

DIVISION OF CORPORATION FINANCE

TRAINING PROGRAM LECTURES

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Subject: Registration Statement of a  
Public Utility

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MR. KAUFMAN: Initially when we assign a case to a new examiner in the Division, we try to give him something easy. A public utility registration statement generally falls within that category. That presents quite a problem for me since how can I talk for an hour about something that presents no problem. The fact of the matter is this: as most of the utility registration statements (I'm thinking now of the companies engaged in the production or distribution of gas or electricity) have fallen into a certain pattern, the types of disclosure are pretty well standardized, and outside of a few boilerplate paragraphs we seldom come up with very much in the line of comment. One statement just follows another. You will find the same kind of information more or less throughout.

So I thought I would try to take a prospectus of a particular company, in this case Consumers Power Company, go through it pointing out the type of disclosures that are fairly typical of the public utility filings, possibly explain some of the terminology that is used that may be new and strange to you, and indicate some of the analytical uses that can be made of the information in the prospectus.

Frankly, we don't try to do too much analysis. Our problem is to get all of the available facts in the prospectus and then, of course, it is up to the investor or the investment counselor to do the analysis from there. We try to give him information.

I am not in the position of trying to do what Al King did yesterday of picking out horrible examples of disclosure or examples of good disclosure, or types of unusual comment. I am going to have to generalize. It is true that once in a while you may run into the case of the public utility which is disappearing under the ground out at Long Beach, California, and you do have disclosure as to how long they think it is going to stay above ground before it goes out of sight, but most of the time we are not faced with any unusual problem.

The first thing you will come across in most of these prospectuses will be a discussion of the use of the proceeds, and there are probably two main purposes: one will be either for refunding purposes or refinancing to get the benefit of lower rates or lower dividend rates if it is a preferred stock; or, what has been fairly typical, for construction and improvement and expansion purposes. We usually like

to get disclosure of the company's plans for at least a year, and sometimes more. Sometimes we get disclosure for three years of what their construction program is, how much money they are going to need for the construction or expansion program, and where the money is coming from. Part of the proceeds will, of course, be used. But quite frequently they will say that the money will be generated from internal sources, depreciation, and retention of earnings; however, usually the additional sale of securities will be required.

Public utilities, unlike industrials, do not finance primarily from internal sources. The rate of return is too low. They have to attract additional capital from external sources and they do that by paying out a very heavy proportion of their earnings in the form of dividends, for example, on their common stock. When they need new money, they have to go to external sources in order to obtain it. That involves the flotation of bonds and preferred stock and the sale of more common.

We accept a fair degree of generality. In other words, we don't try to pinpoint them in saying that it will be a particular type of issue. They may merely say they expect to get another \$50,000,000 from bonds, the form and nature of which has not yet been decided. That is generally acceptable.

The next thing you will probably encounter is a rather large table of operating statistics. This table, of course, can be used in two ways: One (and I think we make less use of it in our particular Division) would be for purposes of comparison with other companies, or, say, with industry averages. If you are going to compare anything, you have got to pick a utility possibly of the same general character, with the same territorial factors, and the same type of generating equipment. I don't think you can make too much use of the statistics for the purposes of comparison such as you might be able to do if you were dealing with one industrial company and comparing it with another industrial. These statistics are very useful from the viewpoint of watching internal trends -- seeing whether things are going up or down; and they should be followed from that viewpoint.

I will go down the line on this table. I am dealing with a company here that generates and sells both gas and electricity. The first thing shown is the amount of electric energy that would be generated and also a small amount purchased from other sources. Then, in turn, the amount of electricity generated (this is in terms of thousands of kilowatt hours) is broken down between hydroelectric plant generation and that generated by fuel plants. This is rather important. Hydroelectric plants are initially more expensive, requiring a greater investment in capital. Conversely, however, they are less affected by changes in fuel and labor costs. Fuel generating

plants may use oil or gas, or bituminous coal, are less costly to construct, but are more dependent upon changes in fuel and labor costs. The depreciation expense is higher for your hydroelectric plant, it is less for your fuel generating plant. Companies whose sources of electricity are largely dependent upon hydroelectric stations are somewhat at the mercy, you might say, of the elements, e.g., the degree of water flow to run the plant. Conditions of drouth may cause a serious problem to a utility that is highly dependent upon hydroelectric generation. Most of them, of course, will have stand-by plants to use as a substitute source of power, or they may have interconnections with other companies in case of need.

The next group of statistics relates to electric sales in terms, once again, of units of energy, that is, thousands of kilowatt hours. This should be broken down, if it is not, into categories of customers. By that I have in mind first, residential, then commercial, then industrial, and then you may have some other minor categories. Those are the three main categories of customers: residential, commercial, and industrial. It is quite important to get that breakdown.

Your residential load is the most stable load. That, in a sense, is your bread and butter. The larger the residential load in relation to the other types of loads, that is, industrial or commercial, the greater is the degree of stability of operations, of revenue, and income. And your domestic load has largely been responsible for the tremendous growth of our public utilities. The domestic load naturally has been influenced by the tremendous use of new appliances, air-conditioners, radio, television, and all the other gadgets that one finds around the house these days.

The commercial load comprises small light and power users: retail stores, office buildings, theaters, hotels, garages, etc. It is a fairly stable business, but it is somewhat vulnerable to the effects of depression. Your residential load is not (I won't say is not completely), but is less subject to cyclical changes in business factors. People will still have their air-conditioners going, and they will still use all of their gadgets and applicances -- as long as they are able to pay their monthly bill, of course.

Your industrial load consists of your large light and power users: your factories. It reflects largely the industrial make-up of the territory being serviced by the company. It is very vulnerable to changes in business conditions. In a severe depression your industrial load can fall off very rapidly. It can be bad if your industrial business is dependent upon a few customers. Some of the prospectuses will enumerate customers, particularly the industrial classes, by different types of customers and number of customers. The figures should be scrutinized to see whether the company is dependent upon perhaps just

a few large industrial concerns, and if you see any sudden falling off in a particular year, particularly in a recent year, it sometimes is well to inquire why there was this fall-off in industrial volume of electric sales. For example, utilities that service the Detroit area and are dependent upon the success of the automobile industry may have a very marked falling off in industrial business, or could have if there were really a severe slump in automobile sales.

So these statistics will show a trend and the principal sources of revenues, that is, at least the people who will be paying the bill. I will come to the revenue figures in a moment. Then, since this concern also sells gas, they have comparable figures on gas production. Some companies will produce a fair amount of gas. Many are now dependent upon pipelines and use natural gas instead of manufactured gas. It is cheaper and a more efficient type of fuel. This company shows where it is obtaining its gas, the particular field, and the amount of gas measured in terms of thousands of cubic feet. Then they break down gas sales by principal categories: residential (cooking, hot water, gas refrigeration, laundry appliances, etc.), space heating (which has really become most important and will cover both residential and commercial), and then finally industrial and commercial sales -- a rather large amount. Since the availability of natural gas depends upon interconnections with the pipelines, many of the utilities have not been able to take on all the customers that they would like to take on. There is still a very large backlog in that particular respect.

Next we come to figures in terms of dollars, of cost of electric energy generated and purchased. If they generate electricity from two different sources, the hydro and the fuel plants, you should have a comparable breakdown of costs between hydro and fuel. By dividing the dollar cost of each type of production by total kilowatts produced by that type of production, you obtain a cost per kilowatt hour. Comparing the most recent cost per unit with previous per unit costs will show trends.

Then, similarly, since this particular company is buying most of its gas, there is a break-down showing the amount the company has to pay for it. By dividing the dollar cost of the gas by the thousands of cubic feet bought you can determine how much the company is paying for its gas and whether there are any unusual trends. The trend of gas cost has been going up. You can see whether that seems to be getting out of line at all.

Then we come to a group of statistics in dollars relating to electric revenue. This, too, will be broken down to correspond with your categories of customers. You will probably find, in terms of kilowatt hours bought, that your industrial customers will take the largest amount, and your residential next. That is not always true.

For example, if you are dealing with the local situation here, the Potomac Electric Power, I believe you would find that the bulk of the demand for electricity comes from the residential load since this is not a manufacturing area. However, even though in terms of kilowatts the residential load may take less than the industrial in terms of dollars, you will find that the largest proportion of the total revenue is derived from the residential load. This is why I speak of it as the bread and butter. It is also the most profitable load -- it carries the highest rates. You would scan these figures likewise for any unusual trend, particularly unfavorable trends.

You will also have some figures for gas revenue broken down by the same categories. Figures will be given for the total number of electric customers and the total number of gas customers, and sometimes when a company generates steam or produces steam, the number of steam customers.

Then you will come to two sets of figures that are really quite important: One is the average annual use in terms of kilowatt hours per residential customer. Some will give the average annual use for the industrial and commercial loads as well; but we are primarily concerned with the average annual use per residential customer. If you have a low average annual residential use or consumption, that indicates the possibility of the company being able to expand its business along those lines by certain promotional efforts -- trying to get customers to take on more appliances or more gadgets. If you find a low average industrial use, it may indicate that the company has a large number of customers and is, therefore, less dependent upon any one particular customer. If the company has a wider diversified use of its services by industrial customers, that might be deemed to be a favorable sign even though the average use per industrial customer may be low.

You will also get under the operating statistics (or possibly under the discussion of rates) the average dollar revenue per kilowatt hour by the different categories of customers. Here, of course, you will find once again that the highest figures are for the residential, the next highest for the commercial, and then the lowest for the industrial. The industrial load is useful because it irons out the peaks. The industrial load can take service at a time when perhaps it is not needed for residential purposes. The plant is there. You have to have the capacity for peak loads and your fixed charges are going on; so naturally, to the extent that you can take on additional business at odd hours you are helping to spread the overhead over a greater amount of revenue which has the effect of reducing unit costs. The only additional expenses, if you take on new customers or these odd hour loads, is what are called the incremental expenses of extra labor or fuel that might be involved. But the overhead is still there and there is no change along that line.

Some statistics will also show the total annual bill of customers. You may find in looking at the statistics that the total annual bill

of residential customers is going up in terms of dollars and cents. You may also find that the average annual use in terms of kilowatt hours for residential customers is going up. But you are apt to find that the annual cost per kilowatt hour is going down because the long-term trend, at least up until recently, has been downward in terms of kilowatt hour costs. But these figures for kilowatt hours per residential customer, of the average annual use and the average annual revenue per customer are important and should be obtained if they are not given in the prospectus.

Most of the prospectuses will also contain a map indicating the service area and the interconnections with other companies. I don't know when that has ever been left out.

The next interesting set of figures you will come to is the summary of earnings. This covers a five-year period and is required. That will start out first by showing operating revenue broken down between your principal sources of revenue. In this particular case it was electricity and gas and a minor amount from steam heating. Naturally you watch for trends. I will come to the discussion of the ratios that can be applied in a moment. The operating revenues will be equivalent, of course, to your sales if you were dealing with an industrial or a commercial firm.

Then instead of cost of goods sold, as you would have in an industrial or commercial firm, you will have a category called operating expenses and taxes. This broad category is made up of the following expenses: operations, maintenance, depreciation, amortization of cost in addition to original cost (which may be required where they are getting rid of certain properties for which, perhaps, the Federal Power Commission felt they had paid an excessive price or which were not needed for the use of customers), taxes, both state and income taxes, and also sometimes a provision for deferred federal income taxes. If they are taking quick amortization and getting the benefit of lower income taxes they may make an additional provision for credit to a reserve which they will use later on when their income taxes do go up. You will note, for one thing, that included in these expenses are federal income taxes (unlike industrial or commercial companies where your federal income taxes are generally the last thing that are deducted before arriving at net income). In public utility accounting, the federal income taxes are included up above with the other expenses. So, if you add up all your total operating expenses and taxes and subtract it from your total operating revenue, you arrive at a figure that is called net operating income.

Now one could stop at this particular point and make a few calculations. You could arrive at what we call the operating ratio. That can be derived in two ways: one would be to simply divide the total of the operating expenses and taxes by your operating revenue. That will show you how much it costs to get a dollar of revenue, and it will also

indicate just how much is going to come down for your investors -- your bond holders and your stockholders -- how much is going to be available to them. It is a sort of measure of efficiency. The higher the operating ratio, the less the efficiency of the plant. There, too, you have to watch out for unusual trends of anything going up. Some analysts say in computing the operating ratio, if you use it the way I just mentioned, you may find in the case of the normal electric and gas utility that that figure may run anywhere from 75 to 80%, just as a rule of thumb. Some analysts say, however, that you should exclude your federal income taxes and possibly also exclude your maintenance and depreciation on the ground that the federal income taxes are more or less beyond a company's control and that depreciation is something that at times perhaps can be juggled by a company, and that the same can be done with maintenance -- a company can over-maintain or under-maintain at times -- also maintenance can be thrown out by unusual conditions. For example, in New England a few years ago there was a flood and maintenance became very high. That is unusual. After repairs have been made, maintenance will drop back to a lower level. So you can compute the operating ratio by excluding the federal income taxes and your maintenance and depreciation figures. You could also make some comparisons, compute the ratios of maintenance to operating revenues to detect any trends there and compute the ratio of depreciation to operating revenue to test the adequacy of the depreciation provisions.

It is possible, if you are interested in comparisons, to get industry averages. You will find those in several sources. The Federal Power Commission gets out annual reports and statistics every year that will contain figures of various utilities and industry averages, or you can turn to a Moody's Public Utility Manual -- and I brought one down with me so I wouldn't have to try to explain what one is. You can see it for yourself.

Public utilities by their very nature are limited in the rate of return that they are permitted to earn. They are under regulation by state commissions in addition sometimes to federal agencies. I won't go into the intricacies of how you compute what is deemed to be a fair rate of return. That has been in the Supreme Court many times. But one rough way to determine the rate of return is to take gross income before any deductions for interest, and compare it against what might be called the rate base, the fixed asset plant as shown in the balance sheet plus a fair amount for working capital. What might be called a fair amount for working capital might be anywhere from 10% of operating expenses or 1-1/2 months' requirements. You could relate the gross income figure to both the gross and net plant.

The significance of that test is simply this: if it looks as though the rate of return may be out of line (and when I say out of line I mean quite high -- 8 or 9% as compared with the usual rate of

5-1/2 - 6-1/2%), it may suggest the possibility that that company will be exposed to rate proceedings or a rate reduction proceeding by the governing public utility commission of the particular state that has control.

In a public utility, unlike an industrial, you start out measuring how much you are going to be entitled to earn, and then you attempt to determine what you are going to be entitled to earn that on. Normally that is deemed to be the property devoted to the public service. In the case of public utilities the bulk of their property is the equipment, that is, the generating plants and the transmission lines. Public utilities have very little in the line of working capital -- they don't need too much.

Another test that can be made is to compare gross income figures to the total of capitalization and surplus. I include in capitalization both the debt and equity securities and surplus. That would indicate the over-all rate of return on the capital invested in the business.

A further test that can be made is to compare the plant investment with the amount of your operating revenues. That will show the number of dollars invested in the plant for each dollar of revenue. Unlike industrials, where you may have a small amount of plant in relation to each dollar of sales, the converse is true in the case of public utilities. Here you have a very heavy investment in relation to operating revenues. A rule of thumb or average figure might be anywhere from \$3.50 to \$4.00 of plant for each \$1 of revenue -- a very slow turn-over, in other words, of your fixed assets.

Coming down to your gross income, you deduct from that your income deductions. Primarily these are your various interest charges: your interest on your long-term debt, amortization of any debt discount, premium and expense, and there may be a credit in there for something called interest charged to construction where money has been borrowed and is being used for the construction of the plant and is not considered an expense. So that is treated as a credit, and the charge goes into the plant expenditures.

Comparing the gross income with the various interest charges and income deductions shows you the extent of coverage for your senior debt and senior securities. That comparison, of course, means (if you are taking the figures without any adjustment for income taxes) that your federal income taxes have already been deducted. It might be well to add back into your gross income the amount of your federal income taxes and also add back interest charged to construction, which is shown as a credit here. If you will look at Form S-9, one of our simple registration forms for high-class debt securities of certain public utilities and other companies, one of the exhibits, Exhibit 5, is required to be submitted showing how the ratio of earnings to fixed



charges has been computed. You will see there that they take gross income as reported in the table and add back the federal and state income taxes, the provision for deferred income taxes, and the interest charged to construction, and compare that with the interest requirements. You will come out with a ratio of earnings to fixed charges. That will vary. Naturally the higher the coverage, the greater the degree of protection to the security, and the lower the coverage, the greater the degree of risk that will be involved. That is your computation, of course, if you are trying to compute the coverage for just interest on the bonds. Sometimes you may have preferred stock being offered, or you want to see the extent of coverage not only on your interest requirements but on your preferred stock. Dividends on preferred stock come out of net income. Dividends are not an expense as such. However, after you deduct income deductions (your interest requirements) from your gross income, you do come out with a figure called net income, as shown here, and from that will be charged your dividends shown as a deduction (the dividends on preferred stock), and the balance is what is available to your common stock. It is not correct merely to take that net income figure and compare it with the amount of dividends on the preferred stock (in this case the net income figure is \$31,000,000 and the amount of dividends on the preferred stock is \$3,000,000) and therefore say that dividends have been covered ten times over. That is a rather misleading comparison. The proper way to make a comparison is what we call on an overall basis, i.e., to take your gross income, or your net income if you want to take a more conservative figure, and compare that against the sum of your fixed charges, that is, your interest requirements and also the dividends on the preferred stock. In this particular case if I were to add up my fixed charges of about \$6,000,000 and my dividends on preferred stock of about \$3,000,000 and round it out, I would come to a figure of about \$10,000,000. Against that my figures here show about \$37,000,000 of gross income. That obviously has cut the overall coverage down to about 3 plus, which is a far cry from the ten times figure that you got merely by comparing the net income against the dividend requirements.

You will also have figures for net income per share of common stock, and you can see whether there have been any unusual changes along that line. Comparisons can be made if you are interested (they are not called for in the prospectus) of the number of times earnings at which the common stock is selling. Take the market price of the stock and compare it with the earnings per share.

The next important thing we encounter is the table of capitalization. The capitalization will show the amount of common stock outstanding, the amount of preferred stock outstanding, and the amount of bonds. The Form S-1 gives a company a choice. They can, if they want to, and I think it more desirable, include in the capitalization the retained earnings or earned surplus, and capital surplus figures as well, to get the entire capitalization. A few ratios or percentages should be computed at this particular point, at least for the benefit of the section chief, since quite frequently if he goes down to the

Commission with a clearance the Commission will ask him what are the capitalization ratios. What proportion of your total capitalization is made up by debt, what proportion is made up by preferred stock, and what proportion is represented by the sum of your capital stock and surplus accounts. You take those two and put them together. The Division of Corporate Regulation at the moment is engaged in a study for arriving at some standards as to what are deemed to be proper capitalization ratios for public utility holding companies. The textbooks have different viewpoints, the Commission itself has expressed its views at times in releases under the Holding Company Act, and you might find, for example, if a company only has bonds and common stock that appropriate ratios might be 60% bonds and 40% common stock and surplus. If you have preferred stock as well, you may have a ratio such as 50% bonds, perhaps 15% preferred stock, and the balance of 35% made up of your capital stock and surplus. Those will be ideal ratios. Perhaps I should say they are standard and not out of line.

What is the significance of these capitalization ratios? If you find a company with a very heavy bonded structure where the bonds are running perhaps 70 or 75%, that company is a bit top-heavy. It means that it is probably loaded with heavy fixed charges. If it had any adverse business conditions -- a falling off in business -- it might, perhaps, have difficulty meeting the fixed charges on its bonds. It may also mean that it may have difficulty selling any more senior securities in the market until it balances out its capital structure by selling more common stock. Of course if conditions were unfavorable for the sale of common stock, that might present some serious problems to that company if it were trying to expand and get in more capital. On the other hand, if a company has a very high proportion of senior securities in its capital structure, this provides a greater degree of leverage or trading on the equity. Some of you may be familiar with that term. All we mean there is that if you can go out and borrow money say at 3% or 4% and put it to work for you to earn 6 or 7%, the difference will work down to you, the owners, or common stockholders. The benefit will go to the common stockholders and not to the senior security holders. You enhance your earnings, and you get the best of it. That has the effect, in times of rising revenues, of enhancing the amount of earnings going to the common stockholders. That is, if sales went up twice or 50%, you might have a 75% increase in the earnings going down to the common stockholders. It works in the opposite way, however. A falling off in revenues and income can have a greater than proportionate effect upon the stockholders in the reverse way of a decline, or magnifying a loss of earnings.

That also ties in with the point that if a public utility is limited to a fixed rate or return of 5-1/2 or 6 or 6-1/2%, whatever the regulatory authority may deem is appropriate, how can the common stockholders make any money? The answer, of course, gets back to the same idea of trading on the equity or leverage, because where the bond holders may only be paid 3 or 4 (rates are going up now) or 5%, and if

the company is able to earn the higher figure of 6-1/2%, it does work down to the common stockholders so that they do get a higher rate of return than the overall rate permitted by the state utility commission. In computing the rate of return you would compute that before deducting the interest charges, if you want to see how much money you have available to meet my capital needs. That is, you pay the bond holders for the use of their money by interest, and, of course, you pay the common stockholders for their money in terms of dividends. But you would compute the rate of return on a gross figure before the deduction of the interest charges. So much for capitalization.

Occasionally you run into limitations on the payment of dividends, particularly if the sale of common or preferred stock is involved, and those restrictions on dividends will generally be disclosed in the footnotes to financial statements, sometimes in the description of the security, and there should be at least a footnote reference. This is of no particular concern if the security being offered is a bond.

Next you will find a discussion of the business and territory served. That is quite important. Utilities that are serving areas of the country that are expanding very vigorously have a greater promise of growth than utilities serving areas that are approaching or have approached economic maturity. As you know, the South and Southwest have had tremendous expansions in recent years and utilities have grown very greatly in that area. In New England where manufacturing business has been falling off there is not that prospect for future growth that you will or do have in the Southeast and the Southwest.

A public utility, almost by definition, is a monopoly -- you don't have two electric power companies serving Washington, for example. However, public utilities are subject to some types of competition. The type of competition is largely governmental or governmentally inspired, and municipal. You will have, for example, the TVA power system, Bonneville Dam. You will have the programs of Rural Electrification Administration; various cooperatives -- the R.E.A. sponsored cooperatives; sometimes even within a particular city (it is true out in Columbus) you may have a municipally owned utility serving a proportion of the city. If there is competition of that nature, it should be spelled out. If there is any danger of some cooperative taking over an area served by the company, that is important.

You will probably find some discussion about atomic power development. A lot of utilities have gone into cooperative ventures to build or establish nuclear reactors. Up to now the amount of money spent has not been too large, but you will generally find some discussion of it, and where they get together as a pool, the obligation of no one utility is excessive.

There will be discussions of property. They will show the units they have of generating equipment, the age (which is important), and the so-called name plate rating capacity in terms of kilowatt hours.

That indicates how much the particular unit can generate. Most of the time they can generate more than the indicated capacity.

There should be a statement showing what we call the peak load or the net maximum demand on the system. That may come sometimes around Christmas time, and is the maximum demand during a particular measured period of time. It might be a 15 minute interval or an hour interval -- of the demand upon the system. There will also be shown the peak plant capability. In other words, how much was the dependable load carrying capacity during periods of greatest system load. By comparing the two you can see what the margin of safety is. In other words, how much can the system carry -- how much was demanded of it -- at any particular moment at the peak time. That would indicate whether there is a fair degree of reserve generating capacity, or whether it looks as though the company is going to have to go out and acquire more generating equipment. A figure that is quite important and can be obtained from the manuals or other sources is something called the load factor. The load factor measures the relationship between the average load during a period of time and the peak load. It is possible to compute the load factor if you (1) are told the maximum instantaneous demand, and (2) divide the total number of hours generated during the year by the number of hours in the year; you could probably use that for your purpose. In other words, your average hourly consumption as compared with the peak load. A high ratio, of course, indicates efficiency of operations since it means that the large investment is being utilized over a fair portion of the time. A low ratio indicates that a good part of the time this equipment is standing by idle. You have got to have the equipment, though, sufficient to meet that peak demand regardless of the demands upon the service at other times. An average figure, of course, might be anywhere from 50 to 60% -- some might be higher, some might be lower. It is also indicative, of course, of the company's ability to meet further increases in demand. If you do have a low ratio, it indicates that the company may be in a position to meet further increases in demand.

Another bit of interesting information, if the company is dependent upon gas or sells gas, will be its sources of gas. What are its reserves? Where is the gas coming from, how much can it count upon getting, and what is it paying for the gas? Our petroleum engineer, Tell White, can be quite helpful on that particular score.

You also run into the problem of regulation. Some utilities that are intrastate are only subject to regulation by a state utility commission. If they cross state lines, they will be subject to the Federal Power Commission; and some companies that are holding companies or subsidiaries of registered holding companies will be subject to our particular commission.

It has been our practice to ask in our letter of comment for copies of the orders of the State or Federal Power Commission authorizing

the company to proceed with its sale of the security. Sometimes (it is not usual) these orders may contain certain conditions or requirements and we will generally advise the company that it is assumed that effect will be given in the prospectus to any such conditions or requirements.

You will find a section in the prospectus discussing rate matters. If there are any pending proceedings involving rate matters, that should be disclosed because it may have an important bearing upon the company's prospects, either favorable or unfavorable. Quite frequently at this particular point you will be given the average revenues per kilowatt hour sold for the different categories of customers. Here for example on residential, the average annual revenue in 1956 was \$2.29, commercial was \$2.61, and the industrial was only \$1.24. With gas: for residential, the average revenues per thousand cubic feet were \$1.41; for space heating, 94 cents; and for industrial and commercial, only 62 cents.

Occasionally you will run into the problem of franchises or permits. Companies have to have a franchise or some sort of permission to serve the territory that they serve. Once in a while a company may be operating without a franchise -- the matter may be in the court, just left idle -- or it may have a so-called indeterminate permit, which can be revoked at the will of the municipality. But if there are any problems, where franchises have expired, that ought to be spelled out because it may represent a danger to the utility from the point of view of its continued operations.

There will generally be a discussion of the employee relationships. If there have been any unusual wage increases or wage demands made, that ought to be spelled out.

The description of the securities I won't go into. You should not rely just upon the section attorney, but you should go through the description of the securities and compare it with the indenture. That doesn't mean you have to read that whole thick document, but you can turn to the description of the securities and look for any unusual features.

One final thing that I might mention: Many utilities in selling securities are required to sell their securities on a competitive bid basis. That is required under Rule U-50 of the Holding Company Act. The Federal Power Commission will generally require it and I.C.C. would require it in the case of railroads. In such a case the registration statement under Rule 415 is permitted to become effective with a lot of the information missing, such as the prices, and if bonds are going to be sold, underwriting discounts and commissions, etc. The statement is permitted to become effective for the purpose of inviting bids. Then after bids are obtained and someone has won the bid, a post-effective amendment is filed with one of the Regional Offices -- usually

New York -- and that becomes effective automatically on the same day. In that post-effective amendment the prospectus will contain the missing information. That is only involved in competitive bid cases.