereas the comparison figures—the costs of the system as it is now managed—were so based. NEES did not show why this combined system, or at least combined billing procedures, should not be continued.⁹⁷ But the Commission concluded that, even accepting the Ebasco figure, the over-all loss was not so substantial

⁸⁹ 49 Stat. 810 (1935), 15 U.S.C. § 79b(a)(29)(B) (1964).

⁹⁰ *New England Elec. Sys.*, supra note 42, at 405.

⁹¹ *Id.* at 405. The court supports its contention by citing *Louisiana Pub. Serv. Comm'n*, supra note 72, a case whose precedent value is debatable. See pp. 724-25 supra.

⁹² 79 Cong. Rec. 8926 (1935) (speech by Senator Wheeler, June 9, 1935).

⁹³ *New England Elec. Sys.*, supra note 42, at 405.

⁹⁴ *North American Co. v. SEC*, supra note 55, at 152, citing *Morgan Stanley & Co. v. SEC*, 126 F.2d 325 (2d Cir. 1942).

⁹⁵ See *In re Pub. Serv. Corp.*, 211 F.2d 231 (3d Cir. 1954).

⁹⁶ *Holding Company Act Release No. 15035*, supra note 47, at 1263-64.

⁹⁷ *Id.* at 1266.

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. . . as to warrant retention of the gas properties. . . Although the amount is larger than the amounts involved in prior severance cases, . . . the test of substantiality of the estimated loss is not [measured] in absolute terms but rather in relation to total revenues, expense and income.⁹⁸

The ratios of the estimated loss of economies (operating revenues, revenue deductions, gross income and net income) were "lower, or not significantly higher, than corresponding ratios [for] gas systems"⁹⁹ where divestment had been ordered by the Commission.

Some of the factors the Commission examines when weighing the issue of substantial economies have been the size of the subsidiaries relative to their ability to have their own financial experts, their capability of independent financing methods, the importance of staff services supplied by the holding company¹⁰⁰ and the increased expenditures to provide customer services, accounting, promotion and billing.¹⁰¹ On the other hand, the Commission does not consider the "economies" from tax savings resulting from the joint operation of the companies, since such savings have no relation to operational factors and are dependent only upon the accidents of ownership and the state of tax legislation at any given time.¹⁰² The claimed economies that would be lost by the severance of the gas utilities are (1) actual expenses now allocated to the gas properties which would have to be paid by the electrical properties after the separation of the two companies (economies caused by the use of joint personnel and property), and (2) increased cost of operations of the gas properties as independent businesses.¹⁰³ The Commission has also emphasized its theory of intangible benefits when considering a holding company's retention of an integrated gas utility system in addition to a principal electric utility system. "The benefits of terminating widespread control, subtle and apparent, must be considered as offsets to the claims of lost economies. Only the balance, though it may be inexpressible in money terms . . . can form the basis of decision."¹⁰⁴ Thus, the Commission theorizes that separation of such systems will result in certain benefits to both the gas and electric utility operating companies as separate systems.

Placed in the context of the historical, legislative and judicial history of the statute, the court of appeals' decision in the *NEES* case seems to be in conflict with the long standing interpretation of section 11(b)(1)(A) and inconsistent with the basic policy objectives of the act pursued by the Commission. The opinion in the case seems to follow the views stated by the Fifth Circuit in *Louisiana Pub. Serv. Comm'n*,¹⁰⁵ and the minority opinion

⁹⁸ *Id.* at 1269-70.

⁹⁹ *Id.* at 1270, citing *Philadelphia Co.*, *supra* note 49, and *General Pub. Util. Corp.*, 32 S.E.C. 807, 837 (1951).

¹⁰⁰ See *North American Co.*, *supra* note 63.

¹⁰¹ See *Engineers Pub. Serv. Co.*, *supra* note 51.

¹⁰² See *Cities Service Co.*, 15 S.E.C. 962 (1944).

¹⁰³ See *Engineers Pub. Serv. Co. v. SEC*, *supra* note 68, at 940.

¹⁰⁴ *North American Co.*, 18 S.E.C. 611, 615 (1945).

¹⁰⁵ *Louisiana Pub. Serv. Comm'n v. SEC*, *supra* note 72.

presented in *Engineers Pub. Serv.*¹⁰⁶ "Only in very exceptional circumstances has the Commission granted approval . . . of the retention of an additional system."¹⁰⁷ Though, as the court correctly points out,¹⁰⁸ there has been no formal administrative policy enunciated on the retention by a holding company of an integrated gas utility system in addition to the principal integrated electric system, the Commission has never permitted the retention of such a system in practice because of their strict interpretation of clause (A) of the act. "Far from proving to be the 'death sentence' . . . the § 11 program has given a new lease on life to private power under public control. More often than not the liquidation of holding companies has resulted in increasing the market value of the aggregate security interests affected. . . ."¹⁰⁹

The Supreme Court has granted the SEC's petition for certiorari¹¹⁰ and their decision should clarify the somewhat diverse opinions on section 11(b)(1)(A).

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¹⁰⁶ *Engineers Pub. Serv. Co. v. SEC*, supra note 68.

¹⁰⁷ *Ritchie, Integration of Public Utility Holding Companies* 191 (1954).

¹⁰⁸ *New England Elec. Sys. v. SEC*, supra note 42, at 409.

¹⁰⁹ *Loss, Securities Regulation* 141 (1961). A statement giving interpretation to legislative policy seems particularly pertinent here:

Before the House Committee, Dr. David Friday, the economist for the utility interests, testified that with companies the size of Detroit Edison, Commonwealth Edison of Chicago, and Southern Edison of Los Angeles, "The holding companies are not necessary at all." According to this testimony, supercredit and supermanagement of a holding company are not needed for companies in large cities. . . . Title I encourages the building up and strengthening of compact systems of related operating units even to the extent of providing exemption for a holding company if it is necessary for the functioning of such a system. Sound operating units or regionally integrated systems, not the giant holding companies, provide the real and only enduring basis of credit for the utility industry.

¹¹⁰ *SEC v. New England Elec. Sys.*, 382 U.S. 953 (1965).