WITH reference to the retention of additional systems, Section 11(b)(1) of the Act provides "That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system; (B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and (C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation."

These three requirements set forth in the so-called "ABC" clauses were the result of the compromise between the House and the Senate concerning the retainability of utility systems by holding companies in addition to the principal group of properties. The Senate bill as originally passed did not permit any additional systems, while the House bill left the entire matter of integration largely to the discretion of the Commission.

The Commission has observed that, generally speaking, the ABC clauses envisage additional systems junior in importance to the principal system and usually dependent upon the continuance of joint control with the single system.\footnote{Cities Service Company, 15 S.E.C. 962 (1944). But see Columbia Gas & Electric Corporation, 17 S.E.C. 494 (1944).}
Furthermore, the requirements of the ABC clauses are cumulative and all must be fulfilled before the retention of an additional system may be approved.\textsuperscript{244} Elimination of most of the possible additional systems has resulted from the application of these provisions of the Act, as will be shown more fully in the following discussion of each clause separately.\textsuperscript{245}

**A. Loss of Substantial Economies**

The first of the cumulative requirements pertaining to the retainability of additional utility systems is that the Commission must find that each of such additional systems cannot be operated by an independent system without the loss of substantial economies which can be secured by the retention of control by the holding company of such system.\textsuperscript{246} The meaning of "substantial economies" is, of course, open to innumerable interpretations. The interpretation adopted by the Commission is shown by the ensuing case studies.

*Republic Electric Power Corporation*

The earliest decision involving Clause A arose under a plan filed by Republic Electric Power Corporation pursuant to Section 11(e). This company was the parent of electric and gas utilities in southern Oregon, northern and southern California, and Oklahoma. The plan proposed the disposition of only the Oklahoma properties. The plan was approved by the Commission, which pointed out that the Oregon and California operations were isolated properties, small in size, and could not be separately operated without the loss of substan-


\textsuperscript{245} The application of these requirements has not substantially differed as between electric utility systems and gas utility systems, and therefore no distinction will be drawn between the two types of systems.

\textsuperscript{246} Section 11(b)(1)(A), often referred to as "Clause A."
tial economies.\textsuperscript{247} It was also noted that the plan called for the ultimate elimination of the holding company. This was obviously an expedient decision, hastily made in the same manner as the American Water Works & Electric Company case discussed in Chapter II.\textsuperscript{248}

\textit{The North American Company}

The North American Company case was the first occasion upon which the Commission laid down definitive rules pertaining to the interpretation of Clause A.\textsuperscript{249} The first postulate was that the phrase "substantial economies" in Clause A refers to economies which may be secured by the systems themselves, rather than to economies which may be secured by the holding company.\textsuperscript{250}

North American argued that the requirement of substantial economies merely meant something more than nominal or "de minimis" economies. This argument was rejected by the Commission, which established the second postulate, to the effect that the word "substantial," as used here, means "important." The position of the Commission was that such meaning naturally resulted when the purpose of Congress to sever all but the closely knit systems was considered.

North American contended that it had consistently handled all of the financing matters of its subsidiaries, particularly the flotation of securities. The subsidiaries claimed that they would be unable to perform such functions without incurring large additional expenses incident to the employment of financial talent. The Commission pointed out that the major subsidiaries of North American were so large that it would not be inappropriate in any event for them to have their own finan-

\textsuperscript{247} Republic Electric Power Corporation, 3 S.E.C. 992 (1938).
\textsuperscript{248} American Water Works & Electric Company, 2 S.E.C. 972 (1937).
\textsuperscript{249} The North American Company, 11 S.E.C. 194 (1942).
cial experts. Further, if the various subsidiaries were permitted to do their own financing and were freed from the restrictions imposed by the holding company, the local officials could soon become familiar with the problems involved, and could manage the financial negotiations themselves. The Commission held that North American had not shown that such financing could not have been done, and done without the loss of substantial economies, without North American's participation. North American advanced another argument along this line to the effect that it had made substantial advances to its subsidiaries over the years and therefore constituted an important source of financing. The Commission replied to this by pointing out that North American had made no advances to subsidiaries since 1935, that the interest rates paid by the subsidiaries were high (4 1/2% to 8 1/8%), and that North American had borrowed considerable sums from its subsidiaries for the purpose of lending the money in the call-money market. North American generally paid interest to its subsidiaries at a rate lower than the current call-money rates. The first postulate stated above was therefore not complied with.

North American further claimed that a loss of substantial economies would result from severance, because the staff of North American furnished the various subsidiaries with advisory and consultative facilities with respect to budgeting, tax matters, major installations, and accounting matters. This contention was rejected by the Commission because of the limited facilities furnished by North American. Its staff consisted of only eight persons, including three clerks, two engineers, a rate specialist, and two executives.

The various North American subsidiaries were represented on three system committees which served as a clearing house for technical and accounting information. The record indicated that the operation of these committees had been of some
benefit to the participating companies. It was testified that the committees could not survive a rupture in the affiliated status of the member companies. The Commission could not understand why such committees could not be retained after severance if they were so valuable, and thought that their dissolution would only be proof of the insubstantiality of the "economies" resulting from them.

Consequently, the Commission found that the requirements of Clause A had not been met with respect to the Wisconsin-Michigan or the Detroit properties of The North American Company system. However, it was found that four small but individually integrated electric utility properties in Illinois could not be operated without the loss of substantial economies which could be secured by their retention under joint control together with the principal electric system of Illinois Power Company and Kewanee Public Service Company.

The same contentions as those discussed above were urged upon the appeal of this case. The Circuit Court of Appeals for the Second Circuit affirmed the action of the Commission relative to Clause A, pointing out that whether economy was achieved by centralized control was always a doubtful question and one peculiarly fitted for decision by an administrative agency staffed by experts. On such an issue the court was of the opinion that it could not review or reweigh the evidence. The court further asserted that it was in accord

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252 Id. at 243-244. See map of The North American Company system at page 45, supra.
253 The North American Company v. Securities & Exchange Commission, 133 F.(2d) 148 (C.C.A., 2d Cir., 1943). Certiorari was granted by the Supreme Court, but the decision by that court did not pass upon matters of statutory interpretation and was limited to the constitutional issue. The North American Company v. Securities & Exchange Commission, 327 U. S. 686 (1946).
with the Commission's ruling that the words "substantial economies" in Clause A meant "important economies."

In the original North American Company decision, the retainability of the integrated gas utility properties of the St. Louis County Gas Company as a system additional to the integrated electric properties of Union Electric Company of Missouri was not determined.\(^{255}\) In view of the submission by North American of a plan for compliance with Section 11, which called for the liquidation of its interest in County Gas, the Commission withheld its decision on this point for several years. However, in 1945 the Commission decided to pass upon the question, because of certain proposed inter-system exchanges with the Ogden Corporation.\(^{256}\)

The area served by the gas facilities of County Gas lay entirely within the territory served by Union with electricity, and many of its customers were served by both companies. Both had the same top executive officers and board of directors, and maintained the same general offices. Both shared several branch offices and certain storage facilities, and numerous operations were jointly conducted, such as customer services (meter service, billing, connection and disconnection of facilities), use and purchase of general equipment, and general supervision and management. Such joint provision of services was the principal basis of North American's claim that substantial economies would be lost if County Gas were severed from the North American system. Stress was also laid on the savings to County Gas resulting to the filing of consolidated returns with North American.

North American contended that independent operation of these two systems would result in additional expenses to Union amounting to 0.14% of its gross operating revenues for 1942 and 0.26% of its operating expenses for the same

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\(^{256}\) The North American Company, 18 S.E.C. 611 (1945).
year; and further contended that there would be additional expenses to County Gas amounting to 6.68\% of its gross operating revenues and 8.43\% of its operating expenses for 1942. To this should be added the savings alleged to result in favor of County Gas from the filing of joint tax returns, amounting to approximately one-third of the latter percentages. It was also claimed that it would cost an amount equal to approximately one-sixth of the percentages applicable to County Gas to effect the separation. And finally, it was asserted that there should be included in the estimates of lost economies the savings to joint customers in postage, fares and trouble, by reason of the single management respecting the gas and electric services.

The assertion of "economies" resulting from tax savings was disposed of quickly. The Commission referred to its decision in the Cities Service Company case, wherein it was pointed out that such "economies" had no relation to operational factors and depended solely upon the accidents of ownership and the state of tax legislation at a given time.\textsuperscript{257} The Commission stated its position as follows:

"... We think the staff is correct in its position that the claimed tax savings cannot be indiscriminately included in an estimate of lost economies under clause (A). Where, as here, the question is whether naturally competitive utilities should be permitted to remain under common control the tax savings, if considered at all, must be regarded as a minor factor."\textsuperscript{258}

It was further the opinion of the Commission that the initial expenses of effecting segregation and the inconvenience to customers, although not to be disregarded, assumed their proper place only in the light of peculiar problems of the

\textsuperscript{257} Cities Service Company, 15 S.E.C. 962 (1944).
\textsuperscript{258} The North American Company, 18 S.E.C. 611, 614-615 (1945).
case. For example, if the initial segregation expense were prorated over the life of the assets being separated, the resulting annual figure would be insignificant. And also, customers' expenses should be weighed, according to the Commission, against customer benefits to be achieved from separation.

Relative to the claimed increases in annual expenses resulting from separation, the Commission first pointed out that such expenses were overstated by certain amounts representing capital expenditures, thereby reducing the ratio of the additional expenses of County Gas to its gross operating revenues and operating expenses of 1942 to 5.87% and 7.43%, respectively.

Considerable emphasis was placed by the Commission on the rule of intangible benefits upon separation enunciated in prior decisions.259 "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," according to the Commission.260 It was pointed out that here the electric and gas businesses, operating in the same territory, were competitors in numerous instances, and that the natural tendency of joint control was to favor the business that was most profitable. Examples of similar problems arising before state utility commissions were cited.261

259 The North American Company, 11 S.E.C. 194 (1942); Engineers Public Service Company, 12 S.E.C. 41 (1942); Cities Service Power & Light Company, 14 S.E.C. 28 (1943); and Cities Service Company, 15 S.E.C. 962 (1944). The last three cases cited will be discussed in detail below.
"This Commission has viewed acquisition of gas utilities by utilities primarily interested in electricity with some concern. Accordingly, although the transfer of gas properties is from one electric utility to another, we made inquiry into operating policies to be followed. Exhibits showing operating comparisons between such controlled gas utilities and all inde-
In connection with the problem involving the existence or lack of economies resulting from the joint operation of electric and gas utility systems, from the point of view of the gas system, the staff of the Public Utilities Division of the Commission had prepared a statistical study which first became available to the Commission in this case. It was noted that the burden of proof did not lie with the staff, but that in any event the Commission desired to have an ample record, notwithstanding the legal situs of the burden of proof. Further, certain weaknesses of statistical comparison, such as insufficient samples, were recognized. The staff had studied the operations of 65 companies for the year 1941, including 39 companies serving gas exclusively and 26 combination

pendent New Hampshire gas utilities were submitted of record. These comparisons show that in independent gas utilities over the last ten-year period, the loss in customers was one percent, while for Public Service gas utilities the loss was 11.5 percent, and for Twin State, 19 percent. Corresponding gas consumption loss percentages over the same period were 4.9, 24.2, 41.5 percent, respectively.

"At least some doubt is raised as to whether the effort of electric utilities is toward maintaining gas sales or discouraging such sales. For instance, the net costs of Twin State's new business effort in 1942 was $4,09 for gas and $12,950.39 for electricity in the Dover Division. The Vice-President testified that this was all the expenditure warranted by the gas business. . . .

"There is little in this record to indicate that there are advantages in permitting an electric utility to operate a gas utility. Rather, there appears to be some loss of the competition between the two industries, a situation which is repugnant to the State Constitution. It would seem that management, favored with a monopoly in the products of competing industries, must make certain that competition is actually and actively maintained if it is not to be viewed with suspicion."

The Montana Commission in the case of Helena Light & Railroad Company, P.U.R. 1920 D, 668, made the following comments relative to joint ownerships of electric and gas facilities:

"It is almost superfluous to say that the evident inertia of the gas service, its deteriorated plant and relatively failing patronage result immediately from the fact that it has it has no competition. Its natural competition, the electric utility, being owned by the same company, favored by the management and enjoying certain popular advantages, has snuffed out the spark of incentive to increased business and improved service. The Company is indifferent to better gas service because its failure in this department results in gain to the electric department, whereas an independent gas entrepreneur would strive to occupy the electric field."
companies serving both gas and electricity. Pertinent excerpts from this statistical study are set forth below. \(^{262}\) Substantially favorable items, from the Commission's point of view, are denoted by an asterisk.

The staff's studies, including the foregoing and other data, indicated to the Commission that, in comparison with combination companies, (a) gas companies tended to sell more gas and derive more revenue per customer at smaller prices per therm; (b) companies serving electricity alone tended to sell more current and derive more revenue per customer at lower prices per KWH; (c) while customer accounting and

### TABLE I

**Comparison of Sales: Gas Companies, Electric Companies and Combined Electric & Gas Companies**

<table>
<thead>
<tr>
<th></th>
<th>Mean Therms or KWH Per Customer</th>
<th>Mean Revenue Per Customer</th>
<th>Average Cents Per Therm or KWH</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Natural Gas:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gas Companies</td>
<td>586</td>
<td>$40.26</td>
<td>6.87</td>
</tr>
<tr>
<td>Combination Companies</td>
<td>434</td>
<td>38.58</td>
<td>8.89</td>
</tr>
<tr>
<td><strong>Manufactured Gas:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gas Companies</td>
<td>157</td>
<td>32.48</td>
<td>20.69</td>
</tr>
<tr>
<td>Combination Companies</td>
<td>148</td>
<td>31.91</td>
<td>21.56</td>
</tr>
<tr>
<td><strong>Electricity:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electric Companies</td>
<td>1012</td>
<td>37.05</td>
<td>3.66</td>
</tr>
<tr>
<td>Combination Companies</td>
<td>882</td>
<td>35.69</td>
<td>4.05</td>
</tr>
</tbody>
</table>

### TABLE II

**Comparison of Fiscal, Managerial and Distribution Expenses**

<table>
<thead>
<tr>
<th>Expense per Customer:</th>
<th>Mean Combination Companies</th>
<th>Mean Gas Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer Accounting and Collection</td>
<td>$1.91*</td>
<td>$2.34</td>
</tr>
<tr>
<td>Administrative and General</td>
<td>2.71*</td>
<td>2.97</td>
</tr>
<tr>
<td>Distribution</td>
<td>4.48</td>
<td>4.03</td>
</tr>
</tbody>
</table>

\(^{262}\) These tabulations are shown in *The North American Company*, 18 S.E.C. 611 at 618-620 (1945).
## TABLE III
### Comparison of Residential Sales

<table>
<thead>
<tr>
<th></th>
<th>Mean Combination Companies</th>
<th>Mean Gas Companies</th>
<th>County Gas</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Including House Heating:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales per customer (therms)</td>
<td>287.40</td>
<td>330.04</td>
<td>366.88*</td>
</tr>
<tr>
<td>Revenue per customer</td>
<td>$35.48</td>
<td>$35.96</td>
<td>$40.43*</td>
</tr>
<tr>
<td>Revenue per therm sold</td>
<td>15.46¢</td>
<td>15.52¢</td>
<td>11.02¢</td>
</tr>
<tr>
<td><strong>Excluding House Heating:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales per customer (therms)</td>
<td>144.33</td>
<td>166.64</td>
<td>158.56</td>
</tr>
<tr>
<td>Revenue per customer</td>
<td>$27.02</td>
<td>$30.47</td>
<td>$23.65</td>
</tr>
<tr>
<td>Revenue per therm sold</td>
<td>19.64¢</td>
<td>20.07¢</td>
<td>14.92¢</td>
</tr>
</tbody>
</table>

## TABLE IV
### Study of Typical Monthly Gas Bills for Residential Service

<table>
<thead>
<tr>
<th></th>
<th>Combination Companies</th>
<th>Gas Companies</th>
<th>County Gas</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cooking:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Therms Mean</td>
<td>$1.06</td>
<td>$1.06</td>
<td>$ .93*</td>
</tr>
<tr>
<td>Median</td>
<td>1.10</td>
<td>1.05</td>
<td></td>
</tr>
<tr>
<td>10 Therms Mean</td>
<td>$1.89</td>
<td>$1.78</td>
<td>1.55*</td>
</tr>
<tr>
<td>Median</td>
<td>1.92</td>
<td>1.84</td>
<td></td>
</tr>
<tr>
<td><strong>Cooking and Water Heating:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 Therms Mean</td>
<td>2.67</td>
<td>2.31</td>
<td>2.18*</td>
</tr>
<tr>
<td>Median</td>
<td>2.79</td>
<td>2.62</td>
<td></td>
</tr>
<tr>
<td>25 Therms Mean</td>
<td>3.91</td>
<td>3.51</td>
<td>3.42*</td>
</tr>
<tr>
<td>Median</td>
<td>4.14</td>
<td>3.71</td>
<td></td>
</tr>
<tr>
<td><strong>Cooking, Water Heating, and Refrigeration:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>35 Therms Mean</td>
<td>5.13</td>
<td>4.63</td>
<td>4.67</td>
</tr>
<tr>
<td>Median</td>
<td>5.54</td>
<td>4.71</td>
<td></td>
</tr>
<tr>
<td><strong>Cooking, Water Heating, Refrigeration, and House Heating:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>100 Therms Mean</td>
<td>10.23</td>
<td>9.75</td>
<td>19.88</td>
</tr>
<tr>
<td>Median</td>
<td>9.90</td>
<td>9.58</td>
<td></td>
</tr>
<tr>
<td>250 Therms Mean</td>
<td>21.32*</td>
<td>21.51</td>
<td></td>
</tr>
<tr>
<td>Median</td>
<td>20.65*</td>
<td>21.67</td>
<td></td>
</tr>
</tbody>
</table>

collection, and administrative and general expenses per customer tended to be higher for gas companies than for combination companies, distribution expenses per customer tended
to be lower; (d) gas companies tended to derive vastly higher revenues from merchandising and jobbing; (e) gas companies tended to sell more gas for residential purposes, derived more revenue per customer and per therm sold whether house heating load was included or excluded, their performance being better when it was excluded; and (f) gas company rates for residential service tended to be lower for all brackets except that of 250 therms, and in that bracket tended to be only slightly higher. It might well be added that in several instances where the performance of the combination companies was not as favorable as that of the gas companies, the performance of County Gas was better than both. The Commission was convinced, however, that the expansion of County Gas's electric sales and revenues was taking place at the expense of the gas business, remarking that "To expect vital competition between the two types of service when controlled by the same interests is, in our opinion, highly unrealistic."263

The conclusion was that County Gas was not retainable for the reason that it had not been shown that substantial economies would be lost, within the meaning of Clause A, if County gas were severed from North American control. It was pointed out that new operating alliances and resulting economies were in prospect by virtue of the proposed integration of the gas utility facilities of County Gas and Laclede Gas Light Company, which served gas in contiguous territories.

This decision obviously sets forth a very carefully considered opinion relative to the requirements of Clause A. The staff of the Public Utilities Division is to be commended for its research into the various state proceedings involving similar problems and for its statistical survey comparing joint

RETENTION OF ADDITIONAL SYSTEMS

electric and gas operations with independent gas operations. The solution, of course, can never become a scientific matter, but this case marked a radical departure from the somewhat haphazard approach to the requirements of Clause A evidenced in prior decisions, a number of which are discussed below. In many cases the Commission has relied on the proposition that the intangible benefits resulting from the separation of gas and electric facilities offset or outweighed tangible benefits from joint operation actually proved by the utility in question. The North American decision of 1945 was the first legitimate attempt made by the Commission to substantiate its proposition. Although the inherent weaknesses of statistical comparison must be recognized, especially where the period of time covered and the samples included are limited, it can be said that the Commission made out a good case for itself.

*Engineers Public Service Company*

An early case involving the application of Clause A of Section 11(b)(1) was that of Engineers Public Service Company. The question arose whether the gas utility system of Virginia Electric & Power Company was retainable as an additional system to the electric utility system of the same company. Engineers claimed that substantial economies in the operation of both the gas and electric systems would be lost if common control of these properties was terminated. The economies asserted amounted to $71,500 in the operation of the gas system and $56,000 in the operation of the electric system. These economies came largely from savings in the

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264 See map of Engineers Public Service Company electric utility system, *supra*, page 42.
265 The Public Utility Division of the Securities & Exchange Commission took the position that the "loss of substantial economies" in Clause A referred exclusively to economies lost to the *additional* system, and Engineers contended that the clause referred to economies lost to both the principal system and the
form of salaries which, upon separation, would either be paid to additional personnel or, instead of being shared, as in the past, would be borne by one system or the other. The Commission viewed these items as follows:

"... In prescribing the conditions under which additional systems may be retained, however, Congress did not speak in terms of increased expenses. It authorized the retention of additional systems if they could not be operated independently without the loss of substantial economies. And in measuring the loss of economies accompanying the severance of a combination of two utility systems it is particularly important to consider the beneficial effects of independent ownership upon the efficient operation of each system. A consideration of increased expenditures alone does not adequately reflect the impact of severance upon the two systems. Where, as here, gas and electric operations are conducted in the same territory and in many ways compete with each other, the danger exists that under a single management one business may be suppressed in favor of the other or that one will bear burdens properly allocable to the other. The record before us shows, for instance, that there have been abuses in allocating expenses between gas and electric properties. Not only has there been a failure to allocate or separate the expenses of many specific items, but there has been an over-all erroneous allocation. Thus, prior to 1933, expenses were allocated between Virginia's departments in the ratio which the gross revenues from each bore to the total. After that year they were allocated on a net additional system. The Commission did not here decide this issue, and assumed for the sake of argument that the latter interpretation was correct. Engineers Public Service Company, 12 S.E.C. 41 (1942). The interpretation of the Public Utilities Division was upheld by the Court of Appeals for the District of Columbia in Engineers Public Service Company v. Securities & Exchange Commission, 138 F. (2d) 936 (C.A.D.C., 1943).
revenue basis, the prior year's revenues furnishing the annual yardstick for the current year's allocation. The effect of this change was to increase the expenses allocable to the electric department and to decrease the expenses allocable to the gas department. Neither method of allocation bore any relationship to the actual expenses involved. . . . The impropriety of the . . . allocations, however, as the respondents admit, has in the past affected the rate structures of the gas and electric operations. It is true that respondents propose to attempt to correct these practices. But that these abuses can most effectively be eliminated by complete severance is unquestionable. Moreover, the possible benefits of unsuppressed development and growth for each business must also be cast in the balance when substantial economies are measured. The economies which may be expected from a personnel single-mindedly devoted to the operation of either a gas or an electric business, although not predictable in precise mathematical form, cannot be ignored."

Further, the Commission found that the increased expenditures anticipated by Engineers were excessive. The need for additional employees for customers' accounting and collection work, advertising and sales promotion, and in executive departments was questioned. The conclusion was that, with respect to the gas properties alone, the record would not sustain a finding of more than one-half of the claimed increased expenses, and that the loss of economies would in fact be less than such increased expenses. Holding that the requirements of Clause A had not been met in this case, the Commission stated:

". . . Since this requirement (relative to the retention of additional systems) is an exception to a clearly ex-

388 Engineers Public Service Company, 12 S.E.C. 41, 57-58 (1942).
pressed general policy, it must be strictly construed. Moreover, in determining what are substantial economies, we must bear in mind that Congress was informed that some loss of economies of the sort principally involved in this situation—in joint administrative, clerical and supervisory services and the use of joint facilities—almost invariably would accompany separation of jointly controlled utility systems. Against this background we 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.\textsuperscript{267}

Upon the appeal of this case, it was pointed out that the claimed economies which would be lost by severance of the gas and electric systems were in two classes: (1) actual expenses previously allocated to the gas property which would have to be paid by the electric properties even after separation; and (2) increased cost of operations of the gas properties as independent businesses. The economies in the first class were chiefly caused by the joint use of personnel and property; the economies in the second class were arrived at by comparing the previous costs of operation allocated to the gas properties with the estimated cost of an independent gas system. The Court of Appeals thought that “substantial economies” meant something more than substantial savings in operational expenses, although the latter was one element of the former. The Court adverted to the decision in The North American Company case,\textsuperscript{268} and pointed out that “substantial economies” meant “important economies.” The Court


agreed with the Commission that there were definite benefits to be derived from the separation of two competitive businesses. The Court of Appeals was of the opinion that Engineers had the burden of proving the following items in this connection: (a) that there would be a continuing substantial strength, enjoyed by the controlled company, which it would not have under its own control; (b) that there would be in the situation no reasonable expectation that a compensating strength would not be enjoyed by reason of its own control; and (c) that such continuing strength would not entail a sacrifice upon the part of the controlling utility. Consequently, the ruling of the Commission was upheld. The statutory basis of the "strength" requirements was not explained by the court. These requirements were essentially judicial legislation.

The heavy burden thus placed upon the party urging retention was justly criticized in the minority opinion in the Engineers case. The approach of the majority and of the Commission was that the "ABC" clauses constituted an exception to the general policy of the Act to break up large combinations of utilities, and therefore they were to be applied only in exceptional circumstances. The theory of the dissenting opinion was that Congress would not have passed the Act without the "ABC" clauses, therefore evidencing a desire to prohibit the unnecessary disturbance of existing conditions. The difference between the majority and the minority was consequently one of emphasis. The dissenting judge felt that substantial savings in operational expenses amounted to "substantial economies," and that it was putting it too strongly to say, as the Commission did, that there must be clear and

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convincing evidence of loss of economies which would seri­ously impair the efficiency of the system. The dissenting judge argued that this was so because the Act did not require more than a preponderance of the evidence to support such a find­ing, and because the loss of economies which would seriously impair the system would not merely be substantial but also destructive. It was his opinion that a loss of substantial econ­omies occurs if the loss is so large that experienced men of affairs would regard it as substantial and, if possible, take steps to eliminate it. He further felt that an annual loss of $91,730, which the Commission had recognized to be prob­able in this case, would meet this test. In addition, he thought that there were probably further savings not considered by the Commission. And finally, he rejected the conjecture of the Commission that compensating advantages might result from separate management for the reason that it was entirely without support in the evidence.

The approach of the dissenting opinion to this problem may perhaps not be entirely sound. Certainly if the Commission had taken the position that the status quo was not to be disturbed unless absolutely necessary, as the dissent implies, the course of the integration program would have been far different. This was the essence of the holding company bill originally passed by the House and later revised. It may well be conceded that this view constitutes too narrow an inter­pretation of the intent and purposes of the Act. Neverthe­less, there is much to be said in favor of the approach of the dissent to the practical problems involved. The Commission was quick to reject many of the loss estimates in the early decisions and did not take time to analyze the rejected figures to see if they were improper in whole or only in part. The Commission also relied strongly upon its postulate that there would be compensating advantages resulting from separation. Such is the basic theory of the Act, but it is difficult to meas-
ure such intangibles, although an attempt in this direction was made in the 1945 North American case, discussed above. Since the purpose of the Act is to require separation, the burden of proof is placed upon the party seeking retention under the enumerated exceptions to the Act. The interpretation of the Commission and of the majority of the Court of Appeals discussed here not only saddles such a party with the burden of proof, but increases such burden by attributing a substantial, though indefinite, monetary value to the results to be achieved through separation.

Engineers contended that the electric utility system of Savannah Electric & Power Company was retainable as an additional system to that of Virginia Electric & Power Company. Engineers calculated that economies to be lost by a separation of these two systems would amount to $28,000 for each company. The Commission observed that this amount represented increased expense principally for advice with respect to taxes, accounting, procurement, etc., which was not necessarily equivalent to lost economies, and which did not take into consideration any improvements in service or efficiency or other benefits that might result from severance, and further that Congress was aware that in the normal course of events certain economies, such as those involved here, could be obtained by common control. The figures submitted by Engineers represented .3% of Virginia’s 1940 electric operating expenses and 2.2% of Savannah’s, or .7% of Virginia’s net income and 5.5% of Savannah’s. The Commission held that these amounts did not constitute “substantial economies” under the standards of Clause A.271 Also, it was pointed out that Engineers’ figures were not to be taken as correct, since they included economies in the operation of Savannah’s transportation properties which were not retain-

271 Engineers Public Service Company, 12 S.E.C. 41 (1942).
able and since the Commission was not convinced that as many additional expert employees would be required as estimated by Engineers. It was pointed out that many of the functions for which Engineers contemplated needing new employees could be efficiently performed by members of the current executive staffs of each operating company.

It was further proposed by Engineers that the natural gas system of Gulf States Utilities Company in Baton Rouge, Louisiana, should be retainable as an additional system to Gulf's electric utility system. The evidence indicated that the increased costs to the gas system in the event of separation would be $42,024.00 and the increased costs to the electric system would amount to $52,452.00, a total of $94,476.00. To the electric department this would result in increased expenses of less than 1% and a net loss of 2.3%, which the Commission did not regard as substantial. The asserted losses to the gas system amounted to 8.7% of its operating expenses and 32.6% of its net income for 1940. Obviously, these amounts were substantial, but the Commission was of the opinion that Engineers' estimate of the additional executives and employees that would be necessitated by a division was overstated by a substantial amount. Other costs, such as those for office, garage, and shop facilities, were considered to be excessive. The question was raised, but not settled, whether lost economies attributable to the operation of a gas merchandising and jobbing business, retainable as "other businesses," could be considered in connection with Clause A. A negative answer was indicated. In the light of all these considerations, the Commission held that the economies to be lost through separate operation of the gas and electric systems of Gulf were not substantial, and therefore that the requirements of Clause A were not met.\footnote{Ibid.} The opinion of the Commission
is open to considerable criticism in view of the fact that it resorted to generalizations to destroy the validity of the substantial amounts adduced in evidence by Engineers, and in no instance did it indicate even approximately the percentage or amount of error existing in Engineers’ figures.

The decision of the Commission with reference to the Gulf electric and gas properties was affirmed on appeal. However, the dissenting opinion took issue with this holding. It was stated that the Commission had held that $25,000.00 of the $42,024.00 asserted additional costs to operate a separate gas system had been proved, although such amount does not appear in the reported opinion of the Commission. This amount was added to the $52,000.00 additional cost to the electric system asserted by Engineers, a total annual loss of $77,000.00. It was pointed out that the 1940 gross receipts for the gas business were approximately $720,000, and the property account was $1,675,000, compared with $10,840,000 and $57,770,000, respectively, for Gulf. The propriety of adding the electric system losses to the gas system losses when comparing lost economies with the gross receipts and property account of the gas system alone is, of course, doubtful; and such losses, even if properly combined, were not substantial in comparison with the electric system receipts and property account. It was the opinion of the dissenting judge, however, that the Gulf gas system was retainable as an additional system.

Engineers also sought to retain the El Paso Electric Company properties as an additional system to the Gulf electric system, asserting savings of $50,700.00 annually in the operation of the two companies, $12,000.00 of which

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274 The dissent appears as part of the majority opinion, but it is in actuality a continuation of the minority opinion on the retention of the Virginia gas system as an additional system.
was allocable to Gulf, $32,800.00 to El Paso, and the remainder to the Baton Rouge Bus Company. These savings were computed by subtracting from the estimated cost of providing assertedly necessary supervisory assistance and services to both companies, if independent, the estimated cost of these services if the companies were under common control. As in the case of Virginia and Savannah, these savings occurred not in the physical, day-to-day operation of the properties, but largely in the administrative, accounting, and financial conduct of the business. The loss of economies claimed represented .5% of Gulf's net and .3% of Gulf's gross income from electric operations in 1940, and 7.4% of El Paso's net and 3.6% of its gross income from electric operations. Or these claims would have resulted in an increase in operating expenses of .2% to Gulf and 1.8% to El Paso. These amounts were held to be inadequate to meet the requirements of Clause A.275

The Commission was further of the opinion that the economies resulting from common control in this case were not in fact as substantial as those claimed. The estimates included savings in the operation of non-retainable transportation properties which could not be considered in this regard, and the Commission rejected the contentions that all of the proposed additional executive assistance was necessary and that none of the functions to be performed by such experts could be efficiently performed by the existing executives. Also, the cost of obtaining the additional services claimed to be necessary was found to be less than the amount claimed. The conclusion was clear that the economies, if any, which would be lost upon the separation of these two electric utility systems were not such as would justify the retention of El Paso by Engineers along with Gulf under the standards of Clause A.

275 Engineers Public Service Company, 12 S.E.C. 41 (1942).
In addition to its principal integrated electric utility system, El Paso Electric Company owned and operated another small but integrated electric system serving the town of Van Horn, Texas. It was stated by the Commission that "material savings" were effected by the combination of El Paso and Van Horn, and that substantial economies would be lost if the two systems were separated. The requirements of Clause A were therefore met in this instance, although the opinion does not give enough of the details to be of much value in this study of Clause A. It is likely that the Commission was influenced by the fact that the small Van Horn system would become an undesirable orphan if separated from El Paso.

Citizens Service Power & Light Company

The numerous integrated utility systems within the Cities Service Power & Light Company empire have previously been defined. In addition to these integrated systems, Cities desired to retain various other systems operated in conjunction with those found to be integrated. It was shown that the natural gas operations of Toledo Edison Company, whose electric operations had been found to be integrated, were carried on by some of the same employees engaged in the electric operations with resulting economies, the amount of which is not shown. Further, there was testimony to show that by reason of the common electric and gas franchise, it would be difficult or impossible to dispose of the gas properties without at the same time disposing of the electric properties. The Commission held that further proof should be adduced upon this point, but indicated that if it were impossible to separate the enterprises for franchise reasons, or if it were necessary to abandon the gas operations to comply with an

276 Ibid.
277 See map of Cities Service Power & Light Company systems, page 52, supra.
integration order, such facts might be relevant to a determination of whether separation could feasibly be ordered; or in other words, such facts might indicate compliance with Clause A.278

Cities sought to retain the integrated electric utility system of St. Joseph Railway, Light, Heat & Power Company with the Mid-Continent system of properties. It was estimated that an annual increase of $76,865 in general and administrative expenses would be necessary to maintain the St. Joseph company outside the Cities Service system. The theory behind this estimate was that the St. Joseph company would have to supply itself independently with the benefits then received from the system service company, and would need additional personnel, such as an executive vice-president and assistant general manager, an assistant secretary and local auditor, and advertising, promotional, and purchasing personnel, a budget director, and an engineer. The increased expenses amounted to 2.67% of average operating revenue for 1939-1940, or 5.23% of average total operating expenses for the same period. The Commission was of the opinion that the estimates were unduly high. It further held that Cities Service had not considered the intangible benefits resulting from separation, discussed above, and stated its views in this manner:

"... One of the cost items (significant, though sometimes difficult of isolation) of operating subsidiaries in a large holding company system, is the cost of maintaining a holding company in some remote center, and the hazard of having operating policies dominated by persons whose interest is not that of any particular company or service area, but the most profitable possible..."
operation of a vast system. That cost is, in our opinion, always a necessary deduction from any estimate of increased expenditures occurring upon separation from a holding company system. The economies that must be lost to warrant retention under Clause (A) must be ‘substantial.’ Even crediting the conclusions of respondents, we cannot find that the increased operating expenses are so great as to require a finding that important economies would be lost to the St. Joseph company by separation from the Power & Light system. Any duplication of effort created by compliance with Section 11(b)-(I) is estimable as a loss. Congress intended, however, that the loss, anticipated for all systems undergoing the processes of Section 11(b)(I), should outweigh the benefits of independence. . . . As we have indicated, not only are these estimates inflated, but benefits to the St. Joseph properties from the elimination of their share in the cost of maintaining the Power & Light Company must be considered. . . ."\textsuperscript{279}

Cities Service wished to retain certain gas operations located in the Mid-Continent area, and in this connection adduced evidence to show the joint use of facilities by the gas and electric businesses. Such facilities consisted of automotive equipment, a meter shop, and the central office. Meter reading, customers’ accounting, and billing were jointly handled for both businesses. It was estimated that separation of the electric and gas departments would result in increased costs for both businesses, totaling $45,749.34. This evidence was considered insufficient to show compliance with Clause A.\textsuperscript{280}

Cities Service contended that if Rawlins Electric Company were operated separately from the Rocky Mountain


\textsuperscript{280} Cities Service Power & Light Company, 14 S.E.C. 28 (1943).
properties, there would be an annual increase in general and administrative expenses of 5% of the average gross operating revenues of the company for the years 1939 and 1940, and an increase in average total operating expenses for the same years of 11%. The Commission did not accept these estimates as correct, however. The opinion pointed out that functionally the Rawlins properties formed a part of the U. S. Bureau of Reclamation system in the Wyoming area, rather than part of the Cities Service system. The physical relationship of the Rawlins properties with the remainder of the group properties in the Rocky Mountain area was extremely tenuous, and was an incidental result of the fact that other group properties shared in the U.S.B.R.'s power sources. Recent major benefits to the Rawlins properties resulted not from connection with the holding company system, but rather from physical interconnection with the government-owned and operated facilities. The conclusion was that the requirements of Clause A were not met in this instance.\(^{281}\)

The Rocky Mountain group of Cities Service properties included a considerable number of gas properties, principally natural gas distribution systems. The decision as to the retainability of these systems was withheld in most instances to allow Cities Service to adduce further evidence. However, the Commission did order the disposition of the manufactured gas operations of the company in Grand Junction, Colorado.\(^{282}\)

These manufactured gas operations were small and unprofit-

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\(^{281}\) *Ibid.* The Commission advanced the theory that the legislative history of the Act required consideration of the possibility that retention within the holding company system might result in substantial aid in the growth and development of the "additional" system. *Cf.*, 79 Cong. Record 14479 (1935). It would not be necessary to show, for compliance with Clause A, that an operating system was totally dependent for its existence on aid from the holding company or other properties in the system. In such event the properties in question might not comply with Section 2(a) (29) (A) as a single integrated system, and the ABC clauses would therefore have no application to them. 14 S.E.C. 28, 62 (1943).

\(^{282}\) *Cities Service Power & Light Company*, 14 S.E.C. 28 (1943).
able, and customers were continually being lost. No attempt had been made to improve service or to build load, and the Commission was of the opinion that little concern was being manifested over the progressive decline of the properties. The Commission drew the following conclusions:

"... These facts illustrate one of the dangers existing when electricity and gas are jointly served in a community. Since Public Service controls both, it is a matter of indifference whether it takes profits from one or the other operation. In fact the higher rate of profit in electric distribution and the necessity of capital outlay to improve the gas properties offer a distinct stimulus to neglect the gas business. This area may perhaps be easily served from natural gas sources. A company which has permitted the condition in Grand Junction to continue and has given no indication of effort to develop its existing manufactured gas resources or to introduce cheaper natural gas and promote its use in competition with electricity certainly cannot claim that substantial economies will be lost by a severance of the properties from its control...."

An attempt was made by Cities Service to secure the approval of its retention of its Deming, New Mexico, and Tucson, Arizona, electric properties as systems additional to its integrated New Mexico properties. Evidence was adduced to show that the U. S. Bureau of Reclamation contemplated an interconnection between the Tucson and the Deming properties, and also between the Deming properties and the integrated New Mexico system to the north. These

284 The integrated system referred to here consisted of the groups designated "C," "D," and "E" on the map of the Cities Service Power & Light Company system, page 52, supra.
proposed interconnections were the principal basis of the claim that substantial economies, within the meaning of Clause A, would be lost if the Tucson and Deming properties were severed from the New Mexico group. The Commission noted that the economies which Cities Service claimed would result should the U.S.B.R. construct such lines would depend upon foreign-owned sources of power and foreign-owned transmission lines, and stated that "Clause (A) does not comprehend economies which could be secured without the continued retention of control."

The U.S.B.R. proposals were in no way affected by the ownership of the Cities Service subsidiaries, and the Bureau had stated that it dealt with each of its purchase points as a separate customer, notwithstanding joint ownership of such markets. The conclusion was that the retention of control of Tucson and Deming by the New Mexico system of Cities Service had not been shown relevant to the procurement of the economies which would result from the proposed interconnection, and therefore such benefits could not be considered in passing upon the application of Clause A.

With reference to these same properties, evidence was introduced to show that the filing of consolidated tax returns by the various units involved reduced the taxes payable by the Tucson and Deming companies. The estimated taxes in 1942 for the Tucson company, based upon a single return, amounted to $505,124; based upon a consolidated return the tax would be $385,087, an estimated saving of $120,037 or 24%. The estimated saving for Tucson in 1943 was $126,860. Further, it was claimed that the independent operation of the Tucson and Deming companies would increase salaries and other operating expenses to compensate for the loss of the services of the system service company. This was claimed to amount

to $66,000 for the Tucson company. Other claimed economies brought the total asserted losses of economy and increased costs to $233,472 on an annual basis for the Tucson company. The Commission took the position that savings resulting from the filing of consolidated tax returns should not be given definitive weight, making this observation:

"... The tax 'savings' resulting from consolidated returns depend upon the present state of the tax laws—which are subject to frequent change. Should the excess profits taxes be reduced, the theory of computing excess profits be changed, or the taxes eliminated, the major 'savings' would disappear. We do not regard this evidence as demonstrating a continuing condition of advantage relevant to a continuation of control.

"Further, although we do not doubt the business wisdom of attempting to save taxes we cannot permit tax advantages, *per se*, to distort the administration of the policy of the Act. We are not persuaded that operating properties spread over three states, not shown to be coordinated or otherwise dependent upon the continuation of joint control for efficient, economical operation, may be continued under joint control merely because certain taxes can presently be avoided. The retention of Tucson is not a close legal question which can thus be resolved. Other evidence in the case points strongly to the conclusion that control should be severed. The claim of tax savings does not outweigh that evidence."

The retention of the Deming company as an electric system additional to the New Mexico electric properties was permitted, however. The company was a small one, with net plant of less than $700,000 and gross income of less than $60,000 for the 12-month period ending October 31, 1943.

The extent of the economies claimed in this case was not set forth, although it was stated that "considerable" new expenses might be incurred and "considerable" aid resulting from current affiliations might be lost. The Commission observed that "This is the type of company whose retention together with stronger operating properties we believe to be within the meaning of the Act." 287 The failure of the opinion to give specific figures in this regard makes it difficult, if not impossible, to compare this system with others.

Cities Service Company

Cities Service Company was the top holding company in a vast system of utility and non-utility enterprises, one of its principal subsidiaries being Cities Service Power & Light Company, discussed above. Although Cities had not made any designation of its choice as to a principal system, it was apparent that its properties known as the "Mid-Continent gas system" constituted such a system. The Mid-Continent gas system consisted of three companies operating in Kansas, Missouri, Oklahoma, and Nebraska. The retainability of various other properties as systems additional to the Mid-Continent gas system thus became an issue. Cities contended that the Arkansas Louisiana Gas Company ("Arkansas Gas") properties constituted an additional system. It was pointed out that Arkansas Gas and its affiliated oil company, Arkansas Fuel Oil Company, derived great advantages from the Cities Service oil system, such as the right to sell under the Cities Service trade name, and that the loss of those advantages would deprive Arkansas Gas of the "economies" resulting therefrom. This argument was completely rejected by the Commission in view of the fact that it had concluded that under no circumstances might the oil business of Cities Service

be retained with any of its utility systems.

It was also estimated that savings in the amount of $96,181 annually, effected through the use of the system service company, would be lost in the event of severance. These claimed savings were 1.1% of the 1941 gross operating revenues of Arkansas Gas, 2.7% of the 1941 operating expenses, exclusive of taxes, depreciation, and depletion, and 1.5% of total expenses. These amounts were not considered substantial by the Commission, and in addition the necessity of the disposition of the service company was taken into consideration. Finally, it was contended that the common control of Arkansas Gas with the Mid-Continent gas system would assure Arkansas Gas of access to more of the extensive gas reserves of the latter system. This claim of "substantial economies" was rejected for the reason that Arkansas Gas did not then have access to such reserves and there was insufficient evidence to prove that it would ever have to resort to those reserves. Consequently, the divestment of Arkansas Gas was required because of its failure to meet the requirements of Clause A.

Cities Service also offered evidence to show compliance of the Mid-Continent electric properties and the Rocky Mountain electric properties with Clause A. The Commission made these preliminary comments:

"In considering the standards of Clause (A), it is important first to place those standards in the proper statutory setting when, as here, it is sought to retain together a gas utility system and electric utility systems. Under Clause (A) it must be shown by clear and convincing proof that 'substantial' economies will be lost by severance, and this means 'important' economies. The proof offered must be considered in the light of the facts that

Congress was aware that many holding companies controlled both gas and electric utility companies, and that the retention of additional integrated utility systems is an exception to the general policy of the statute—that holding companies must confine their operations to those of a single integrated public utility system.  

It was claimed by Cities Service that tax savings amounting to $970,000 for Public Service of Colorado and $230,000 for the Mid-Continent electric system for the year 1942 would result from the filing of consolidated tax returns instead of separate returns. The Commission laid emphasis on three principal fallacies of this argument. First, the estimates of tax savings were based upon the assumption that the oil properties were to be retained, and the effect of the required severance of these properties had not been explored. Second, such "economies" bore no relation to operational factors, and the extent of the economies depended not upon the type of property involved or the way in which the properties were operated, but upon the accidents of ownership and the state of tax legislation at a given time. Such savings might exist where utility and totally unrelated nonutility properties were combined. And third, there could be no assurance of a continuation of tax savings, as has been pointed out above.

Cities Service also claimed the existence of substantial administrative and general overhead economies resulting from the use of the various system service companies, which would not be available to the Mid-Continent electric properties and the Rocky Mountain electric properties in the event of severance. It was estimated that such separation would cause the Mid-Continent electric group additional costs in the

amount of $71,000 annually. This was 1.6% of the 1941 electric revenues of such properties. The Commission was of the opinion that the estimated additional costs were considerably overstated; but assuming that they were correct, they did not satisfy the requirements of Clause A. The same considerations prevailed for the Rocky Mountain electric properties.

The Middle West Corporation

The Middle West Corporation requested the Commission to find that its electric properties in Wisconsin, Wisconsin Power & Light Company and Lake Superior District Power Company, could be retained as an additional system to the electric properties of Central Illinois Public Service Company and Kentucky Utilities Company, located in Illinois and Kentucky. The evidence of “economies” adduced in this connection with reference to Clause A consisted of estimated savings accruing from the joint servicing of these companies and the other northern subsidiaries of Middle West by the system service companies. The service companies handled various administrative functions of the utility business, such as insurance, purchasing, advertising, new business, engineering, finance, accounting, rates, taxes, and legal services. The estimated net savings for the various companies amounted to the following percentages of operating revenue for each company: 1% for Kentucky Utilities; 0.35% for Central Illinois; 1.3% for Wisconsin Power; and 1.9% for Lake Superior District. If the service companies were not allowed to serve the southwestern properties of Middle West, these savings would be smaller by a substantial, although indeterminate, amount. Citing the decisions in the North American

291 See map of the Middle West Corporation system, page 65, supra.
Company case,\textsuperscript{292} and the Engineers Public Service Company case,\textsuperscript{293} the Commission held that it could not find that the severance of the electric or gas utility businesses of Wisconsin Power and Lake Superior District from joint control together with any retainable system in the northern sector of Middle West would cause the loss of substantial economies.\textsuperscript{294}

Oklahoma Power & Water Company, a Middle West subsidiary in northern Oklahoma, jointly carried on electric and gas operations. Personnel used in the operation of the gas department was, to some extent, the same as that used in the electric operations. General office facilities were shared, billing and meter reading were jointly done, and the same garage facilities were used by both. It was estimated that the elimination of both the gas and water departments of the company would result in increased expenses to the electric department of $54,578, or 5.1\% of the gross electric revenues of the company for 1939.\textsuperscript{295} The Commission pointed out that it was impossible to determine what portion of this amount would be due to the elimination of the gas properties alone. Furthermore, the evidence was insufficient to show how many integrated gas properties were involved. Consequently, it was held that the requirements of Clause A were not met in this instance.\textsuperscript{296}

\textsuperscript{294} The Middle West Corporation, 15 S.E.C. 309 (1944).
\textsuperscript{295} Note that the approach here is the claim of savings to the retainable electric system, and not to the gas system. In Engineers Public Service Company v. Securities Exchange Commission, 138 F.(2d) 936 (C.A., D.C., 1943), the court indicated its disapproval of such an approach to the problem, although it is not mentioned in this case.
\textsuperscript{296} The Middle West Corporation, 15 S.E.C. 309 (1944).
Philadelphia Company

Philadelphia Company was a sub-holding company in the Standard Gas & Electric Company holding company system, which in turn was a sub-holding company in the Standard Power & Light Company holding company system. Philadelphia Company was engaged, through its subsidiary companies, in supplying electric, gas, transportation, and other services in the City of Pittsburgh and its surrounding area. The date of its organization was 1871, and its operations commenced in 1884, thereby making it one of the oldest utilities in the nation. It was originally engaged in the natural gas business, but in 1899, it acquired electric and street railway interests, and after that date it operated as a holding company. In 1941 the Commission held that the electric utility system of Philadelphia Company was integrated. Seven years later the gas utility system was found to be integrated. Philadelphia Company elected to retain its electric properties as its single or principal system, thereby raising the question of the retainability of the gas utilities as an additional system.

Philadelphia Company introduced evidence to show that increases in annual operating expenses would result upon severance of common control. The claimed increases are shown in the following table:

<table>
<thead>
<tr>
<th></th>
<th>Electric Group</th>
<th>Gas Group</th>
<th>Transportation Group</th>
<th>Total</th>
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<tbody>
<tr>
<td>Payroll</td>
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<td>$84,542</td>
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<tr>
<td>Social Security, annuity, insurance &amp; hospitalization</td>
<td>22,527</td>
<td>21,816</td>
<td>5,255</td>
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<tr>
<td>Space Rental</td>
<td>61,312</td>
<td>40,358</td>
<td>4,919</td>
<td>106,589</td>
</tr>
<tr>
<td>Other Expenses</td>
<td>63,823</td>
<td>71,096</td>
<td>3,377</td>
<td>138,296</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$525,188</strong></td>
<td><strong>$500,328</strong></td>
<td><strong>$98,093</strong></td>
<td><strong>$1,123,609</strong></td>
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</tbody>
</table>

The Commission conceded that these alleged amounts of increased expenses were substantial in the absolute sense, but

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298 Philadelphia Company, Release No. 8242 (June 1, 1948).
was of the opinion that, in the context of Clause A, the "substantiality" of asserted losses of economies could not be measured in absolute terms, but rather should be evaluated in relation to total revenues, expenses, and income. This approach had been adopted by the Commission in earlier decisions, notably in connection with the Virginia Electric & Power Company gas system and the Gulf States Utility Company gas system of Engineers Public Service Company, and the gas system of St. Louis County Gas Company in The North American Company system. In each of these latter cases it had been held that the claimed losses of economies were not adequate to meet the requirements of Clause A. An interesting comparison of Philadelphia Company with these companies is shown by the table on the following page.

This table shows that in each instance Philadelphia's claimed increases in expenses were considerably less than those held not to be substantial in the Engineers and North American cases. The conclusion naturally followed that, even on the basis of Philadelphia's own figures, the Commission could not find that the claimed increased expenses would represent a loss of substantial economies within the meaning of Clause A.

In addition, the Commission found that the claims of Philadelphia in this regard were fallacious. The company's proof had consisted principally of certain studies made by Paul B. Coffman, president of Standard Research Consultants, Inc., and an assistant professor in the Harvard Graduate School of Business Administration. The figures given above were

299 Philadelphia Company, Release No. 8242 (June 1, 1948), mimeo. p. 16.
300 Engineers Public Service Company, 12 S.E.C. 41 (1942).
302 This table appears in Philadelphia Company, Release No. 8242 (June 1, 1948), mimeo. p. 19. Also, see the same table as revised to include General Public Utilities Corporation, infra, p. 186.
303 Philadelphia Company, Release No. 8242 (June 1, 1948).
### Comparison of Losses of Economies Under Clause A

<table>
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<tr>
<th>Company</th>
<th>Estimated Increases in Gas Expenses</th>
<th>Gas Operating Revenue</th>
<th>Percent Increase</th>
<th>Gas Operating Expenses</th>
<th>Percent Increase</th>
<th>Gas Gross Income</th>
<th>Percent Increase</th>
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<td>Philadelphia Company</td>
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<td>Engineers Public Service Co.:</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Virginia— Company figures</td>
<td>71,500</td>
<td>1,054,987</td>
<td>6.78</td>
<td>780,802</td>
<td>9.16</td>
<td>270,370</td>
<td>26.45</td>
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<tr>
<td>Company figures</td>
<td>35,750</td>
<td>1,054,987</td>
<td>3.39</td>
<td>780,802</td>
<td>4.58</td>
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<td>Virginia— Commission figures</td>
<td>42,024</td>
<td>638,711</td>
<td>6.58</td>
<td>481,602</td>
<td>8.73</td>
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<td>25.62</td>
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<tr>
<td>Gulf States—</td>
<td></td>
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<tr>
<td>The North American Co.: Company</td>
<td>182,900</td>
<td>2,748,770</td>
<td>6.65</td>
<td>2,169,027</td>
<td>8.43</td>
<td>582,027</td>
<td>31.42</td>
</tr>
<tr>
<td>Company figures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>After eliminating capital expenses</td>
<td>160,900</td>
<td>2,748,770</td>
<td>5.85</td>
<td>2,169,027</td>
<td>7.42</td>
<td>582,027</td>
<td>27.64</td>
</tr>
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</table>
taken from his presentation. In a scathing denunciation, the Commission held that Coffman lacked the necessary qualifications for a study of this type, that his methods were inadequate, and that he was generally unfamiliar with the work, even after its completion by his staff. In addition, the Commission objected to his failure to study the effect of segregation upon the overall operations of the system, to his assumption that the existing administrative organization should be continued, to his acceptance of the company's method of allocating general administrative expense among the companies of the system without testing the reasonableness or accuracy of such allocations, to his failure to make an independent examination of rental space requirements and costs after segregation, and to his assumption that upon segregation Philadelphia Company would continue as a holding company over the electric group and the real estate company of the system.

Philadelphia Company tried to reinforce Coffman's conclusions by the testimony of two other witnesses, Jay Samuel Hartt, a utilities analyst, and E. C. Stone, a retired officer of the company. Neither of these witnesses made any separate independent investigation, but merely examined Coffman's studies to determine the accuracy of his conclusions. They expressed the opinion that the methods of procedure employed by Coffman in his studies were sound and produced a reasonably assured result. The Commission was of the opinion that the basic defects in Coffman's studies were carried over into the conclusions reached by Hartt and Stone, and consequently rejected their testimony also as proof of the loss of substantial economies on segregation. It was consequently impossible for

304 Id. at mimeo. pp. 27-28.
305 The opinion of the Commission is very detailed and sarcastic at this point. It is an interesting illustration of the difficulties involved in complying with Clause A. Philadelphia Company, Release No. 8242 (June 1, 1948), mimeo pp. 28-39.
the Commission to find that the record would only support a part of the claimed increase in expenses, as was done in the Engineers' case, since here the basic defects in the evidence offered on increased expenses made it impossible to attempt to estimate just what the proper amount would be, if any.

Philadelphia included another item in its claim of loss of substantial economies, the savings resulting from the use of a consolidated tax return by the parent company and its subsidiaries. The Commission rejected this contention once again, remarking that "we cannot permit the incidence of tax savings to disrupt the basic policy of the Act that holding companies generally be limited to a single integrated system."

After the Commission had entered its adverse decision against Philadelphia Company, the latter filed a petition for rehearing and for leave to adduce additional evidence. The Company claimed that the Commission had for the first time presented an extensive series of legal tests and requirements relative to the proof of compliance with the standards of Clause A, and that the company had been prejudiced by reason of its lack of advance notice or knowledge thereof. These assertions were found to be without merit by the Commission. As we have seen, the legal tests and requirements set forth by the Commission in this case were merely the application of established principles laid down in earlier decisions. The Commission was of the opinion that no amount of supplementation of Coffman's testimony would suffice to alter its conclusions. It was noted that no contention was made that any evidence desired to be adduced at this time was unavailable at the time of the hearings or that in the exercise of due diligence it could not have been presented then. The petitioners' claims were interpreted merely as an expression

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173 Engineers Public Service Company, 12 S.E.C. 41, 6o (1942).
of their disagreement with the conclusion reached in the original case.

The decision of the Commission in the Philadelphia Company case was affirmed upon appeal to the U. S. Court of Appeals for the District of Columbia. The principal grounds for the affirmance on the Clause A issue were the recognized rules that such problems were peculiarly fitted for decision by an administrative agency staffed by experts, and that the determinations of such an administrative body should not be disturbed upon appeal unless they appeared to be unreasonable. The court also adopted the "intangible benefits" theory so often employed by the Commission. It was noted that in spite of possible increased costs resulting from segregation, certain compensating advantages should accrue from the concentration of the energies of all personnel on the problems of each of the single systems to which they would be assigned and to which they would owe undivided allegiance. The companies argued that these so-called advantages were based upon unsupported conjecture and speculation. The court held that the Commission was entitled to draw inferences from facts not of record and that the "Commission did not err in assuming (1) that men can give more time, energy, and allegiance to an employer if they give none to his competitor and (2) that, within normal limits, more is better than less." The court further confirmed the Commission's opinion that economies were not "substantial," within the meaning of Clause A, unless their loss would cause a serious economic impairment of the system such as to render it incapable of independent economical operation. In any

510 Id. at pages 724-725. The court noted that perhaps the Commission had set up an erroneously high standard of proof under Clause A in requiring "clear and convincing evidence," but that no prejudice resulted to the companies involved since the Commission did not think their case was proved by any standard, however low.
event, "substantial" economies must be "important" economies, and this requirement was not met in this case.  

*Eastern Utilities Associates*

The Commission found that Eastern Utilities Associates and its subsidiaries included an integrated electric utility system operating in the states of Rhode Island and Massachusetts, covering an area of approximately 500 square miles, with electric operating revenues for the year 1948 amounting to $19,142,000, and that the manufactured gas properties of one of the subsidiaries, serving an area of approximately 100 square miles in Rhode Island, with gross operating revenues for 1948 of $2,234,002, constituted an integrated gas distribution system, within the meaning of the Act. The electric utility operations obviously constituted the principal system of the company, but EUA sought to retain the gas system as an additional system. It was conceded by the Commission that the requirements of Clauses B and C were met, and EUA introduced considerable evidence to demonstrate the retainability of the gas system under Clause A. In the first place it was contended that the separation of the electric and gas businesses would result in the loss of substantial economies because of certain construction expenditures which would be required if the properties were separated. In discussing the various items presented by EUA, the Commission first pointed out that there was considerable question as to the weight to be given to the necessity for capital expenditures as compared with increases in operating expenses under Clause A.  

The major item of construction alleged to be required upon separation was a new steam plant, estimated to cost
$600,000. The Commission was of the opinion (a) that after separation the electric company could easily supply excess steam to the independent gas company on a contract basis; and (b) that a substantial part of the estimated cost of the new steam plant was attributable to an increased capacity to take care of future needs and therefore would not be a loss resulting from the separation of the gas and electric system. EUA also contended that separation would require the construction of a new wharf and the purchase of new coal handling equipment, estimated to cost $175,000. The Commission found that neither the wharf nor the coal handling equipment had been used by the electric department to any substantial degree since 1923 and could see no reason why these facilities should not be divested with the gas properties. It was recognized that some small expenditures might be required for new furniture and similar items upon separation, but the Commission was of the opinion that the estimates submitted in this regard were excessive but in any event not large enough to meet the test of Clause A.

EUA also claimed that substantial increases in operating expenses would result upon separation of the gas and electric systems. The principal items involved were the increases in payroll expenses required by the addition to the full time gas employees of Blackstone Valley Gas & Electric Company, the EUA subsidiary operating the gas system, of the number of employees estimated to be necessary to perform the services currently rendered by employees serving both the gas and electric departments. The staff of the Public Utilities Division prepared a statistical comparison of the current and projected expenses of Blackstone with those of all manufactured gas companies in Massachusetts which were solely gas utilities and which were comparable in size with Blackstone’s gas department. Condensed, these figures showed the following:
RETENTION OF ADDITIONAL SYSTEMS

<table>
<thead>
<tr>
<th>No. of Customers</th>
<th>Commercial, New Business and General Expense, per Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 independent gas companies, average</td>
<td>$8.86</td>
</tr>
<tr>
<td>Blackstone</td>
<td>9.00</td>
</tr>
<tr>
<td>Blackstone adjusted</td>
<td>13.17</td>
</tr>
</tbody>
</table>

The adjusted figures for Blackstone included all of the increased operating expenses estimated by EUA except for interest, depreciation, and taxes on the projected new facilities. The adjusted estimates for Blackstone upon separation were 30% higher than the expenses of the highest comparable company, and over 50% higher than the average. The Commission recognized that the expenses of a given gas company did not of necessity have to correspond with those of any other, but was of the opinion that the burden was upon EUA in such a situation to adduce proof of unusual circumstances to justify this variance in expenses, commenting that no such proof had been submitted. The conclusion of the Commission was that "the record does not support the Respondents' (EUA's) contention that the combined operation of the electric and gas properties has resulted and will result in such efficiency and savings to counterbalance the economy of operation generally resulting from the normal and true competition existing between these two basically competing sources of energy. In fact, the record suggests the opposite conclusion." Consequently, retention of the gas system was denied under Clause A.

Lone Star Gas Corporation

The large group of natural gas properties owned by Lone Star Gas Corporation and located in northern and north central Texas and a small adjoining portion of Oklahoma was held to constitute a single integrated gas utility system, but the outlying gas properties at El Paso and Galveston were

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excluded from the integrated area. Lone Star contended, however, that these latter properties were retainable as additional systems. With reference to substantial economies, Lone Star estimated that it would cost independent operators an additional $18,733 for the El Paso properties and $17,957 for the Galveston properties per year in the event of separation, being salaries of management and supervisory personnel needed to replace the holding company management and control. These figures amounted to 2.2% and 4.1%, respectively, of total 1941 operating expenses of $844,108 for the El Paso division and $432,867 for the Galveston division. The Public Utilities Division submitted studies which indicated that there would be no increase in such charges in the event of separation, and the City of El Paso introduced evidence tending to show that it would cost less to operate the El Paso properties separately than as a part of the Lone Star system. Relying upon the rule laid down in The North American Company case, to the effect that "substantial economies" in Clause A meant economies of an important nature rather than purely nominal or minor economies, the Commission held that the requirements of Clause A were not met by the El Paso and Galveston properties. This conclusion would seem to be justified even if the estimates submitted by Lone Star were deemed to be accurate.

Columbia Gas & Electric Corporation

The gas utility operations of the Charleston, Pittsburgh, and Columbus properties of Columbia Gas & Electric Corporation were each held to constitute a single integrated gas utility system. The parent company sought to retain these three systems as one principal system and two additional

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316 Lone Star Gas Corporation, 12 S.E.C. 286 (1942).
systems, the principal system not being specified. The utilities in the Charleston and Pittsburgh groups were operated as coordinated systems and derived their natural gas from common sources of supply. These facilities were connected with those of the Columbus group, and there existed a close operating relationship among the three systems. Drilling, production, storage, and transmission operations were coordinated with the marketing requirements of the three systems in order to obtain a maximum use and conservation of the available gas supply, particularly significant because of the depletion of natural gas in the Appalachian area. Without discussion of any dollar amount of estimated economies, the Commission held that these three systems were jointly retainable. However, retention of the Cincinnati and Dayton groups of properties, both electric and gas, was denied under the ABC Clauses for lack of evidence. The Commission was of the opinion that no showing of compliance could be made because of the divergent character of the respective properties, the lack of operating relationships between the properties, and the financial independence of these two systems.

Peoples Light & Power Company

The principal subsidiary of Peoples Light & Power Company was Texas Public Service Company, which was mainly a natural gas utility serving the cities of Austin, Galveston, and Port Arthur, Texas. The acquisition of the Galveston properties by Texas Public Service Company was authorized under Section 10(c) of the Act in Peoples Light & Power Company, 15 S.E.C. 120 (1943), and the acquisition of the Port Arthur properties was approved in Peoples Light & Power Company, 14 S.E.C. 555 (1943). The basis of these decisions was not that the three groups of properties in Austin, Galveston, and Port Arthur constituted an integrated gas utility system, but that "certain operating economies" would result and that upon the proposed dissolution of Peoples Light & Power Company, the Texas Public Service Company would be a local operating company confined to the State of Texas and consequently not subject to the jurisdiction of the Commission. This is a patent evasion of the issue by the Commission.

\[218\] Ibid.

\[219\] The acquisition of the Galveston properties by Texas Public Service Company was authorized under Section 10(c) of the Act in Peoples Light & Power Company, 15 S.E.C. 120 (1943), and the acquisition of the Port Arthur properties was approved in Peoples Light & Power Company, 14 S.E.C. 555 (1943). The basis of these decisions was not that the three groups of properties in Austin, Galveston, and Port Arthur constituted an integrated gas utility system, but that "certain operating economies" would result and that upon the proposed dissolution of Peoples Light & Power Company, the Texas Public Service Company would be a local operating company confined to the State of Texas and consequently not subject to the jurisdiction of the Commission. This is a patent evasion of the issue by the Commission.
Company also operated an electric utility system at the town of La Grange, Texas, located between Austin and Galveston, and sought to retain it as an additional system. The company contended that it would cost considerably more to operate the La Grange properties independently than under the ownership of the Company, although it had made no cost study of this matter. The president of Peoples Light & Power Company testified that independent operation of the La Grange properties would result in an increase in expenses of between $6,000 and $8,000 per year, consisting of $2,500 for an independent manager, $2,000 for an additional employee to handle billing done mechanically by the main office of Texas Public Service Company, and $1,000 for attorney's fees, with the balance unexplained.

Practically all the power requirements of La Grange were purchased from a non-affiliated source and only a small generating unit was maintained for stand-by purposes. The feeling of the Commission in this connection was that the La Grange properties could well be operated in conjunction with this non-affiliated source upon separation, thereby securing the same benefits claimed by Texas Public Service Company. Also, the lack of generating problems made the problems of management much less extensive than if substantial production and supply problems were also involved. Further, the record showed that the La Grange electric properties were separately staffed and there was no evidence that the current local manager could not continue to provide the necessary managerial services upon severance. Finally, the Commission doubted the necessity of the increased expense for the billing employee, since such service might well be secured from an outside source or even from the main office of the Peoples' system at Austin. The conclusion of the Commission relative to the retention of the La Grange Electric properties as an additional system was stated as follows:
"It is clear that the statutory requirement of 'substantial economies,' which is contained in an exception to the general policy that a holding company is to be limited in its operation to a single integrated public utility system, must be strictly construed against those claiming its benefits. [Citing Engineers Public Service Company, 12 S.E.C. 41 (1942)] Having the policy of the Act in mind, we have carefully considered the evidence and are satisfied that it will not sustain a finding that 'substantial economies' within the meaning of Clause (A) would be lost by the severance of the La Grange electric properties from the control of Peoples. This conclusion renders unnecessary any findings under Clause (C) and requires that we order divestiture of the La Grange electric properties."

American Gas & Electric Company

The three divisions of the American Gas & Electric Company system have been described above. It was contended by American Gas & Electric Company that its northeast Pennsylvania and south Jersey systems were retainable as additional systems to the central system. In connection with Clause A, it was alleged that joint operation of these three systems resulted in administrative, accounting, financial, engineering, purchasing, tax, and other economies. It was claimed that additional personnel would be required for each of these systems upon separation, in the form of a president, vice-president, secretary, treasurer, controller, chief auditor, counsel, statistician, purchasing agent, two engineers, and additional clerical, stenographic, and other office employees. The Commission felt that the estimated additional number of personnel required was excessive; that the asserted expenses relating to such personnel were too high; and that
the company overlooked the offsetting cost of maintaining the holding company over these two subsidiaries, which the Commission considered to be substantial, although difficult to isolate. And finally, the Commission believed that the credit and investment standings of the Pennsylvania and New Jersey properties were such that there would be no loss of economies in the raising of capital if they should be severed from the control of American Gas & Electric Company. Accordingly, the Commission held that the requirements of Clause A were not met in this situation.  

General Public Utilities Corporation

General Public Utilities Corporation was organized in 1944 as the successor to Associated Gas & Electric Company and heir to the Hopson utility empire. The affairs of Associated Gas & Electric Company and its subsidiaries had been administered by trustees since 1940, when petitions for reorganization under Chapter X of the Bankruptcy Act were filed. The trustees worked closely with the Commission and a number of Commission employees were engaged by the trustees to assist in the reorganization of the company and its many subsidiaries. After 1940, therefore, the company demonstrated a spirit of cooperation with the Commission quite generally lacking in the other public utility holding companies. This fact must be kept in mind when studying the Associated Gas & Electric Company and General Public Utilities Corporation cases.

New York State Electric & Gas Corporation, a subsidiary of General Public Utilities Corporation, was engaged in the electric and gas utility businesses in the eastern, central, and western parts of the state of New York, an area of approxi-

mately 16,700 square miles. For the calendar year 1948, its electric operating revenues totaled $38,167,264, and its gas operating revenues were $6,300,168. Before the formation of General Public Utilities Corporation, the trustees of AG&E and its subsidiaries had indicated that they believed the empire could be divided into four separate integrated holding company systems.323 One of these systems was located in New York and northern Pennsylvania, and included New York State Electric & Gas Corporation, Rochester Gas & Electric Corporation, and Northern Pennsylvania Power Company ("North Penn") as its principal components. At a later date, however, General Public Utilities decided to divest itself of New York State separately from its neighboring companies.324 Inasmuch as New York State and North Penn had been under common control since 1926, and since the former had been supplying the power requirements of the latter since that time, the Commission found itself in the novel position of questioning a separation of utility companies. The Commission was not concerned with the separation of New York State from Rochester, since both of these companies were of sufficient size and scope of operations to be in a position to operate economically and efficiently as independent entities and there were no significant operating relationships between the two.325

In addition to furnishing power to North Penn, New York State rendered other services to that company, including meter supervision, billing of customers' accounts and maintenance and repair of transmission lines. North Penn also employed, on a part-time basis, the power sales promotion engineer and

324 The operations of New York State Electric & Gas Corporation were conducted in southern and northeastern New York.
the safety director of New York State. The Commission felt that New York State and North Penn, under these conditions, could well be deemed an integrated system under the provisions of Section II (b) (i), and was reluctant to permit their separation from each other. However, the Commission concluded that it would not overrule the judgment of the management in this regard.\textsuperscript{326} Testimony had been adduced to show that North Penn could be converted into an independent company and that a continuing supply of power would be available to it, although it could hardly be called "clear and convincing." The opinion expressly reserved the question as to whether North Penn might be retained with the other properties of General Public Utilities Corporation in Pennsylvania and New Jersey. This decision appears to indicate that Clause A cannot be applied conversely, i.e., that if an additional system cannot be operated as an independent system without the loss of substantial economies, it may still be segregated if its companion system so desires. This interpretation must be considered in the light of the circumstances surrounding the integration problems of General Public Utilities Corporation, however.

In a subsequent proceeding the fate of North Penn was determined. GPU sought to retain North Penn in addition to its integrated Penn-Jersey System. In order to prove that the loss of economies to North Penn would be substantial if it were separated from the principal system, GPU presented a severance study. The results of this study are shown on the following page in comparison with similar data for other systems.\textsuperscript{327} This table indicates that claims of larger losses in

\textsuperscript{326} Ibid.

\textsuperscript{327} This table is set forth in General Public Utilities Corporation, Release No. 10982 (December 28, 1951), at mimeo. p. 26. The difference between the figures in this table and those in the table set forth at page 171, supra, result from the fact that federal income taxes were deleted from the figures in this table.
prior cases had been rejected as insufficient to satisfy the requirements of Clause A, and consequently GPU’s claims were also rejected.

GPU also asserted that North Penn would incur increased costs in obtaining equity capital upon severance. The Commission discarded this argument for several reasons. First, it felt that within a relatively short time the common stock of North Penn, if independent, would become sufficiently seasoned. Secondly, the Commission did not agree that the 15% differential asserted by GPU was supported by the evidence. And thirdly, it appeared that during the preceding 10 years the common stock financing of North Penn had only averaged $73,000 per year, and the Commission noted that 15% of this amount, $10,950, was not substantial.

Further, the Commission concluded that North Penn was not incapable of independent economic operation. As of December 31, 1950, its fixed property amounted to $9,671,000 and for the calendar year 1950 its gross operating revenues were $4,499,000. Its gross income was $674,000 and its net income was $541,000. It was also observed that in the proceedings involving New York State Electric & Gas Corporation the question of the ability of North Penn to operate independently was considered at length, and it was at the insistence of GPU that the two properties were separated from each other, in spite of their long history of joint operation. It was therefore held that North Penn did not satisfy the requirements of Clause A as a system additional to Penn-Jersey.328

GPU also sought to retain the integrated gas utility system of Jersey Central Power & Light Company (“Jersey Central”), along with the integrated electric utility system of Penn-Jersey. A severance study had also been made in connec-

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<tbody>
<tr>
<td>Operating revenues</td>
<td>$638,711 (6.58%)</td>
<td>$1,057,000 (3.38%)</td>
<td>$2,748,770 (5.85%)</td>
<td>$16,656,560 (3.00%)</td>
<td>$4,027,081 (1.44%)</td>
</tr>
<tr>
<td>Operating revenue deductions (excluding Federal income taxes)</td>
<td>444,006 (9.46%)</td>
<td>735,294 (4.86%)</td>
<td>2,009,757 (8.01%)</td>
<td>13,197,846 (3.79%)</td>
<td>3,046,479 (1.90%)</td>
</tr>
<tr>
<td>Gross income (before deducting Federal income taxes)</td>
<td>201,594 (20.85%)</td>
<td>317,890 (11.25%)</td>
<td>742,027 (21.68%)</td>
<td>3,565,357 (14.03%)</td>
<td>981,980 (5.90%)</td>
</tr>
<tr>
<td>Net income (before deducting Federal income taxes)</td>
<td>166,402 (25.25%)</td>
<td>168,412 (21.23%)</td>
<td>661,110 (24.34%)</td>
<td>N.A.</td>
<td>855,101 (6.77%)</td>
</tr>
<tr>
<td>Estimated loss of economies claimed by companies</td>
<td>$42,024</td>
<td>$35,750</td>
<td>$160,900</td>
<td>$500,328</td>
<td>$57,890</td>
</tr>
</tbody>
</table>

N.A.—Denotes not available.

* Engineers Public Service Company, 12 SEC 41 (1942) and exhibits filed in that proceeding.

b The North American Company, 18 SEC 611 (1945) and exhibits filed in that proceeding.

tion with these properties, but it, too, was rejected by the Commission as insufficient to prove compliance with Clause A. The study contemplated the distribution of manufactured gas by Jersey Central, whereas the system was being converted to natural gas which, it was contemplated, would substantially improve its earning capacity. Further, the estimated losses of economies shown by the study were comparatively less than those rejected in previous cases, provided certain adjustments were made to the income figures of the gas system so as to reflect a fair return.

The Commission held that the requirements of Clause A had not been met here.\textsuperscript{329} It refused to consider estimates indicating a loss of economies to the separated electric system as compared with the electric department of the combination company, on the ground that the losses in economies which could be considered under Clause A were limited to those directly related to the additional system sought to be retained and not to the principal system.\textsuperscript{330}

*Summary of the Requirements of Clause A*

It is obvious from the foregoing that the requirements of Clause A have been rigorously enforced by the Commission, and only in rare instances has compliance been decreed. The rules relating to the retention of additional systems have been viewed as an exception to a clearly expressed general policy, and as such have been strictly construed. The “loss of substantial economies” set forth in Clause A must be proved by “clear and convincing evidence,” which appears to require more than proof by a preponderance of the evidence. Although this added burden of proof is probably not justifiable, it has been upheld by the courts.

The standard of “substantial economies” is related to the

\textsuperscript{329}Ibid.

\textsuperscript{330}Citing Philadelphia Company, Release No. 8242 (June 1, 1948).
economies which redound to the benefit of the integrated systems involved rather than to the holding company standing over such systems, so that the gain or loss to the holding company upon separation is not to be taken into consideration. There is always some cost required to maintain the top holding company, and upon its elimination there will be some concomitant increase in cost to the operating properties. The Commission feels that such cost must always be deducted from any estimate of loss of economies upon separation.

The basic rule laid down by the Commission for the interpretation of Clause A is that the word "substantial" means "important," and not merely something more than nominal. This principle is also founded upon the consideration that Congress intended to eliminate all but the most closely knit systems. The corollary of this is that economies are not substantial, within the meaning of Clause A, unless their loss would cause a serious economic impairment of the system involved, so as to render it incapable of independent economical operation. This interpretation of Clause A virtually removes all possibility of compliance therewith and seems to be unduly strict in view of the fact that Congress apparently recognized that there were some exceptions worthy of recognition.

The method of proof in the cases concerned with compliance with Clause A has generally been the production of evidence showing increased expenses resulting to the systems upon separation. The Commission has noted that the law makes no reference to increased expenses, but speaks of loss of economies, and has never conceded that the two words are equivalent for the purposes of the Act. Perhaps the proper view is to consider a substantial saving in operational expenses as one element of substantial economies. The particular expenses claimed by the various systems to be increased by a separation of properties have been quite extensive. They
have included increases in the following departments and functions: accounting, auditing, budgets, taxes, meter reading, billing, collection, administrative, executive, clerical, stenographic, sales promotion, advertising, purchasing, financing, insurance, legal, rates, engineering, safety, maintenance, and repair. The Commission normally compares the total amount of estimated increase in expenses with the operating revenue, operating expense, and gross income of the system involved for the most recent year available to determine its substantiability. The highest percentages in each instance resulting from these comparisons have been 6.58%, 9.46%, and 20.85%, respectively, all have been held to be inadequate for compliance with Clause A. Also, the Commission consistently discounts these estimates as being exaggerated, both with regard to the number of additional personnel required and the cost of procuring such personnel. Although it is advisable to consider all three items, revenue, expense, and gross income, the second one is perhaps the best basis for testing the claimed expenses. Certainly it would seem that increased expenses amounting to 10% of operating expenses should be deemed substantial, and in appropriate cases something less than that amount might suffice.

Claims of increased expenses upon separation, other than for additional personnel, have been based upon the joint use of facilities by the systems to be divided, usually a gas and an electric system serving the same general area. These facilities have included automotive equipment, meter shops, central office, steam plant, and coal handling equipment. None of such claims have been held to be substantial. Numerous companies have presented evidence of large savings resulting from the filing of consolidated income tax returns by the systems involved. The Commission refused to take this evidence into consideration for two basic reasons. First, tax savings have no relation to the operational factors which the
Act contemplates, and such savings depend upon the accidents of ownership and the state of tax legislation at a given time, not upon the type of properties involved or the way in which they are operated. And secondly, the tax laws are subject to frequent change and the excess profits tax which then prevailed might be eliminated. The wisdom of this latter proposition needs no elaboration.

A majority of the cases under Clause A have been concerned with the possible retention of an integrated gas utility system in addition to a principal electric utility system. In this situation the Commission has adopted its theory of intangible benefits. This theory is that the separation of the electric and gas properties will result in certain benefits to both, particularly the gas system, which, although intangible and incapable of accurate measurement, must be taken into consideration as a factor offsetting claimed increases of expenses or other losses of economies upon separation. It was the observation of the Commission that in numerous instances the gas business of a combined electric and gas company, being the one which produced the smaller amount of revenue and profits, was suppressed or neglected by the company, to its substantial detriment. The two lines of business are competitive to a large extent and the natural tendency of joint control is to favor the most profitable function. In an effort to measure this intangible factor the staff of the Public Utilities Division compiled figures comparing the operations of combination gas companies and independent gas companies. The comparison was favorable to the independent operations, although the margin of difference was small. However, there has been considerable evidence to prove the abuse of gas properties in this situation, and the Commission is justified in assuming in a proper case that separation will result beneficially to the gas system. The courts have sustained the intangible benefits theory and it now appears to be a fixed rule of interpretation under Clause A.
Only in very exceptional circumstances has the Commission granted its approval under Clause A of the retention of an additional system. In The North American Company, Engineers Public Service Company, and Cities Service Power & Light Company cases, the Commission permitted retention of several extremely small orphan systems which had been held to be individually integrated on somewhat tenuous grounds. In the Columbia Gas & Electric Corporation case, three substantial gas properties were held to constitute a principal system and two retainable additional systems under Clause A, but the proof indicated that the three properties more closely resembled a single integrated gas utility system. The retention of a gas utility system in addition to an electric utility system has never been permitted to date, mainly by virtue of the strict interpretation of Clause A by the Commission.

B. GEOGRAPHICAL PROXIMITY

The second of the cumulative requirements imposed by the Act for the retention of utility systems in addition to the principal system provides that all of such additional systems must be located in one State, or in adjoining States, or in a contiguous foreign country.\textsuperscript{331} This brief requirement of the Act has probably been more disastrous to the sprawling utility empires than any other provision of the law. It was early referred to as "Big B," and it has amply justified the title. At the outset the Commission seized upon the requirements of this provision to pare large segments of existing utility combinations before the more difficult and abstruse standards of the Act were applied. Although at first glance the meaning of Clause B is clear, there were complications which had to be resolved by the Commission. The Commission acted quickly.

\textsuperscript{331} Section 11(b)(1)(B), referred to herein as "Clause B."
in this regard, and, although it might be accused of a bit of administrative legislation, the Commission enunciated an interpretation which was sustained by the courts. This interpretation has been consistently followed throughout the history of the Act and has been long considered as part and parcel of the law itself. Consequently, the study of Clause B must begin with such interpretation.

In connection with the integration proceedings involving The United Gas Improvement Company, the Public Utilities Division of the Commission prepared a memorandum with respect to the meaning of Section 11(b)(1)(B) of the Act, this document being entitled "Memorandum of Public Utilities Division of Securities & Exchange Commission to Commission, January 8, 1941. Re: Interpretation of Section 11(b)(1)(B)—the Term 'Adjoining States.'"332 The memorandum begins with several basic postulates. In the first place it points out that Section 11(b)(1), Section 2(a)(29) and Section 1(b)(4) of the Act indicate the Congressional purpose of confining the operations of utility systems to a limited area or region. Secondly, all of the integration provisions of the Act taken together indicate that Congress intended that each holding company system should be reduced to a single integrated system, and only such additional systems as might comprise small operating units in close geographic proximity to the principal system, if such operating units could not economically stand alone, and if the whole aggregation would not create a holding corporation so large as to impair the advantages of localized management or the effectiveness of regulation. Thirdly, Clause B was designed to eliminate a larger portion of the controversial systems by simple reference to a map. Clauses A and C were so worded that proof of

332 Cf., The United Gas Improvement Company, Release No. 2500 (January 18, 1941). The Memorandum of January 8, 1941, was not given an official release number. See Par. 75,123 of C.C.H. Securities Law Reporter.
retainability thereunder might require extensive hearings, and there was danger that the range of testimony and argument in each case might be almost as extensive as the legislative hearings, which were voluminous. The repetition of such extensive hearings for each holding company system would result in colossal expenditures and interminable delays, thereby making enforcement of the Act virtually impossible. Clause B therefore affords the means of substantially narrowing the area in which proof is necessary as to how many other integrated systems are retainable by a particular holding company. However, various holding companies in the early stages of the integration proceedings were contending for an interpretation of Clause B which made it ineffectual as a means of limiting the factual issues in the hearings. The Public Utility Division was accordingly confronted with conflicting theories, set forth in the succeeding paragraph, which it proceeded to resolve.

The interpretation placed upon Clause B by the Public Utilities Division was that a company might, if it met the standards of Clauses A and C, retain integrated systems in addition to the principal system, if such additional systems were located in one or more states adjoining the states in which the principal system was located. Various holding company counsel advanced an interpretation of Clause B which would permit the retention of additional systems located in any one state of the United States, no matter how remote from the principal system in question, or in states adjoining each other but likewise remote. These two conflicting interpretations were labeled the single-area interpretation and the two-area interpretation, respectively.

The Public Utilities Division conceded that the two-area interpretation was plausible in the light of the literal wording of Clause B. However, such theory was rejected by the Division for three basis reasons, namely, (1) it was believed to be
more logical to interpret the word "adjoining" in Clause B as referring to the state or states where the "single" or principal system was located, than as referring to a separate and unrelated area; (2) the two-area interpretation was inconsistent with the language of Clause C and Section 2(a)(29); and (3) the two-area interpretation was negatived by the legislative history of the Act.

(1) The Division pointed out a number of illogical results of the use of the two-area theory. For example, if additional systems were located in the same state as the principal system, or in any adjoining state or states, and also in a remote state and adjoining areas, then the result would be the same under either theory, unless the additional systems in the same state as the principal system were eliminated, and the two-area interpretation would therefore not be consistently a two-area interpretation. Further, under the two-area theory, a holding company might be limited to a single system in the area where its principal system was located and where its management was concentrated, but could retain any number of systems in some remote and unrelated area, if such area consisted of one state or a group of states adjoining each other. And finally, the words "or in a contiguous foreign country" used in Clause B could only be used with reference to the principal system, or with reference to the states where the principal system was located. For example, if the principal system should be located in a state adjoining Canada, while additional systems were situated next to the Mexican border in Mexico, and in Canada, the Division was of the opinion that it would be manifestly absurd to conclude that such holding company system could retain an additional system in Mexico and could not retain an additional system in Canada contiguous to the principal system.

(2) The definition of an integrated public utility system set forth in Section 2(a)(29) of the Act provides that such a
system must be "confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation." Clause C of Section 11(b)(1) uses almost the same language, providing that "the continued combination of such systems" in any one holding company system must be "not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation or the effectiveness of regulation." The Division pointed out that the italicized words were in the singular, and plainly referred in both provisions to a single area or region, rather than to two areas or regions. Also, it was noted that the parenthetical clauses quoted above appear in the Act not as themselves imposing a limitation, but as a reference to a limitation elsewhere imposed. In Section 2(a)(29) the reference is to the limitation imposed in the preceding phrase, "confined in its operations to a single area or region," whereas there is no such antecedent phrase in Clause C. The conclusion was that the antecedent limitation in this case is to be found in Clause B. Furthermore, the Division objected to the two-area interpretation because the qualification "not so large... as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation," makes no sense unless applied to the entire holding company system, and clearly connotes confinement to a single area or region. The provisions of Section 1(b) of the Act describing the evils intended to be corrected, it was also noted, include the following:

"... it is hereby declared that the national public interest, the interest of investors in the securities of holding companies or their subsidiary companies and affiliates, and the interest of consumers of electric energy and
natural and manufactured gas, are or may be adversely affected . . . when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties."

(3) Because of the textual difficulty in the interpretation of Clause B the Public Utilities Division was of the opinion that reference to the legislative history of the Act was appropriate. The Conference Report on the compromise bill, known as the "Barkley Compromise," containing Clause B in the same form in which it was finally enacted, described the purpose of the provisions for additional systems, as follows:

"The substitute, therefore, makes provision to meet the situation where a holding company can show a real economic need on the part of additional integrated systems for permitting the holding company to keep these additional systems under localized management with a principal integrated system. Under such circumstances the Commission is directed to permit the holding company to retain control of such additional systems, even though not physically integrated with the principal system, provided all such integrated systems are located in the same State or States, or in adjoining States or a contiguous foreign country." (Italics added)\[33\]

It was noted that if the antecedent of the italicized phrase was the phrase "such additional systems," then the ambiguity present in the Act was reasserted. It was argued that the more natural construction was that the italicized phrase referred

\[33\] Memorandum of January 8, 1941, from the Public Utilities Division to the Commission, Re: Interpretation of section 11(b)(1)(B)—the term "adjoining States," page 16.
to both the principal and the additional systems.

After the approval of the Conference Report by the Senate, but on the same day, Senator Wheeler, the principal exponent of the Act in Congress, made a brief statement explaining the differences between the Senate and House bills. The following excerpts from his statement shed some light upon the question:

"... After considerable discussion the Senate conferees concluded that the furthest concession they 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 in the same region as the principal system and were so small that they were incapable of independent economical operation and if the combination of these small systems under one holding company would not create a corporation so large as to impair the advantages of localized management and the effectiveness of regulation...."

It was shown by these and other remarks of Senator Wheeler that he deemed the Act to require that all of the systems retainable by a holding company be located in close geographic proximity to each other, thereby bolstering the interpretation placed upon Clause B by the Public Utilities Division.

Concurrently with the publication of the "single area" interpretation of Clause B by the Public Utilities Division, Chairman Jerome N. Frank of the Commission issued a statement to the public relative thereto. He noted that the report was significant because it indicated for the first time with respect to a specific company (The United Gas Improvement Company) what the Commission tentatively believed was

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79 CONG. RECORD 14479 (1935).
CCH Securities Law Reporter, par. 75,124.
meant by the geographical limitations of the Act. The Commission tentatively adopted the view that a holding company could not control several different integrated systems in several parts of the country. He pointed out that this position on the part of the Commission would greatly shorten the integration proceedings by eliminating at the outset consideration of countless remote properties.

The specific utility in question, as noted above, was The United Gas Improvement Company. In applying the standards of Clause B to the properties of that company in a preliminary and tentative decision, the Commission adopted the "single area" theory advocated by the Public Utilities Division. It was accordingly tentatively concluded that a holding company might continue to control an integrated public utility system or systems additional to the principal system if all such additional systems were located in the same state or states in which the principal system was located, or in states adjoining thereto. Since the principal system of The United Gas Improvement Company appeared to be located in southeastern Pennsylvania and northern Maryland and Delaware, the utility assets of the company in Arizona, New Hampshire, Tennessee, Kansas, and Connecticut could not be retained.

The interpretation of Clause B was crystallized in an early decision relating to Engineers Public Service Company. The company urged the "two-area" interpretation of Clause B, while the staff of the Public Utilities Division relied upon the "single area" principle discussed above. The Commission inquired into the intent of Congress in its effort to resolve the patent ambiguity on the face of Clause B. The conclusion, again, was that the question of policy with respect to the

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336 The United Gas Improvement Company, Release No. 2500 (January 18, 1941).
337 See, also, The United Gas Improvement Company, 9 S.E.C. 52 (1941).
338 Engineers Public Service Company, 9 S.E.C. 764 (1941). See map of Engineers Public Service Company system at page 42, supra.
The geographical limitation of holding company system operations had been finally determined by Congress itself and was not open for re-examination or re-determination by the Commission, and that the policy of Congress was to limit the additional systems to a state or states adjoining the state in which the principal system was located, or in a foreign country contiguous thereto.\(^{339}\) The inconsistent results of the application of the "two area" theory were demonstrated in this case. Under such interpretation, if the Virginia-North Carolina system was the principal system, a vast empire in the west might be retained because the western properties lay in adjoining states, but the other systems close to the Virginia-North Carolina system could not be retained in such case. The Commission was of the opinion that such an interpretation might be within the letter of the statute and yet not within the statute because not within its spirit nor within the intention of its makers. The absurd results which followed from such an interpretation made it unreasonable to believe that Congress so intended the law.\(^{340}\)

The company advanced another possible meaning for the words of Clause B consistent with the two-area theory. It was argued that if "adjoining" must be related to some antecedent contained in Section 11(b)(1), then that antecedent must be the "one state" referred to in Clause B, without, however, in any way relating such "one state" to the location of the principal system. On such basis all the additional systems, whether near to or distant from the principal system, would have to be located in one state or in states adjoining such state. The Commission reduced this contention to an absurdity by assuming the location of a principal system in

\(^{339}\) Engineers Public Service Company, 9 S.E.C. 764 (1941).

Virginia, with other systems in Maryland and North Carolina, in which case one of the latter two could not be retained since they do not adjoin each other. On the other hand, the Virginia system could have an additional system in California, Oregon, Nevada, and Arizona under this interpretation. Under the one-area interpretation of Clause B no such absurd results would follow. The Commission stated its position as follows:

"We concur in the suggested conclusion that 'a geographical limitation in furtherance of the integration of holding company systems that would allow the retention of systems in two distant areas, and yet prohibit the retention of two additional systems adjoining the principal system, cannot be found to be based on any rational purpose or policy consistent within itself.' An interpretation that would have that result is, we think, entirely contrary to the legislative concept of limiting holding company control to related operating properties in a restricted territory, and inconsistent with the purpose of fostering effective regulation and localized management as contemplated by the Act."

Consequently, whether the Virginia-North Carolina system of Engineers Public Service Company or its Louisiana-Texas system was chosen as its principal system, the Commission's interpretation of Clause B precluded the retention of its properties located in Washington, the western states, and Florida. If the Virginia-North Carolina system was selected as the principal system, then the Louisiana-Texas and Texas-New Mexico properties would have to be disposed of under Clause B. If the Louisiana-Texas system was the principal system, then the properties in Virginia, North Carolina, and Georgia

\[341\] Engineers Public Service Company, 9 S.E.C. 764, 786-787 (1941). The inner quote is from the brief of the Public Utilities Division relative to the interpretation of Clause B.
would have to be eliminated under Clause B.

Upon the appeal of this case, the company contended that the incongruities that might result from the association of systems far removed from one another under the two-area interpretation would be obviated by applying Clauses A and C, which preclude the retention of additional systems unless the Commission finds that they are needed to effectuate substantial economies and are not so large as to impair the advantages of localized management, efficient operation or the effectiveness of regulation. The United States Court of Appeals for the District of Columbia reviewed the legislative history of the Act relative to Clause B and concluded that the interpretation of the Commission was correct, admitting that the matter was not free from doubt. The court was also persuaded by the irrational consequences that would flow from the two-area interpretation of Clause B. The company pointed out that the one-area theory would lead to certain inequalities in some cases, since it restricts the permissible area covered by a principal system and additional systems more severely when the principal system is located in a state, such as Maine, which has few adjoining states, than it does in a state like Missouri to which eight states are contiguous. The Court answered this argument with the proposition that in the Missouri situation all the additional systems sought to be retained, which might be very numerous, would be retainable in actual practice only if it could be shown to the satisfaction of the Commission that they complied with the standards of Clauses A and B. The Court probably meant Clauses A and C, rather than A and B. If so, the Court tacitly adopted the argument of the company relative to the solution for the incongruities possible under the two-area interpretation of Clause B.

The application of Clause B to The North American Company presented an interesting problem. The electric operations of the Union group, considered by the Commission to be the principal system of the company, were carried on in Missouri, Illinois, and Iowa.\textsuperscript{343} The Commission held that Clause B barred the retention of the Ohio, District of Columbia, and California utility operations as additional systems. In spite of their physical separation by Lake Michigan, Michigan and Illinois were held to be adjoining states.\textsuperscript{344} Therefore, Clause B did not bar the retention of the Michigan and also the Wisconsin properties of the companies as additional systems.

North American attempted to justify the retention of its Cleveland, Ohio, properties as an additional system on the ground that Wisconsin adjoins Illinois, Michigan adjoins Wisconsin, and Ohio adjoins Michigan. This was characterized as the "chain" theory of Clause B. The Commission noted that this theory would permit the retention of properties from one coast of the country to the other, as long as the holding company retained property in each state of the chain of states, and rejected the contention as patently invalid.

**Summary of the Requirements of Clause B**

Subsequent applications by the Commission of the one-area theory of Clause B are numerous.\textsuperscript{345} However, such ap-


\textsuperscript{344} See The Commonwealth & Southern Corporation, Release No. 2626 (March 19, 1941), to the contrary. The Commonwealth and Southern opinion was only a tentative decision, however, and should be treated as overruled by The North American Company case.

\textsuperscript{345} The more important decisions are as follows: Cities Service Company, 15 S.E.C. 962 (1944) (The question was raised whether a system in Arkansas, Louisiana, and Texas adjoined a Missouri-Kansas-Oklahoma-Nebraska system, since Louisiana was not adjacent to any of the latter four states. This issue was not decided, but the Louisiana properties would apparently not be retainable under the Engineers Public Service Company decision requiring additional systems to be located in the same state as the principal system, in adjoining state or states, or in a contiguous foreign country. Engineers Public Service Company,
RETENTION OF ADDITIONAL SYSTEMS

Applications have been largely automatic and do not merit extended consideration. Despite the ambiguity inherent in Clause B, the legislative history of the Act in general supports

9 S.E.C. 764, affirmed on this point in Engineers Public Service Co. v. Securities & Exchange Commission, 138 F.(2d) 936 (C.A.,D.C., 1943). Missouri-Kansas-Oklahoma-Nebraska system adjoined by Missouri-Kansas-Oklahoma-Arkansas system and New Mexico system. Systems in Ohio, Arizona, New York, and Canada did not adjoin Missouri-Kansas-Oklahoma-Nebraska system. Cities Service Power & Light Company, 14 S.E.C. 28 (1943) (Missouri system did not adjoin Colorado, Wyoming, Arizona, or New Mexico properties. Washington, Tennessee, Virginia, Connecticut, and North Carolina properties did not adjoin Ohio, Colorado, or New Mexico systems. Washington, Virginia, Connecticut, and North Carolina utilities did not adjoin Missouri system. However, since the electric properties in southwestern Missouri and adjacent portions of Arkansas, Oklahoma, and Kansas were found to be integrated, Clause B would not have barred the retention of Colorado and New Mexico properties. See map of Cities Service system at page 52, supra.) Columbia Gas & Electric Corporation, 17 S.E.C. 494 (1944) (West Virginia-Kentucky-Ohio system, Pennsylvania-West Virginia-Ohio-Maryland system, and Ohio system were mutually adjoining.) Associated Gas & Electric Corporation, Release No. 2983 (Denis J. Driscoll and Willard L. Thorp, Trustees, September 4, 1941), and 11 S.E.C. 1115 (1942) (Utility properties in Maine, Indiana, Illinois, Virginia, Kentucky, Tennessee, North Carolina, South Carolina, Georgia, Florida, Louisiana, Arkansas, Missouri, Texas, Oklahoma, Arizona, and the Philippine Islands did not adjoin systems in New York or Pennsylvania. Properties in Delaware, West Virginia, Maryland, and Ohio did not adjoin New York systems. Connecticut and Vermont properties did not adjoin Pennsylvania system.) The Commonwealth & Southern Corporation, Release No. 2626 (March 19, 1941), and Release No. 7615 (August 1, 1947) (Properties in Mississippi, Alabama, Georgia, Florida, South Carolina, Illinois, and Pennsylvania did not adjoin Michigan system. Utilities in Michigan, Illinois, Ohio, Pennsylvania, and South Carolina did not adjoin Mississippi or Alabama systems. The same utilities plus those in Mississippi did not adjoin Georgia system. Michigan system did not adjoin Pennsylvania-Ohio system. Properties in Michigan, Illinois, Ohio, and Pennsylvania did not adjoin Mississippi-Alabama-Georgia-Florida system. See map of The Commonwealth & Southern Corporation system at page 61, supra.) Engineers Public Service Company, 12 S.E.C. 41 (1942) (Electric system and gas system in same state, Virginia, met requirements of Clause B. Georgia system adjoined Virginia-North Carolina system. Clause B satisfied where additional system was in Louisiana or Texas and principal system was in Louisiana and Texas. Texas-New Mexico system adjoined Texas-Louisiana system. See map of Engineers Public Service Company system at page 42, supra.) The Middle West Corporation, 15 S.E.C. 309 (1944) (Properties in Kansas, South Dakota, and Nebraska did not adjoin Illinois-Kentucky or Kentucky-Tennessee-Virginia systems. Oklahoma, Texas, Louisiana, Arkansas, and Mississippi properties did not adjoin Illinois or Kentucky systems. See map of the Middle West Corporation system at page 65, supra.) Pennsylvania Gas & Electric Corporation, Release No. 8490 (September 3, 1948) (Property in Rhode Island did not adjoin either New York or Pennsy-
the one-area theory of the Commission. Furthermore, it may be said that, carried to absurd extremes, the one-area principle is less incongruous than the two-area interpretation. The Commission deserves commendation for the fact that early in the interpretative history of the Act it took a clear and definite position on a difficult problem and adhered to it steadfastly throughout subsequent proceedings. The correctness of this position was affirmed two years later by the appellate court. The existence of this guidepost has been an important factor relative to integration, in that it has enabled the Commission to eliminate large quantities of evidence by mere reference to a map.

Good examples of this statement are the systems of The United Light & Power Company and United Public Utilities Company. Although the companies naturally resisted the

vania. Note that Rhode Island is separated from Long Island, a part of New York state, only by Long Island Sound. By analogy to The North American Company case, 11 S.E.C. 194 (1942), where Michigan and Illinois were held to be adjoining states, although physically separated by Lake Michigan, it would seem that New York and Rhode Island might well be held to adjoint each other even though Long Island Sound is a part of the Atlantic Ocean rather than one of the Great Lakes.) Standard Power & Light Corporation, 9 S.E.C. 862 (1941), and Release No. 8242 (June 1, 1948) (Properties in Oregon, California, Kentucky, Indiana, Washington, Idaho, Wyoming, North Dakota, South Dakota, Montana, Minnesota, Illinois, Wisconsin, Iowa, Arkansas, Oklahoma, Colorado, Michigan, and Mexico did not adjoin Pennsylvania and West Virginia systems. Pennsylvania and West Virginia systems did adjjoin.) The United Light & Power Company, Release No. 2820 (June 13, 1941), and 9 S.E.C. 833 (1941) (Systems in Ohio, West Virginia, and Texas did not adjoin system in Kansas and Missouri. Systems in Missouri, Kansas, Iowa, Nebraska, and Oklahoma met the requirements of Clause B relative to Missouri-Kansas system. Texas system did not adjoin system in Michigan and Wisconsin. Michigan, Wisconsin, Texas and Indiana properties did not adjoin Missouri-Kansas system. Also, see The United Light & Railways Company, 14 S.E.C. 3 (1943).) United Public Utilities Corporation, Release No. 3105 (October 31, 1941), and 11 S.E.C. 33 (1942) (Arkansas property did not adjoin Ohio-Indiana or North Dakota-South Dakota systems. Ohio-Indiana system did not adjoin North Dakota-South Dakota system, and vice-versa.)

The United Light & Power Company, Release No. 2820 (June 13, 1941), and 9 S.E.C. 833 (1941); The United Light & Railways Company, 14 S.E.C. 3 (1943); United Public Utilities Corporation, Release No. 3105 (October 31, 1941), and 11 S.E.C. 33 (1942).
one-area theory at the outset, the firm position of the Commission enabled them to see at a glance that extensive and expensive efforts to support the retainability of remote properties would be futile.\textsuperscript{347}

C. THE SIZE REQUIREMENT: LOCALIZED MANAGEMENT, EFFICIENT OPERATION, AND EFFECTIVENESS OF REGULATION

The third of the cumulative prerequisites under the Act relative to the retention of additional systems requires that the continued combination of such systems under the control of the holding company shall not be 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.\textsuperscript{348} Identical language in Section 2(a)(29)(A) and Section 2(a)(29)(B) of the Act has already been noted and discussed at length in Chapter II, above, relative to the standards of integration as applied to particular electric and gas utility systems. It was there noted that the factors of localized management, efficient operation, and effective regulation are largely subordinate in importance to the other requirements for integration. In the treatment of the problem of additional systems, the size requirements of Clause C have not played a major part. Most of the proposed additional systems have been eliminated at the outset by the geographical requirements of Clause B; if such systems survived Clause B, then they were subjected to the substantial economies test of Clause A, which resulted in further drastic eliminations. It has been very seldom that a proposed additional system which met both of such tests has been subjected to close scrutiny under Clause C. However, the pertinent cases are discussed below.

\textsuperscript{347} Blum, Robert, "SEC Integration of Holding Company Systems," 17 JOURNAL OF LAND & PUBLIC UTILITY ECONOMICS, 423 (1941).

\textsuperscript{348} Section 11(b) (t) (C), referred to herein as "Clause C."
Public Utility Holding Companies

The North American Company

The various electric utility systems of The North American Company were among the first to be scrutinized by the Commission in the light of the requirements of Clause C.\(^{349}\) Such systems centered around St. Louis, Missouri, East St. Louis, Illinois, eastern Wisconsin, Detroit, and Cleveland, respectively. Previously, in its analysis of the single area and two-area theories with respect to Clause B, the Commission had pointed out that Clause C referred to the "area or region," in the singular, in which the principal and additional systems were to exist.\(^{350}\) Furthermore, it was the opinion of the Commission that one of the basic objectives of the Act was to eliminate each holding company system operating in diverse and distant areas, as evidenced by the legislative history set forth in the study of Clause B. The conclusion was that the singular reference to "area or region" in Clause C and such legislative history prevented the retention of additional systems where such retention would result in the control by the same interests of unrelated properties in widely separated areas.\(^{351}\) The Commission was also of the opinion that the fact that the language in Section 2(a)(29) of the Act was almost identical to that of Clause C necessitated similar interpretations of the two provisions, and also indicated that the considerations involved in applying the size standards of Clause C to a combination of principal and additional systems were similar to those involved in applying the size standards of Section 2(a)(29) to determine the maximum limits of a single integrated system.\(^{352}\)

It was noted that Milwaukee and St. Louis were 285 miles

\(^{349}\) See map of The North American Company electric utility system at page 45, supra.

\(^{350}\) Engineers Public Service Company, 9 S.E.C. 764, 787 (1941).


\(^{352}\) Citing United States v. Cooper Corporation, 312 U.S. 600 (1941).
apart; that Detroit and St. Louis were 415 miles apart; and that Cleveland and St. Louis were 424 miles apart. Each of The North American Company systems operating in the vicinity of these cities was a vast enterprise. The St. Louis properties in 1939 had 249,096 customers in an area of 3,100 square miles. The eastern Wisconsin properties had 250,770 customers in an area of 8,289 square miles. The Cleveland system had 330,000 customers in an area of 1,700 square miles. The number of customers and the area served by the properties centering around Detroit were not shown, but they appear to be considerably larger than the Cleveland figures, and perhaps slightly smaller, particularly as to area served, than the eastern Wisconsin statistics. The property and plant account of The Detroit Edison Company as of June 30, 1940, was $327,619,644 before deduction of reserves. It was found that each of these cities was the focal point of a different area or region, in a geographical, sociological, and operational sense. North American argued that the management of each of these subsidiaries was local in character. The Commission felt that the test did not lie in the current status of management, whether localized or centralized, since the policy of the company in this respect could be changed at will. The requirement was the size and the area or region affected, not the policy of a particular management group. Consequently, it was held that a combination of either the eastern Wisconsin, the Detroit, or the Cleveland properties with the St. Louis (Union) group would not satisfy Clause C. 353

The application of Clause C to the gas utility properties of The North American Company was also in issue. 354 One of its subsidiaries, Northern Natural Gas Company, was in turn the parent of two gas utility companies, Argus Natural Gas Company, Inc., and Peoples Natural Gas Company, operat-

354 See footnote 228, supra.
ing in Kansas, Nebraska, Iowa, and Minnesota. The Com-
mmission was of the opinion that the centralized control exer-
cised by Northern Natural Gas Company over these com-
panies did not leave to each of them the advantages of local-
ized management. The evidence merely showed divisional
maintenance, location of local offices, and localization of retail
activities. The Commission stated its position as follows:

"... When in fact management is highly centralized,
as it is in Northern’s main office at Omaha, and there
is no evidence as to the local nature of important policy
determinations, we cannot find that the advantages of
localized management are not impaired by central con-
trol. We believe that under Clause (C) no combination
of systems should be permitted which would impair
true localization of management and policy making.
Otherwise, as is the case in the area in which Northern
operates, small communities are pitted against strong
‘absentee control’ with respect to matters vitally affect-
ing the interests of the communities. Insofar as possible,
we are required under Section 11(b)(1) to insure local
management responsive to local needs and local public
feeling.”356

Report No. 621, 74th Congress, 1st Session (1935), pointed out at pages 11-12
that one of the purposes of the Act was “to confine the operations and interest
of each public utility system to the actual utility business of a given region so
that the system will have to work out a modus vivendi with the population of
that region. . . . A far-flung disjointed system is independent and absentee so
far as any particular community in its system is concerned. Its management has
the problems of no one community for its exclusive consideration. It derives a
great portion of its power and its profits from outside sources over which the
community has no control. It can never be successfully regulated by the
community it serves. . . .

"An operating system whose management is confined in its interest, its
energies, and its profits to the needs, the problems, and the service of one regional
community is likely to serve that community better, to confine itself to the
operating business, to be amenable to local regulation, to be attuned and re-
sponsible to the fair demands of the public, and, more often, to get along with
the public to mutual advantage. . . . Essentially local systems will tend to
operate utilities rather than to play with high finance; and essentially local
The main operating areas of Illinois Iowa Power Company, a subsidiary of The North American Company, in Illinois were held to be integrated, but four smaller electric utility systems of Illinois Iowa in the same state were held not to be parts of the principal system, although each of the four constituted an integrated system within itself. Illinois Iowa sought to retain each of these as additional systems. The five properties combined served 217,571 customers in an area of 15,233 square miles with a population of 750,000. It was held that the combination of the four smaller systems with the principal system of Illinois Iowa under the control of a single holding company was not so large as to impair the advantages of localized management, efficient operation, and the effectiveness of regulation under Clause C. It was also contended by Illinois Iowa that the integrated system of Des Moines Electric Light Company, operating in the state of Iowa, was retainable as an additional system. It was held that the requirements of Clause C were not met in this instance. It appeared that Iowa companies were subject to regulation by the Iowa State Commerce Commission in certain respects, but not with regard to rates, which were subject to negotiation with the individual communities served. The Commission believed that the absence of central regulation made it particularly necessary to apply rigorously the standards of Clause C in order to assure the localization of each system’s policy determinations. The control of policy, it was felt, by men who were not in their daily business activities responsive to local public opinion, and the disadvantages of the local communities as opposed to the holding company with its great enterprise is far less likely to accumulate a disproportionate amount of political and economic power.”

356 See map of The North American Company electric utility system at page 45, supra.

357 The North American Company, 11 S.E.C. 194, 244 (1942).
resources in the matter of regulation resulted in the impairment of effective public regulation, contrary to the principles set forth in Section 1(b)(5) of the Act.\textsuperscript{368}

Engineers Public Service Company

In the Engineers Public Service Company case the question arose whether Savannah Electric & Power Company, operating in the state of Georgia, could be retained as a system additional to the Virginia Electric & Power Company system in Virginia and North Carolina.\textsuperscript{859} The company suggested that Clause C did not refer to geographical conditions, since such conditions were imposed by the Act in Clause B. This suggestion was rejected, the Commission stating its position as follows:

\begin{quote}
"... While these clauses impose separate conditions, these conditions do not set up mutually exclusive types of standards. The fact that Clause (B) is concerned with certain geographical considerations does not mean that all geographical factors are excluded from the scope of the other two clauses. And, in fact, the words, 'not so \textit{large} (considering the ... area or region affected) ...," indicate the existence of geographical considerations to be taken into account in applying the standards of Clause (C). The relevance of such considerations in the sensible application of the clause is manifest. The clause is concerned with the effect of the size of a \textit{combination} of integrated public utility systems on the advantages of localized management, efficient operation, and effectiveness of regulation. The magnitude of the distances and differences between the service areas of the components of the combination clearly has some bearing upon the possibility of obtaining for the com-
\end{quote}

\textsuperscript{368} The North American Company, 11 S.E.C. 194, 245 (1942).
\textsuperscript{859} See map of Engineers Public Service Company electric system at page 42, \textit{supra}. 
RETENTION OF ADDITIONAL SYSTEMS

Combining the advantages of localized management, efficiency of operations and effectiveness of regulation. It is almost too obvious to need explicit statement that, other things being equal, the advantages of localized management, for example, are less likely of achievement in a combination whose properties are separated by 450 miles than in a combination of adjacent properties. Of course, the fact that the geographical factors must be considered in determining whether a combination is too large does not mean that an examination of the size of the physical properties, plant account, revenues or income is not also apposite in treating the requirements of Clause (C).²⁸⁶⁰

It was also observed that the legislative history of the Act supported this position.²⁸⁶¹ Consequently, it was concluded that the geographical restrictions of Clause C supplemented the automatic limitations of Clause B based upon state boundaries in effectuating the purposes of the Act.

The electric systems of Virginia and Savannah were 315 miles apart at the closest points and 525 miles apart at the most distant points. Their executive offices were 443 miles apart. The service area of Savannah was surrounded by marshy, uninhabited territory. The industrial and agricultural life of Virginia's service area had little economic relationship with that of Savannah. The Commission was convinced that an awareness of and sensitivity to the problems of the population of Savannah were not likely to exist in a management centered in Richmond, Virginia, and, accordingly, that a finding could not be made that the combination of these two sets of properties was not so large as to impair the advantages of localized management. The requirements of Clause C were

therefore not met in this instance.\textsuperscript{862}

Engineers Public Service Company also sought a ruling to the effect that the electric properties of El Paso Electric Company might be retained as an additional system to the properties of Gulf States Utilities Company. The Service area of Gulf was composed of 27,000 square miles in southwest Louisiana and southeast Texas. Of the 270 communities served, 92.2\% had a population of less than 2,500, and its service area was essentially rural. The region's economic character was primarily agricultural, but the production, refining and distribution of oil and gas consumed considerable electric power. El Paso, on the other hand, served an area of 700 square miles in west Texas and southeast New Mexico. Except for the city of El Paso, its system was confined to a narrow valley surrounded by mountains and desert and was also largely pastoral in its economic character. There was no operating relationship between the two systems. There was little intercourse between their service areas and little in common, geographically, politically, or economically. The two areas were 500 miles apart at their closest points and 1,000 miles apart at their farthest points. Their principal offices were 750 miles apart. In view of these facts, it could not be found that the combination of Gulf and El Paso would not be so large as to impair the advantages of localized management.

Further, with regard to the effectiveness of regulation in connection with this proposed combination, it was observed that the properties involved were scattered over three states. In Louisiana and New Mexico the properties were subject to the respective state public service commissions. However, in Texas regulation depended upon the municipalities served and the state district courts which had jurisdiction to declare unreasonable rates illegal. The Commission felt that a com-

\textsuperscript{862} Engineers Public Service Company, 12 S.E.C. 41, 67 (1942).
combination which could be locally regulated only by so scattered and diverse a group of regulatory bodies probably did not meet the size requirement of Clause C with respect to effectiveness of regulation.

The holding company advanced the argument that because the combined electric plant account of Gulf and El Paso was not as large as that of Virginia Electric & Power Company, which had been held to be a single integrated electric utility system, the combination of Gulf and El Paso could not be too large under Clause C. The Commission did not agree. It was of the opinion that the "state of the art and the area or region affected" must be considered in this connection. Although the area or region affected by Virginia might be such as not to render Virginia's size unduly large, yet it was held that it did not mechanically follow that a combination which was smaller in the magnitude of its financial operation was not, in another area or region, so large as to violate the principles of Clause C. The Commission accordingly would not accede to the theory that any combination whose financial magnitude was smaller than any utility system that had been found to be integrated must ipso facto be not so large as to violate the standards of Clause C. Consequently, it was held that the proposed combination of Gulf and El Paso did not meet the requirements of Clause C. It was conceded, however, that the electric property at Van Horn, adjacent to the El Paso properties but physically separate and distinct, met the test of Clause C in combination with the El Paso system in view of its small size and geographical proximity.

The Engineers Public Service Company system also raised another interesting problem under Clause C. It will be recalled that the Commission, after some vacillation, had taken the position that electric and gas properties could not

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363 Engineers Public Service Company, 12 S.E.C. 41, 89 (1942).
364 Engineers Public Service Company, 12 S.E.C. 41, 90 (1942).
be retained together as a single integrated system. This
relegated the owners of such electric and gas combinations to
the doubtful solace of the ABC clauses. In addition to its
electric utility business, Gulf States Utilities Company also
distributed natural gas to customers in Baton Rouge, Louisiana,
and its suburbs, a territory of about 15 square miles in
an area with a population of 70,000. It operated 169 miles of
gas mains. On January 1, 1941, the company had 12,542
gas customers. As of December 31, 1940, the utility plant
account of the gas system was 2.8% of the total for Gulf;
the operating revenues for the year 1940 of the gas system
were 5.9% of the total of the system; and its net income for
that year was 5.3% of the total. It was held that the gas
system constituted an integrated utility system, and, further
that it met the requirements of Clause C in connection with
the electric properties of Gulf. It was noted that all of the
gas customers of Gulf were also electric customers and that
the service area of the gas system was not an addition to the
electric service area, but merely coincided with part of it.
The financial size of the gas system was small in comparison
with the electric system. The rates and services of both the
gas and electric systems in Louisiana were under the jurisdic-
tion of the Department of Public Service of Louisiana.

Engineers Public Service Company also sought to retain
the integrated gas utility system of Virginia Electric & Power
Company, in addition to the integrated electric utility sys-
tem of Virginia. The gas system consisted of a gas manu-
facturing plant located at Norfolk, Virginia, and a distribu-
tion system serving an area of approximately 35 square miles
in and around Norfolk. As of July 1, 1941, the gas system
had 29,363 customers and 357 miles of mains. It was located

Engineers Public Service Company, 12 S.E.C. 41, 79 (1942). The gas
utility system also met the requirements of Clause B, but failed to meet the test
of Clause A.
wholly within the 13,500 square miles of electric service area of Virginia. The gas plant account of Virginia was 8.9% of its electric plant account; its gross operating revenues from gas were 7.1% of its electric revenues for 1940. Both the gas and the electric systems were subject to regulation by the Virginia State Corporation Commission, which had authority to fix rates and regulate the issuance of securities and the keeping of accounts. The Commission found that this was not a prohibitively large combination and was permissible under Clause C. 366

Southern Union Gas Company

In addition to its principal gas utility system located in west Texas and New Mexico, Southern Union Gas Company also operated gas properties in central Texas, south Texas, and central Oklahoma. These latter properties were 250, 350, and 300 miles, respectively, from the nearest points of the principal system. The Commission felt that the advantages specified in Clause C would sooner be attained by the concentration of the management's time and efforts in the area served by the principal system than by being spread over such system plus the three sets of outlying properties. Accordingly, a finding of compliance with Clause C in regard to a combination of these properties was denied. 367 This finding was novel in that it is one of the exceptionally few situations where retention of additional systems was denied on the basis of Clause C alone, the usual situation being the invocation of Clause C to bolster a finding of non-compliance with Clause A.

366 Engineers Public Service Company, 12 S.E.C. 41, 57 (1942). Here again, however, the retention of the gas property as an additional system was denied under Clause A.
Lone Star Gas Corporation, whose principal gas utility system was located in the north central portion of the State of Texas and adjoining portions of the State of Oklahoma (identified as its "Central System"), also controlled gas systems in the cities of El Paso and Galveston, Texas. Such latter systems had been excluded from the integrated Central System for the reason, among others, that they were not in the same area or region as the Central System within the meaning of Section 2(a)(29)(B) of the Act.\textsuperscript{368} Although there was no finding that each of these smaller systems was individually integrated, they were tested for retainability under the ABC clauses. The Commission invoked the rule of The North American Company case, to the effect that the size standards imposed by Section 2(a)(29)(B) and Clause C should be similarly construed.\textsuperscript{369} The Galveston property was 250 miles from Dallas, the headquarters of the Central System, and 125 miles from College Station, the nearest town served by the Central System. The El Paso system was 700 miles from Galveston, 575 miles from Dallas, and 350 miles from the nearest town served by the Central System. Other non-affiliated gas systems operated in the intervening areas. Since the El Paso and Galveston properties had been held to be outside of the area or region of the Central System properties for the purpose of Section 2(a)(29)(B), it followed that they were also outside for the purpose of Clause C.\textsuperscript{370}

Furthermore, the gas operations in El Paso and Galveston were subject to a high degree of supervision by the management at Dallas. Most of the policies with respect to the relations of the company with customers, with governmental

\textsuperscript{368} Lone Star Gas Corporation, 12 S.E.C. 286 (1942).
\textsuperscript{369} The North American Company, 11 S.E.C. 194 (1942).
\textsuperscript{370} Lone Star Gas Corporation, 12 S.E.C. 286, 295-296 (1942).
RETENTION OF ADDITIONAL SYSTEMS

authorities, and with employees were determined in Dallas. Depreciation policies, rate policies, and budgets were supervised in Dallas. The Commission felt that where operations were located at a substantial distance from the management, as they were in El Paso and Galveston, and supervision by absentee management was present in the degree indicated in this case, it was not likely that the advantages of localized management were reflected in operations and doubted that such management was responsive to local needs and local public feeling. Further, the Commission believed that regulation was less effective when management was absent from the situs of operations and the location of the regulatory authorities, it being noted that the municipalities of El Paso and Galveston controlled the rates of their respective gas systems. Consequently, it was found that the standards of Clause C had not been met.\(^{371}\)

**Cities Service Power & Light Company**

Cities Service Power & Light Company contended that all of its electric utility properties in the Rocky Mountain group could be retained either as a single integrated system or as a principal system and systems additional thereto.\(^{372}\) These properties were located in the States of Wyoming, Colorado, New Mexico, and Arizona. The north to south extremes of these properties were 900 miles apart. The property in northern Wyoming was 240 miles from the nearest section of the remainder of the system. Tucson was 320 miles from the nearest of the other properties of the system, and Deming was 200 miles therefrom. All of the intervening stretches of territory between these properties were mountainous and sparsely settled. After holding that such a combination of properties did not meet the size stand-

\(^{371}\) Lone Star Gas Corporation, 12 S.E.C. 286, 296 (1942).

\(^{372}\) See map of Cities Service Power & Light Company electric system at page 52, supra.
ards of Section 2(a)(29)(A) of the Act, the Commission again referred to the principle of The North American Company case that highly similar standards as to size exist in Clause C. It was stated that "The statute and its legislative history make it clear that, consistently with geographic conditions (in the broad sense of that term) as much compactness should be achieved in outlining the spheres of holding company influence as physical facts permit." The company urged that the Commission find that the States of Wyoming, Colorado, New Mexico, and Arizona were located in a single area or region within the meaning of the Act. This interpretation of the Act, in the eyes of the Commission, would comprehend hegemonies of holding company control so vast that, under the area or region standard, the Act would permit a few holding companies to divide the country, contrary to the intent of Congress. In view of their scattered location and their remoteness from the central body of compact properties of the system, the properties in Sheridan, Wyoming, Deming, New Mexico, and Tucson, Arizona, were held to be not within the same area or region with the remainder of the system properties or with each other within the meaning of Section 2(a)(29)(A) of the Act. However, in view of the fact that certain interconnections between the main body of the system and the Deming and Tucson properties were contemplated, jurisdiction was reserved as to these two properties.

Federal Light & Traction Company, a subsidiary of Cities Service Power & Light Company, was the parent of all of the Rocky Mountain group of Cities Service properties except Public Service Company of Colorado. Subsequent to the fore-

going proceedings, Federal Light & Traction Company filed a plan of reorganization under Section 11(e) of the Act for compliance with Section 11(b). The plan proposed that Federal and its subsidiaries operating in Arizona, New Mexico, and Colorado be merged or consolidated into the Tucson Gas, Electric Light & Power Company. The properties of this system from Walsenburg, Colorado, to Belen, New Mexico, had been held to constitute an integrated electric utility system in the decision discussed above. Certain interconnecting transmission lines were proposed which would connect the Deming properties with the lines of the principal system at Belen and which would connect the Deming properties with the Tucson system. The extremes of the three systems were 600 miles apart in a straight line and many more miles distant by transmission line. Three states were involved with the resulting divergence of local regulation. The Commission held that, although it gave no definite weight to distance as such, the accumulation of negative factors persuaded it that the Tucson properties did not meet the requirements of Clause C.

A contrary decision was reached with regard to the Deming property. The net utility plant of the Deming company was 5% of the net utility plant of the principal system. Its gross operating revenues were 7.7% and its net income was 8.5% of the comparable figures of the principal integrated system. In view of its small size and proximity (about 100 miles) to the main properties of the system, the Commission was satisfied that it met the requirements of Clause C as an additional system thereto.

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378 See map of the Cities Service Power & Light Company system at page 52, supra.
380 Ibid.
In The Middle West Corporation integration proceedings it was held that the properties of Central Illinois Public Service Company in Illinois and the western Kentucky properties of Kentucky Utilities Company constituted a single integrated system, and that the central and eastern Kentucky, Virginia, and Tennessee properties of Kentucky Utilities Company constituted another integrated system. These two integrated systems were identified as the "Northern Properties." In between them lay the properties of the Midland United Company system. The latter company was undergoing a reorganization. Middle West contended that the Northern Properties and those of Midland United together formed a single integrated system. In view of the reorganization proceedings, the Commission reserved jurisdiction to pass upon this question at a later date. However, Middle West requested a finding that the electric properties of Wisconsin Power & Light Company, operating in the central and southern portion of the State of Wisconsin, and the electric properties of Lake Superior District Power Company in northern Wisconsin and Michigan constituted retainable additional systems to the Illinois and Kentucky systems. Wisconsin Power served an area roughly 190 miles from north to south and 100 miles from east to west, and its electric plant account and electric revenues were comparable in size to those of Kentucky Utilities and around a third less than those of Central Illinois. Lake Superior District was about 20% as large as Wisconsin Power in these respects. The electric properties of Lake Superior District and Wisconsin Power combined extended from the northern to the southern boundary of Wisconsin, a distance of approximately 300 miles. The distance from Lake Superior to east Kentucky was about 900

See map of The Middle West Corporation system at page 65, supra.
miles. After considering the extent of these properties in conjunction with that of other properties in the area, the marked differences in the territories served, and the fact that a gap of 125 miles separated the service areas of Central Illinois and Wisconsin Power, the Commission refused to find that common control of the Wisconsin companies would not impair the advantages of localized management. 382

Further with regard to the Middle West properties, the Commission held that the southern group of properties in Oklahoma, Arkansas, Louisiana, and Texas was so widely separated from the Central Illinois and Kentucky Utilities properties, and so unrelated thereto, that it could not be found that its retention along with the Northern Properties would not impair the advantages of localized management. 383

Before leaving the Middle West system, attention should be directed to the principal system discussion of the southwestern properties of Middle West in Chapter II, supra. These properties were located in the States of Texas, Oklahoma, Arkansas, and Louisiana and extended 1,200 miles from one end to the other. They constitute the largest aggregation of utilities, geographically speaking, that have yet been approved as a single integrated system or as a principal system and systems additional thereto. Although Clause C was not involved in this decision, the identical language of Section 2(a)(29)(A) of the Act was applicable, and therefore the liberal application of such size standards here is pertinent in the analysis of Clause C. Such liberality in the interpretation of the size requirements was an important deviation from the narrow construction applied in the earlier cases, as discussed herein.

382 The Middle West Corporation, 15 S.E.C. 309, 320 (1944).
383 The Middle West Corporation, 15 S.E.C. 309, 344 (1944).
In the case of Columbia Gas & Electric Corporation, it was held that the three groups of natural gas utilities of the company centering around Charleston, West Virginia, Pittsburgh, Pennsylvania, and Columbus, Ohio, each constituted a separate integrated system. The relative financial sizes of these three groups are shown by the following figures reflected in the December 31, 1943, annual statements of the companies involved:

<table>
<thead>
<tr>
<th></th>
<th>Charleston Group</th>
<th>Pittsburgh Group</th>
<th>Columbus Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Utility Plant</td>
<td>$139,507,406</td>
<td>$101,681,506</td>
<td>$117,216,847</td>
</tr>
<tr>
<td>Net Utility Plant</td>
<td>84,423,449</td>
<td>61,589,894</td>
<td>87,666,612</td>
</tr>
<tr>
<td>Gross Revenues</td>
<td>38,641,300</td>
<td>26,001,815</td>
<td>35,388,713</td>
</tr>
<tr>
<td>Net Operating Revenues</td>
<td>4,517,021</td>
<td>2,444,870</td>
<td>4,359,390</td>
</tr>
</tbody>
</table>

It is thus apparent that these properties were roughly comparable in size and that all of them were large in scope of operations. The facilities of the three groups were interconnected and there was a close operating relationship among them. Drilling, production, storage, and transmission operations were coordinated with the requirements of the various systems in order to obtain a maximum use and conservation of the available gas resources. Such advantages appeared to the Commission to be particularly significant in view of the rapid depletion of the natural gas resources in the Appalachian area. Retention of these properties under common control would permit a continuation of such coordinated operations, which were subject to the supervisory jurisdiction of the Federal Power Commission and the three respective state commissions. The Commission believed that the "unique circumstances" of this case justified the retention of the three groups of companies under Clause C, in spite of the fact that the size of these properties, both absolutely and relatively,

might otherwise have led to the conclusion that separation was essential under the Act. The expression "relatively" referred to the principle laid down in the Cities Service Company case that, generally speaking, the ABC clauses contemplated additional systems junior in importance to the principal system and dependent upon the continuation of joint control with such system. Although these three groups of properties may well have constituted one integrated gas utility system, as pointed out in Chapter II, it does not appear that ample justification existed here for the Commission to abandon its customarily strict interpretation of Clause C. This decision was further indication of the weakening of the Commission's narrow application of the ABC clauses.

American Gas & Electric Company

The extensive limits of the Central System of American Gas & Electric Company, operating in the States of Michigan, Indiana, Ohio, Virginia, West Virginia, Tennessee, and Kentucky, and the controversy in connection with the size standards of Section 2(a)(29)(A) of the Act as applied thereto, have been described in the principal system discussion of the company. Briefly stated, the Central System in 1944 served 749,899 customers in 1,706 communities and encompassed an area of 90,000 square miles with a population of 3,018,000. This vast system was held to constitute a single integrated electric utility system, although it was observed that such system approached the maximum size permissible under the Act. This was an unusually generous concession in the light

Columbia Gas & Electric Corporation, 17 S.E.C. 494, 511 (1944). In view of the subsequent extension of natural gas pipe lines into this area from Oklahoma and Texas, it would seem that one of the "unique circumstances" leading to this decision, the depletion of the natural gas resources, has been largely eliminated.


See map of the American Gas & Electric Company system at page 78, supra.
of the earlier restrictive applications of the size requirements.

In addition to the Central System, American Gas & Electric Company sought to retain its South Jersey system, operating in New Jersey, and its Northeast Pennsylvania System, operating in that state. The South Jersey System served 104,805 electric customers in 225 communities with a population of 308,000 in 1944. The Northeast Pennsylvania System served 78,469 electric customers in 57 communities with a population of 344,000 in 1944. Comparative financial figures for the three systems of the company for the year ending December 31, 1944, are set forth below:

<table>
<thead>
<tr>
<th>System</th>
<th>Central System</th>
<th>South Jersey System</th>
<th>Northeast Pennsylvania System</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Utility Plant</td>
<td>$442,613,062</td>
<td>$46,006,729</td>
<td>$28,072,396</td>
</tr>
<tr>
<td>Net Utility Plant</td>
<td>332,462,421</td>
<td>33,158,876</td>
<td>14,056,843</td>
</tr>
<tr>
<td>Gross Revenues</td>
<td>102,198,514</td>
<td>10,661,915</td>
<td>6,956,846</td>
</tr>
<tr>
<td>Operating Income</td>
<td>21,386,205</td>
<td>2,201,788</td>
<td>1,715,052</td>
</tr>
</tbody>
</table>

The South Jersey System was 185 miles from the nearest extremity of the Central System and the Northeast Pennsylvania System was 240 miles therefrom. Considering the extent and size of the Central System and the extent and size of the South Jersey and Northeast Pennsylvania systems in conjunction with the Central System, the nature of the territories served, and the distances separating the three systems, the Commission held that common control of the three systems would impair the advantages of localized management and therefore that the two smaller systems were not retainable as additional systems to the Central system under Clause C. 388

The Commonwealth & Southern Corporation

The principal utility system of The Commonwealth & Southern Corporation, as defined by the Commission, em-

embraced 94,159 square miles with an estimated population of 4,700,000 and 653,726 customers as of November 30, 1946. As of September 30, 1946, the gross property accounts of the companies involved amounted to $459,729,103, and the net property accounts amounted to $373,357,728. Their electric operating revenues for the twelve months ended on said date totalled $77,570,768, and their net operating revenues were $21,504,840. Consequently, the Commission was of the opinion that this combination of properties approached the maximum size consistent with the standards of localized management, efficient operation, and effective regulation contained in Section 2(a)(29)(A) and Section 11(b)(1) of the Act, as has previously been noted in the discussion of the principal system of Commonwealth & Southern.

Adjoining the principal system of Commonwealth & Southern on the east were the properties of South Carolina Power Company, another subsidiary of Commonwealth & Southern. The latter company did not seek to retain the South Carolina system, either as part of the principal system or as a system additional thereto, and agreed to divest itself of its interest in that company, but nevertheless the Commission examined the South Carolina properties in the light of the size requirements of Section 2(a)(29)(A) and Clause C. It was found that the efficient operation of the properties in the principal system arising from coordinated control thereof did not extend to the South Carolina system also, and the operating efficiency which moved the Commission to permit the combination of four of the southern systems as one integrated system was not effective enough in relation to the South Carolina property to permit its retention as part of the principal system or as an additional

389 See map of The Commonwealth & Southern Corporation system at page 61, supra.
system. Consequently, the Commission held that the addition of the South Carolina properties to those of the principal system would violate the size standards of Section 2(a)(29)(A) and Clause C. This was a rather obvious conclusion, the only questionable matter being whether the principal system by itself came within the true spirit of the size limitations of the Act.

Summary of the Requirements of Clause C

The best that may be said for Clause C, in the light of its interpretation by the Commission, is that it imposes a relative test of size, rather than a fixed test as exemplified by Clause B, for the retention of additional systems. The parenthetical phrase of Clause C, "considering the state of the art and the area or region affected," has been construed by the Commission to give a great deal of leeway in the application of the standards of that clause to a particular system. One important effect of this principle of relativity is to eliminate, to a large extent, the value of precedents, since it has been held that the fact that a combination of certain systems of a certain size has been permitted does not mean that all combinations of systems of an equal or lesser size will be permitted.

Another feature of Clause C to be noted is that almost identical language is included in the tests for integrated electric and gas utility systems set forth in Section 2(a)(29)(A) and Section 2(a)(29)(B) of the Act. It has been held that Clause C should be applied in a manner similar to those sections, and consequently a study of Clause C is incomplete without examination of the size standards imposed upon single integrated systems. In the foregoing discussion of Clause C, the attempt was made to correlate the leading

cases involving such standards without completely repeating the earlier discussion thereof.

The singular reference to "area or region" in Clause C has been held to be of considerable importance. Additional systems in another area or region, geographically speaking, from the principal system or from each other may not be retained in combination. This means that Clause C imposes a geographical limitation in addition to the geographical requirements of Clause B. However, Clause C contemplates more factors in regard to size than merely area covered. The physical properties involved, the plant accounts, revenues, and income should all be considered under the size standards of Clause C, though in numerous cases some of these factors appear to be ignored.

Of the three objectives of Clause C, localized management, efficient operation, and effectiveness of regulation, the first has concerned the Commission most frequently. One of the principal objectives of the Act was to remove the absentee control over the operations of local public utilities, which existed during the period of the vast utility empires. It was felt that management at a remote place had little sympathy with the local problems of the individual utilities. The third objective, effective regulation, has been the next most important provision. In fact, the first and the third objectives are largely interrelated. The great resources of the utility empires were disproportionate to those of the local regulatory authorities or to those of the local customers who might be dissatisfied with their service. The pursuit of effective local regulation has not proceeded at an even pace, however, as evidenced by the narrow decision on this point in the Engineers Public Service Company case and the liberal decisions in the Middle West and Lone Star Gas Corporation cases, involving similar aggregations of regulatory authorities.

It has been said that compactness of holding company
utility systems was one of the principal objectives of the Act and that systems additional to the principal system should be small in comparison with such principal system. Clause C provides the essential requirements for the attainment of these criteria. The Van Horn property of the Engineers Public Service Company western system and the Deming property of the Cities Service Power & Light Company system in Colorado and New Mexico are good examples of such smaller properties retainable in addition to principal systems. On the other hand, in the case of Columbia Gas & Electric Corporation, three large systems were held to constitute a principal system and additional systems retainable therewith. With regard to the requirement of compactness, the differences in the regions or areas involved in the western properties of Engineers Public Service Company, for instance, were emphasized by the Commission in denying retainability, whereas a much larger geographical expanse of properties in the same territory was held to constitute a single integrated utility system in the Middle West case. The lack of uniformity in the application of Clause C is therefore another factor preventing a statement of the precise limits of its application.

Finally, it should be noted that the liberal decisions of the Commission relative to the size requirements of the Act, those involving The Middle West Corporation, The Columbia Gas & Electric Corporation, American Gas & Electric Company, and The Commonwealth & Southern Corporation, are all more recent than The North American Company, Engineers Public Service Company, and other decisions hewing to the restrictive interpretation of Clause C and the related provisions of Section 2(a)(29). The liberal decisions began in 1944 and, generally speaking, have continued in unbroken line since that time. The explanation does not lie in any radical change in the membership of the Commission,
since it has not changed rapidly until very recent years, and, in any event, four of the five Commissioners who decided the North American and Engineers cases also passed upon the Middle West case. Perhaps it may be said that time has healed the wounds which gave rise to the Act and that the Commission has accordingly mellowed its former strict construction of the size standards of the Act.