9 July 1982

Dear John:

Thank you for sending me a copy of your opening statement before the Subcommittee on Energy Conservation and Power of the House Committee on Energy and Commerce concerning the Public Utility Holding Company Act. I appreciate the time you have taken to forward it to me.

With best personal regards,

Sincerely,

EDWIN MEESE III
Counsellor to the President

The Honorable John S. R. Shad
Chairman
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

cc: Ed Meese

EM:ES:vml--

Dear John:

Thank you for sending me a copy of your opening statement before the subcommittee on Energy, Conservation and Power of the House Committee on Energy and Commerce concerning the Public Utility Holding Company Act. I appreciate the time you have taken to forward it to me.

With best personal regards,

Sincerely,

EM

cc to Meese

EME;s

202/272-2000

JOHN S.R. SHAD
CHAIRMAN

U.S. SECURITIES AND EXCHANGE COMMISSION
500 NORTH CAPITOL STREET
WASHINGTON, D.C. 20549

6/9/82 a.m. Draft

OPENING STATEMENT OF JOHN S.R. SHAD, CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION; CONCERNING THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 BEFORE THE SUBCOMMITTEE ON ENERGY, CONSERVATION AND POWER OF THE HOUSE COMMITTEE ON ENERGY AND COMMERCE

June 9, 1982

Chairman Ottinger and Members of the Subcommittee:

I would like to mention at the outset that yesterday the Administration announced that it supports repeal of the Public Utility Holding Company Act.

In December, the Commission unanimously recommended repeal of the Act (which it administers) for the following reasons.

Although there are valid arguments in support of the proposed amendments, their enactment would be tantamount to repeal. The Commission would be left with the appearance of oversight but minimal regulatory authority.

Act has served its purpose

More important, the principal purpose of the Act – simplification or elimination of the multi-tiered electric and gas holding companies – was accomplished over twenty years ago. Passage of the Act – nearly half a century ago – demonstrated strong Congressional leadership, as would its repeal, since it has fulfilled its purpose.

At one time or another since 1938, over 220 holding companies, which controlled over 1,000 operating utilities and 1,200 non-utility subsidiaries – a total of over 2,400 companies – have been registered under the Act. Today, only 5% of these companies are still registered under the Act – 12 holding company systems*, which control 66 operating utilities and 53 non-utility subsidiaries, a total of 131 companies.

The 12 holding companies are required to obtain prior Commission approval of their intra-system transactions, acquisitions and financings. The rates charged their utility customers have never been subject to the SEC's jurisdiction. These 12 utility systems generate 20% of the Nation's electric utility revenues and 8% of our natural gas distribution revenues. The Act also

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* 9 electric and 8 gas systems; 1981: Revenues $28 billion; assets $60 billion. 1982-86 projected capital expenditures $165 billion.

inhibits the financing, acquisition and geographical expansion decisions of some 90 exempt holding companies.

Fairness

None of the Nation's other utility holding companies – which include telephone, sewage, pipeline, transportation, communication and other industries – are subject to comparable SEC regulations or inhibitions. Repeal will remove the element of unfairness now present in application of the Acts substantive provisions to a fraction of the nation's electric and gas utilities.

It will not happen again

If the Act is repealed the economic, industry and regulatory fundamentals which permitted the abuses of half a century ago will not recur for the following reasons.

From 1902 to 1927 electric generation capacity doubled every five years. Electric utilities were a dynamic growth industry. Notwithstanding their essentially unregulated monopolistic position, improving technology and economies of scale, permitted these companies to reduce their rates and thereby expand demand for their services. They also benefitted from the introduction of new electrical appliances and equipment and rising urban populations.

These favorable fundamentals resulted in high rates of return on the capital actually invested in generation facilities. Paper profits were pyramided through highly leveraged, multi-tiered holding companies.

State and federal rate regulation and disclosure requirements were lax to non-existent. There were no uniform accounting standards. Assets were reappraised upward to facilitate financings. The investing public was unsophisticated. Credit was cheap and margin requirements were low (10%).

Today:

- Sophisticated institutional investors account for 70% of the market in listed stocks and half of the over-the-counter market.
- Credit is dear and margin requirements are high (50%).
- Investment banking and brokerage has become a highly regulated service industry.
- Accounting standards are uniform and highly refined.
- The SEC enforces full and accurate disclosure by all issuers and surveils and securities industry and the accounting profession.

- The Federal Energy Regulatory Commission (FERC) has established uniform systems of accounts and regulates wholesale interstate utility rates and the issuance of securities (in the absence of state jurisdiction).

- Most State Commissions have pervasive controls of the books and records, consumer rates, issuance of securities, mergers and consolidations, transactions with affiliates, property transfers and other aspects of all utilities doing business within their states, including those subject to the Act.

- Several states also regulate transfers of control. All have the authority to do so.

- The operating utilities controlled by the 12 holding companies, represent a very small fraction of the utilities subject to such state regulation.

- Financial services publish objective, qualitative bond ratings.

- Holding company debt securities have for years generally been rated lower than those of their operating subsidiaries, because a principal source of holding company earnings is the dividends they receive from their subsidiaries.

- Electric and gas utilities are no longer glamorous industries.

- Neither their image nor their economics will support highly leveraged, multi-tiered holding companies.

They will still be regulated

If the Act is repealed, these holding companies will continue to be subject to the anti-trust laws and to SEC registration and reporting requirements; and their operating subsidiaries will continue to be subject to pervasive rate and other regulations by FERC and the State Commissions.

A common misconception is that the SEC regulates utility rates under the Act. Such has never been the case. Under the Act, the SEC only regulates the 12 holding companies' intra-system transactions, acquisitions and financings.

Deteriorating financial condition

It should be noted in the latter regard that over the past several years there has been a serious deterioration in the financial condition of the nation's electric and gas utilities. On balance:

- their bonds are being downgraded;

- their interest and construction costs are soaring;

- and their stocks are selling at 20% discounts from book value.

As of April of this year, the common stocks of the 12 holding companies were selling at a 25% average discount from their book values. Nevertheless, they are being forced to do dilutionary equity financings in order to hold their debt ratings. This is like eating your seed corn. It provides a meal at the expense of next year's crop.

The electric and gas companies' financing alternatives are narrowly defined under the Act; whereas, virtually all other utilities' discretionary financing alternatives include negotiated and competitive offerings of convertible debentures and preferreds, preference shares, warrants, Eurodollar issues, leverage leasing, sale and leasebacks, zero coupon bonds and others.

Obsolete plants need to be replaced and additional capacity is required to meet future consumer demands. In order to finance such requirements these 12 companies must improve their profitability.

Repeal of the Act is not a panacea, but it will increase their financing, acquisition and other alternatives. Alternatives which these companies should be permitted to pursue, like all other utility holding companies, in order to improve their profitability and strengthen their financial conditions; which will in turn, permit them to better serve their utility customers. They are certainly not going to be in a better position to serve them, if their financial conditions continue to deteriorate. And regardless of their profitability, repeal is long overdue.

Congress has recognized and encouraged the concept of Sunset review.

For all of these reasons, the burden should be upon those who would retain an Act which served its purpose over a generation ago.

Thank you.