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## SECURITIES LEGISLATION - PUBLIC UTILITY HOLDING COMPANY ACT JURISDICTION OF THE SECURITIES AND EXCHANGE COMMISSION

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SECURITIES LEGISLATION — PUBLIC UTILITY HOLDING COMPANY ACT — JURISDICTION OF THE SECURITIES AND EXCHANGE COMMISSION — In 1935 the International Paper and Power Company filed an application with the Securities and Exchange Commission to secure permanent exemption from the provisions of the Public Utility Holding Company Act of 1935. While this application was pending, the company formed a plan for recapitalization of its stock, and applied to the commission for an order validating the plan. The report of the commission on this plan was approved by the requisite number of shareholders of the company, whereupon the commission entered an order purporting to exempt from the provisions of the act the stock and the warrants for stock to be issued under the plan. The commission's order was reversed by the Circuit Court of Appeals for the First Circuit<sup>1</sup> on the theory that, until the company registered under the act, the commission could not issue an order concerning the validity of the plan of recapitalization. The commission then granted the company complete exemption from the terms of the act according to the original application; and dismissed a petition of a class of preferred stockholders to have the commission issue an order either allowing the recapitalization plan to become effective on more favorable conditions to the class, or determining what "restitution" the class might have because of reliance on the commission's original orders regarding the plan. On review of this latter order of dismissal before the Circuit Court of Appeals for the Second Circuit, *held*, that the first circuit had exclusive jurisdiction to construe its mandate regarding the commission's order on the recapitalization plan; but assuming that the second circuit had jurisdiction over the order sought to be reviewed, the question of the commission's jurisdiction to pass on the plan of recapitalization in any way was rendered moot by the commission's order exempting the company completely from the provisions of the act. *Morris v. Securities and Exchange Commission*, (C. C. A. 2d, 1941) 116 F. (2d) 896.

It is a familiar and well-settled principle that an administrative body which

<sup>1</sup> *Lawless v. Securities and Exchange Commission*, (C. C. A. 1st, 1939) 105 F. (2d) 574. For an excellent comment on the proceedings before the Securities and Exchange Commission prior to the Lawless case, see 47 YALE L. J. 289 (1937).

is a statutory creature is confined in its jurisdiction and functions by the statute creating it.<sup>2</sup> Under the Public Utility Holding Company Act of 1935,<sup>3</sup> companies which fall within the definition of a "holding company"<sup>4</sup> are required to register with the Securities and Exchange Commission.<sup>5</sup> By section 4,<sup>6</sup> unregistered "holding companies" are denied certain privileges such as using the mails for the sale of securities, or selling and transporting gas or electricity in interstate commerce. A company which seeks a declaratory order of the commission exempting it from the provisions of the act finds itself in an uncomfortable position if it attempts to do any of the acts which are subject to the commission's jurisdiction and the commission then determines that the company must register under the act.<sup>7</sup> Although the company concerned in the principal case was not required to register under the commission's ultimate decision, an equally exacting problem was raised by the reliance of petitioners on the commission's order approving the recapitalization plan and by the subsequent invalidation of this order on appeal.<sup>8</sup> It would seem that more expedient consideration of applications for exemption under the act by the commission<sup>9</sup>

<sup>2</sup> *Merritt v. Welsh*, 104 U. S. 694 (1881); *Waite v. Macy*, 246 U. S. 606, 38 S. Ct. 395 (1918).

<sup>3</sup> 49 Stat. L. 803 et seq. (1935), 15 U. S. C. (Supp. 1939), § 79 et seq. The act was declared constitutional at least as to its registration provisions in *Electric Bond & Share Co. v. Securities and Exchange Commission*, 303 U. S. 419, 58 S. Ct. 678 (1938).

<sup>4</sup> 49 Stat. L. 806 (1935), 15 U. S. C. (Supp. 1939), § 79b (7). By this section, the commission may declare a company to be a "holding company," "subsidiary company," or "affiliate" only by order, after notice and opportunity for hearing.

<sup>5</sup> 49 Stat. L. 812 (1935), 15 U. S. C. (Supp. 1939), § 79e.

<sup>6</sup> 49 Stat. L. 812 (1935), 15 U. S. C. (Supp. 1939), § 79d (a). See comment, 36 MICH. L. REV. 1324 (1938).

<sup>7</sup> For instance, if a company were in the middle of a plan of reorganization, its plan would be considerably disrupted by an order requiring it to register under the act, thus submitting the company to the gamble that the commission would approve the plan as one of a "registered holding company" under § 11(g). 49 Stat. L. 823 (1935), 15 U. S. C. (Supp. 1939), § 79k (g). By 49 Stat. L. 810 (1935), 15 U. S. C. (Supp. 1939), § 79c (a), the commission is authorized to exempt those companies whose structures and activity comply with certain requirements, unless contrary to the public interest.

<sup>8</sup> For an analysis of the recapitalization plan involved in the principal case, see Report on Reorganization Plan for International Paper & Power Co., S. E. C. Release No. 641 (Public Utility Holding Co. Act), May 5, 1937. The court in the *Lawless* case refused to find authority in the "elastic" clause of § 20 (a), 49 Stat. L. 833 (1935), 15 U. S. C. (Supp. 1939), § 79t (a), which gives the commission authority to make "such rules and regulations and such orders as it may deem necessary or appropriate to carry out the provisions of this title," for the commission to make orders under sections literally applicable only to "registered holding companies" concerning activities of applicants for exemption.

<sup>9</sup> The act confers automatic exemption from the act to good faith applicants for exemption until the commission acts on the applications; the commission is to act thereon "within a reasonable time." 49 Stat. L. 811 (1935), 15 U. S. C. (Supp. 1939), § 79c (c). A similar requirement for acting on applications for exemption "within a reasonable time" is found in § 2(a)(7), which defines a "holding company." 49 Stat. L. 806 (1935), 15 U. S. C. (Supp. 1939), § 79b (7).

would be most desirable, particularly in view of the practical considerations involved where the stockholders of a company are seeking to effect a plan of reorganization, and where the value of stocks and warrants for stock are subject to rapid fluctuation in the market. To be weighed against the advantage of speedy action to the applicant for exemption is, of course, the advantage to the commission of considered action, allowing it to scrutinize carefully the intricate structure and holdings of the applicant in order to carry out the purposes of the act and avoid constitutional difficulties in its orders. As far as the jurisdictional limits of the commission are concerned, however, it is submitted that the court in the principal case reached a sound result, because the provisions as to the commission's function of passing on recapitalization plans are limited to "registered holding companies," and because the act gives the commission no jurisdiction to order the "restitution" petitioners requested.<sup>10</sup> *Robert Kneeland*

<sup>10</sup> Aside from the construction of the act, the court in the principal case stated that the petitioners were not entitled to "restitution" by any analogy to restitution in court proceedings (where there is reversal on appeal), because (1) the order concerned in the Lawless case directed nothing to be done, but was merely an order of approval, and (2) any reliance by shareholders on the order in exchanging old securities for new was "voluntary." 116 F. (2d) 896 at 898. Such a distinction may be sound in legal theory; but it does not take into account the position of one who is dealing with stocks in a fluctuating market.