Philadelphia, Pennsylvania
February 12, 1943

The Honorable Hugh Butler
United States Senate
Washington, D. C.

My dear Senator Butler:

I have your letter of February 5, 1943 asking for my personal views respecting the wisdom of postponing for the duration of the war the "death sentence" clause of the Public Utility Holding Company Act. This is a question that we have considered with extreme care and I welcome the opportunity of giving you the conclusions that we have reached.

Let me first address myself to a point which we think is essential to clear thinking regarding any question of a moratorium on Section 11. In the administration of Section 11, there is an important distinction between the entering of orders (including the settlement of legal issues relating to our procedures and to our interpretation of the statute) and the time and manner of enforcing our orders once they have been issued. For a period of several years, we were in the stage, broadly speaking, of arriving at a determination of the kind of action required by the statute with respect to each holding company system. The greater part of that task is now behind us, for in all but a relatively few cases we have entered orders prescribing most, if not all, of the action which must be taken to comply with the requirements of Section 11(b)(1). As to the remaining cases, proceedings have reached the stage where such orders may be expected in the near future. In the course of these proceedings, the Commission has had occasion to pass upon most of the disputed questions of interpretation of the Act and the managements of most of the leading holding company systems are now substantially advised as to the scope of the action which must be taken to bring about compliance with Section 11. A number of companies have appealed our orders to the courts and the cases now pending in the courts should settle most of the legal questions at issue. My point is that in the main we are bringing to a completion the first stage of entering orders and getting the legal formalities behind us, especially with respect to procedures, construction and interpretation.

When that stage is completed with respect to the various holding company systems, each will know definitely beyond dispute where it stands in relation to the requirements of Section 11. Then if they want to talk about the period of time that they are to be allowed to effectuate our orders, we will be as liberal as the specific facts of each case warrant for the protection of the investors concerned, as well as the consumers and the public.

A significant result of the progress that we have made in winding up the first stage in the administration of Section 11 is that many of the major systems have now evidenced a willingness to proceed with the task of carrying out our orders. To that end several of the systems have filed voluntary plans and others are engaged in doing so and in discussing their proposals with us. It may be this change in policy has been influenced by the decision of the United States Circuit Court of Appeals for the Second Circuit in The North American Company case. We know, however, that an important reason in some cases has been the realization by security holders and managements alike that compliance with Section 11 will effect a reduction or elimination of holding company expenses and taxes and thus clear the way for an undiluted flow of dividends from the underlying operating companies to investors. I cannot agree that the public interest would be served if we were to stop in our tracks now, just short of reaching the goal set forth in the Act.

As you know, there are registered with the Commission 134 public utility holding companies, the total consolidated assets of which amount to nearly $16,000,000,000, which is about 68% of the private electric and gas utility industry of the United States. Hundreds of thousands of investors own holding company securities. In my view, any further delay in the enforcement of Section 11 would adversely affect the interests of those investors as well as the interests of the operating subsidiaries' consumers, since it would prolong the period of uncertainty and confused thinking. I submit that our policy of proceeding to a settlement of the issues in each proceeding with the full knowledge that it is our duty and responsibility to protect the interests of investors with respect to each step which a holding company proposes to take in complying with our orders is the constructive thing to do; it will tend to conserve values whereas an interruption of further proceedings would dissipate values.

Now let me comment on the thought that our proceeding with the Section 11 program will require the sale of securities at a most

unfavorable time. We have repeatedly stated our position in this regard. I do not believe our announced policy could be stated more clearly than it was in the following remarks made by former Chairman Eicher in an address before the annual convention of the Edison Electric Institute on June 5, 1941:

> "The second truth is that there is nothing in the law which requires the sale of any holding company assets at unfair or inequitable prices. In fact, it is clearly the statutory duty of this Commission to protect holding company security holders against sales on such terms. It is our duty to see to it that assets and securities are disposed of (to quote the law) on a 'fair and equitable' basis. Our show cause order directed against The North American Company in connection with its proposed dissolution of the North American Light and Power Company in the past week indicates that we will not permit a proposed method of compliance with Section 11 where we are not satisfied that the interests of security holders or consumers would be adequately protected. I can state unequivocally for the entire Commission that we shall perform that duty, even though at times it may appear to slow up the effectuation of our orders under Section 11(b)(1)."

I should also like to refer to what we said in our order in The North American Company Section 11(b)(1) case, Holding Company Act Release No. 3405, page 62:

> "At various points in this opinion and in connection with our discussion of the retention of various interests, we have adverted to respondents' claims of alleged difficulties in disposing of such interests. We have stated, and we again exphasize the fact, that, under the standards of the Act, difficulties of disposition have no bearing at all on whether any particular interest is retainable; and that such difficulties are pertinent only to the question when compliance with our order of divestment should be enforced. Consequently, respondents' references to adverse market conditions for the sale of securities

have no relevancy whatever at this time. The statute provides a year within which respondents may comply with our order. Furthermore, on an appropriate showing (which would certainly include a showing that bona fide attempts to dispose of properties had been prevented by adverse market conditions), we may grant an additional year for compliance. And even at that time our orders under Section 11(b)(1) are not self-enforcing. For under the Act compulsory compliance can occur only after the Commission makes application to a court.

"It is appropriate also to point out once again that compliance with our Section 11(b)(1) orders need not always be effected by the outright sale of properties for cash. It seems clear that a very large part of the divestments and dispositions necessary to comply with Section 11(b)(1) and our orders thereunder may be effectuated by stock dividends, by exchanges of portfolio securities with the security holders of the holding company, and through the exchange of properties between systems. It may be that these methods in practice will overshadow sales."

In that citation, you will note that we said that an appropriate showing for an extension of time would certainly include a showing that bona fide attempts to dispose of the properties had been prevented by adverse market conditions.

As far as actual experience is concerned, I call your attention to the fact that not one sale has been made to date at a loss except a few cases where "the loss" is computed upon inflated book values. Many sales have been at a profit and several proposed sales were not made because the profit would have been such that substantial capital gains taxes were involved. In no single instance has any of our divestment orders specified the manner of divestment, except where so requested by the company. That is a matter to be worked out by the management in the first instance. As you know, The North American Company has successfully divested itself of its Detroit Edison stock without selling a share. It has been distributed to its stockholders as a dividend. The U.G.I. plan is an illustration of the fact that compliance with these orders can, where desired, be worked out without sales. In fact, we have not imposed any straight-jacket upon holding company managements with respect to the particular methods that they may devise in complying

with our orders. After we have passed upon specific applications filed by them to meet our orders, any action that we take is reviewable in the courts.

Lest it be thought that our Section 11 orders have a depressing effect on the market, I advise you that these orders have almost without exception been accompanied by increases in market prices. For example, The United Gas Improvement Company common stock in the early part of December 1942 was selling around $4 a share. On December 22, that company, even though it has a case pending in the courts to test our Section 11 order, filed an 11(e) plan, with which you are no doubt familiar. After the filing of the plan, the price quickly moved up to around $6 a share. On the 31st of December 1942, Federal Water and Gas Company also filed an 11(e) plan providing for dissolution. Its common stock was selling just under $5 at the end of September 1942. From that time on there were rumors that the company was discussing plans for complying with Section 11. By December 2, 1942, the stock was selling at $7, at the end of the year at $9⅛ and on January 11, 1943, the date when I last checked the market for that stock, it was selling at $10⅛. We have made similar observations with respect to recapitalization cases. On May 5, 1942, we instituted an 11(b)(2) proceeding against Empire Gas and Fuel Company, which is a subsidiary of Cities Service Company, and on August 5, 1942, we approved a plan for reorganizing that company. The $6 preferred stock the day before we instituted our proceeding sold at $87. Three days after we approved the plan, on August 8, 1942, that stock was quoted at $131⅛. On January 11, 1943, the equivalent market price of that stock in terms of the 3½% debentures which were exchanged for it in reorganization was $113¾.

We recognize the fact that the securities of holding companies are subject to wide fluctuations as a result of general factors affecting the earnings of the operating companies at the base of their attenuated structures. Nevertheless, we think it is fair to assume that a substantial portion of the advances referred to above reflected the market's appraisal of the advantages expected to flow from the enforcement of Section 11. I refer to the reduction or elimination of holding company taxes and expenses and to the preference of investors for securities "closer to the rails".

I now wish to comment on the suggestion that the enforcement of Section 11 orders may require a large amount of new financing and

thereby interfere with the war program. The various plans that have been filed or discussed with us demonstrate that the enforcement of Section 11 is not contingent upon new financing. The major part of the job can be handled through exchanges and distribution of securities, although in some instances holding companies may sell portfolio securities and use the proceeds to retire debt or other senior securities. In the latter case, it will be noted that no new money is involved. It would simply mean the substitution of one class of securities in the hands of investors for another class. Moreover, since the volume of public financing by industrial corporations and utilities for refunding or new money purposes is now relatively small and since the resort to public financing to effectuate Section 11 is likely to be the exception rather than the rule, there is little or no danger that it will interfere in any way with the war program. In any event, however, we regard it as part of our duty to weigh each Section 11 plan in the light of its possible effects upon the war program, whether in the field of finance, production or manpower.

Thank you again for writing to me. If you have any questions with respect to the views that I have expressed, I hope that you will let me know.

Sincerely yours,

Garson Purcell
Chairman

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