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"FAIR AND EQUITABLE" DISTRIBUTION OF VOTING POWER UNDER THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

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IN THE Public Utility Holding Company Act of 1935[1] Congress gave the Securities and Exchange Commission the task of investigating voting power distribution among security holders in electric and gas holding companies and their subsidiaries. If the Commission finds that the corporate structure or continued existence of any company in a holding company system "unfairly or inequitably" distributes voting power among the investors in the system, it is the Commission's duty to order the offending corporation to take "such steps as the Commission shall find necessary" to cure this condition.[2] This paper is an attempt to ascertain what the Commission considers an unfair or inequitable distribution of voting power and the steps necessary to eliminate it.

I

THE COMMISSION'S GENERAL APPROACH

The Commission was directed by Congress to interpret the various provisions of the act so as "to meet the problems and eliminate the evils" listed in section 1.[3] This list includes a declaration that "the interest of investors in the securities of holding companies and their subsidiary companies and affiliates . . . [is] or may be adversely affected . . . when control of subsidiary public-utility companies . . . is exerted through disproportionately small investment. . . ."[4] The Commission has concluded that in administering the section requiring fair and equitable distribution of voting power Congress intended that the Commission should cope with the evil of "undue concentration of voting control in holding company systems"[5] and that this required comparing the "relative voting strength" of the different classes of security holders in a company "with the relative investments" of each

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1 49 Stat. L. 803 (1935), 15 U.S.C. (1946) §79.

2 Id., §11(b)(2).

3 Id., §1(c).

4 Id., §1(b)(3).

5 American Water Works and Electric Co., 2 S.E.C. 972 at 985 (1937).

class.[6] In determining the investment of a particular class of security holders the Commission has been guided by another evil listed by Congress in section 1, namely, the adverse effect upon investors when "securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions."[7] The Commission believes that the best estimate of the money invested in a company by a class of security holders is found in the property base shown on the company's books "after eliminating from the property and investment accounts such inflationary items as writeups and 'paper profits from intercompany transactions.' "[8] In addition, the Commission generally considers the past earnings record of the company and estimates of future earnings in determining whether voting rights bear a "fair relation to the 'earning capacity of the properties.' "[9]

II

WHEN DOES THE CORPORATE STRUCTURE OF A COMPANY UNFAIRLY DISTRIBUTE NORMAL VOTING POWER AMONG ITS SECURITY HOLDERS?

A. *Determining Property Investment of Security Holders with Voting Control*

1. *Subsidiary Operating Companies.* Generally the Commission has found voting control in a subsidiary operating company is vested in the common stock, at least a majority of which is held by the parent holding company.[10] In determining the property investment represented by the common stock the Commission looks at the company's most recent balance sheet for a statement of the security structure or capitalization. On its face the balance sheet may show a sizable percentage of the total capitalization allocated to the common stock and surplus.[11] However, if the security structure contains preferred stock

[6] Columbia Gas & Electric Corp., 8 S.E.C. 443 at 467 (1941). This comparison, however, must be weighted by differences in risk, return and other factors affecting the position of the different classes of security holders. Electric Bond and Share Co., 9 S.E.C. 978 (1941); Middle West Corp., 14 S.E.C. 250 (1943).

[7] Sec. 1(b)(1).

[8] Puget Sound Power & Light Co., 13 S.E.C. 226 at 233 (1943); Virginia Public Service Co., 14 S.E.C. 406 (1943).

[9] Puget Sound Power & Light Co., 13 S.E.C. 226 at 233 (1943).

[10] Community Gas and Power Co., 13 S.E.C. 532 (1943), and cases cited in following footnotes to this sub-section.

[11] E.g., in County Gas Co., Holding Company Act Release No. 7948 (1947), the capitalization per books showed the common stock and surplus as representing 31.53% of the total.

which is carried on the company's books at an amount which is less than its involuntary liquidation preference, the Commission adjusts the book figures to reflect the larger amount.[12] If any cumulative preferred stock dividends are in arrears the percentage of the total capitalization represented by the preferred stock is increased to reflect these arrearages.[13] Since both of these adjustments increase the percentage of capitalization represented by the preferred stock, they effect a corresponding reduction in the percentage attributable to the common stock and surplus.[14] These adjustments in capitalization may be enough to show that the common stock lacks sufficient equity in assets to justify its carrying voting control in the company[15] but the Commission generally proceeds to compare the adjusted security structure with the company's property base.[16]

As mentioned above,[17] the Commission does not rely on the amounts stated in the company's books for the property or plant account unless these figures contain no inflationary items such as writeups. The Commission does not require any particular system of accounts for public utility companies which are subject to the accounting jurisdiction of either a state commission or the Federal Power Commission.[18] The

[12] Green Mountain Power Corp., Holding Company Act Release No. 10524 (1951); Tide Water Power Co., 16 S.E.C. 445 (1944); Seattle Gas Co., Holding Company Act Release No. 7128 (1947); Pennsylvania Power & Light Co., Holding Company Act Release No. 6167 (1945); Minnesota Power & Light Co., 19 S.E.C. 376 (1945); County Gas Co., Holding Company Act Release No. 7948 (1947); Georgia Power and Light Co., 18 S.E.C. 89 (1945); Federal Water and Gas Corp., 12 S.E.C. 766 (1943).

[13] Eastern Minnesota Power Corp., Holding Company Act Release No. 7822 (1947); Southern Colorado Power Co., 14 S.E.C. 115 (1943); Great Falls Gas Co., 14 S.E.C. 377 (1943); Kewanee Public Service Co., Holding Company Act Release No. 6797 (1946); Midland Utilities Co., Holding Company Act Release No. 7054 (1946); Memphis Street Railway Co., Holding Company Act Release No. 8942 (1949); Ogden Corp., 13 S.E.C. 340 (1943); County Gas Co., Holding Company Act Release No. 7948 (1947); Tide Water Power Co., 16 S.E.C. 445 (1944); Georgia Power and Light Co., 18 S.E.C. 89 (1945); Green Mountain Power Corp., Holding Company Act Release No. 10524 (1951); Seattle Gas Co., Holding Company Act Release No. 7128 (1947).

[14] If, for analytical purposes, the Commission sets up a new balance sheet to reflect these adjustments, they are charged off against surplus. Pennsylvania Power & Light Co., Holding Company Act Release No. 6167 (1945). This may create a surplus deficit which wipes out a portion of the common stock account. Great Falls Gas Co., 14 S.E.C. 377 (1943); Kewanee Public Service Co., Holding Company Act Release No. 6797 (1946). If the surplus deficit exceeds the book value of the common stock, the preferred stock account shows an impairment. Georgia Power and Light Co., 18 S.E.C. 89 (1945); Eastern Minnesota Power Corp., Holding Company Act Release No. 7822 (1947).

[15] Seattle Gas Co., Holding Company Act Release No. 7128 (1947).

[16] This has been done even where the adjusted capitalization showed no equity left for the common stock. Eastern Minnesota Power Corp., Holding Company Act Release No. 7822 (1947).

[17] Note 8 supra and accompanying text.

[18] S.E.C., TENTH ANNUAL REPORT 73 (1944).

Federal Power Commission has promulgated uniform systems of accounts for utilities subject to its jurisdiction and the National Association of Railroad and Utilities Commissioners has recommended uniform systems of accounts which are identical with the Power Commission's for present purposes.[19] All of the state commissions regulating electric utilities have adopted one or the other of these systems.[20] The Securities and Exchange Commission requires all electric utilities not subject to accounting regulation by a state commission or the Power Commission to keep their accounts in the manner prescribed by the Power Commission and gas utilities not otherwise regulated must keep accounts in the manner recommended by the association.[21]

These uniform systems require the division of the plant account into three categories. Account 100.1 is to include the original cost of the physical plant when it is first devoted to public use.[22] Account 100.5 is to include any amounts in the book figures which represent the difference between the arm's length cost to the company and the original cost properly classifiable in Account 100.1.[23] If the company paid more for its plant than it would in an arm's length transaction, because the property was purchased from the holding company parent or an affiliate seeking intra-company profits, or if after acquisition the acquiring company appraised the plant at a figure higher than arm's length cost, such excess must be segregated in Account 107.[24]

If the book figures in the plant account contain any known elements properly classifiable in Accounts 100.5 or 107 they are usually deducted when determining the sums invested in the company's property.[25] The

[19] F.P.C., UNIFORM SYSTEM OF ACCOUNTS PRESCRIBED FOR PUBLIC UTILITIES AND LICENSEES SUBJECT TO THE PROVISIONS OF THE FEDERAL POWER ACT (1936); F.P.C., UNIFORM SYSTEM OF ACCOUNTS PRESCRIBED FOR NATURAL GAS COMPANIES SUBJECT TO THE PROVISIONS OF THE NATURAL GAS ACT (1939); N.A.R.U.C., UNIFORM SYSTEM OF ACCOUNTS FOR ELECTRIC UTILITIES (1937); N.A.R.U.C., UNIFORM CLASSIFICATION OF ACCOUNTS FOR GAS UTILITIES (1939).

[20] Kripke, "A Case Study in the Relationship of Law and Accounting: Uniform Accounts 100.5 and 107," 57 HARV. L. REV. 433 at 435 (1944).

[21] RULE U-27, GENERAL RULES AND REGULATIONS UNDER THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 (Government Printing Office Edition, 1946).

[22] Kripke, "A Case Study in the Relationship of Law and Accounting: Uniform Accounts 100.5 and 107," 57 HARV. L. REV. 433 at 436; Southern Colorado Power Co., 14 S.E.C. 115 (1943).

[23] This includes intangible items such as good will or going concern value, costs of financing, organization costs and franchise costs. Florida Power and Light Co., 15 S.E.C. 85 (1943); Southern Colorado Power Co., 14 S.E.C. 115 (1943).

[24] See cases cited in preceding note.

[25] Tide Water Power Co., 16 S.E.C. 445 (1944); Mississippi River Power Co., 19 S.E.C. 65 (1945); Green Mountain Power Corp., Holding Company Act Release No. 10524 (1951); Eastern Minnesota Power Corp., Holding Company Act Release No. 7822 (1947); County Gas Co., Holding Company Act Release No. 7948 (1947); Spokane Gas

Commission is not so often concerned with investigating the adequacy of depreciation reserves[26] and, when they are found to be deficient, does not require a retroactive correction through a charge to earned surplus.[27] But if a company admits its depreciation reserve is inadequate and proposes an increase, the reserve is adjusted to reflect this change.[28] This reserve plus any others pertinent to the plant account[29] are deducted from the adjusted gross plant to obtain the adjusted net plant. The latter is then combined with other net assets representing a present value.[30] Against the total net assets, as adjusted, are ranked the claims of the various security holders in the order of their priority: debt, preferred stock at liquidating value plus arrears, and common stock.[31]

& Fuel Co., 16 S.E.C. 565 (1944); Utah Power & Light Co., 14 S.E.C. 764 (1943); Great Falls Gas Co., 14 S.E.C. 377 (1943); Federal Water and Gas Corp., 12 S.E.C. 766 (1943); Ogden Corp., 13 S.E.C. 340 (1943); North Shore Gas Co., 10 S.E.C. 504 (1941).

In a few cases part or all of the known inflationary items were not eliminated from the adjusted balance sheet set up by the Commission but they were specifically noted and seem to have been relied on in reaching the conclusion that voting power was unfairly distributed. Pennsylvania Power & Light Co., Holding Company Act Release No. 6167 (1945); Minnesota Power & Light Co., 19 S.E.C. 376 (1945); Electric Power & Light Corp., 15 S.E.C. 1048 (1944). But cf. Kewanee Public Service Co., Holding Company Act Release No. 6797 (1946).

26 Possibly because elimination of inflationary items from the plant accounts frequently shows a complete lack of common stock equity in assets. E.g., Spokane Gas & Fuel Co., 16 S.E.C. 565 (1944).

27 Midland Utilities Co., Holding Company Act Release No. 7054 (1946). Cf. Indiana Hydro-Electric Power Co., 15 S.E.C. 941 (1944), where the Commission required an increase in the depreciation reserve when a company was in effect selling its assets through a merger into another company.

28 Long Island Lighting Co., Holding Company Act Release No. 8449 (1948); Great Falls Gas Co., 14 S.E.C. 377 (1943); Utah Power & Light Co., 14 S.E.C. 764 (1943); Georgia Power and Light Co., 18 S.E.C. 89 (1945). In one case the Commission's conclusions appear to have been affected by the inadequacy of the reserve although the amount of the deficiency was not determined and the company had not proposed an increase. Ogden Corp., 13 S.E.C. 340 (1943). In another case the Commission merely noted the small common stock equity "without taking into account any deficiencies in the depreciation reserve." Pennsylvania Power & Light Co., Holding Company Act Release No. 6167 (1945) at p. 9.

29 Such as reserves previously set up by the company to cover inflationary items. These items, of course, are subtracted from the plant account only once. Georgia Power and Light Co., 18 S.E.C. 89 (1945); Memphis Street Railway Co., Holding Company Act Release No. 8942 (1949).

30 Deferred charges such as capital stock discount and expense, debt discount and expense, revaluation expenses, and abandoned property being amortized are carried on the asset side of the balance sheet. The Commission excludes such items since they "do not represent any present assets or value in any real sense." Tide Water Power Co., 16 S.E.C. 445 at 449 (1944); Federal Water and Gas Corp., 12 S.E.C. 766 (1943); Indiana Hydro-Electric Power Co., 15 S.E.C. 941 (1944).

31 E.g., Tide Water Power Co., 16 S.E.C. 445 (1944); Georgia Power and Light Co., 18 S.E.C. 89 (1945). Another method used to show the effect of eliminating inflationary items and assets of no present value plus any increase in depreciation reserves is through additional adjustments in the capitalization comparable to those used in adjusting for

2. *Holding Companies.* When the issue is whether the corporate structure of a holding company controlled by its common stockholders unfairly distributes voting power among its security holders, determination of the property investment of the common stockholders differs somewhat depending on whether the Commission relies on the holding company's corporate balance sheet or upon a consolidated balance sheet covering the holding company and its subsidiaries.[32] If the holding company's corporate balance sheet is used, the procedure is the same as the Commission follows in dealing with a subsidiary operating company, except for an additional problem of appraising the value of the holding company's investment in subsidiaries.[33] These investments will constitute the most important assets of a company which is solely a holding company but are of less relative importance where the company is principally an operating company.[34] Yet even in the case of the former, the Commission does not attempt an independent evaluation of the investments. It is only where the holding company itself proposes to write down its investment accounts that the Commission adjusts the corporate balance sheet to reflect this change.[35]

preferred stock arrears. See note 14 supra; County Gas Co., Holding Company Act Release No. 7948 (1947).

[32] The Commission generally uses one or the other but in three cases both were examined. Central Public Utility Corp., Holding Company Act Release No. 7691 (1947); United Gas Corp., 16 S.E.C. 531 (1944); Peoples Light & Power Co., Holding Company Act Release No. 6000 (1945).

[33] Long Island Lighting Co., Holding Company Act Release No. 8449 (1948); United Gas Improvement Co., Holding Company Act Release No. 7913 (1947); Central Public Utility Corp., Holding Company Act Release No. 7691 (1947); Eastern Minnesota Power Corp., Holding Company Act Release No. 7441 (1947); New England Gas and Electric Assn., Holding Company Act Release No. 6729 (1946); Pennsylvania Edison Co., Holding Company Act Release No. 6723 (1946); York County Gas Co., 17 S.E.C. 644 (1944); Standard Gas and Electric Co., 17 S.E.C. 279 (1944); United Gas Corp., 16 S.E.C. 531 (1944); United Corp., 13 S.E.C. 854 (1943); Federal Water and Gas Corp., 12 S.E.C. 766 (1943); Community Power and Light Co., 6 S.E.C. 182 (1939); Peoples Light and Power Co., Holding Company Act Release No. 6000 (1945).

[34] Cf. United Gas Improvement Co., Holding Company Act Release No. 7913 (1947) with Pennsylvania Edison Co., Holding Company Act Release No. 6723 (1946).

[35] Community Power and Light Co., 6 S.E.C. 182 (1939) (elimination of arbitrary writeups); New England Gas and Electric Assn., Holding Company Act Release No. 6729 (1946) (reduction to underlying book value); Long Island Lighting Co., Holding Company Act Release No. 8449 (1948) (reduction to nominal value pursuant to order of state commission, reduction to underlying book value of stock to be received after recapitalization of subsidiary); York County Gas Co., 17 S.E.C. 644 (1944) (reduction to undefined "present value" in anticipation of a sale of the investments). Cf. Standard Gas and Electric Co., 17 S.E.C. 279 (1944), where the company proposed to exchange investment securities for those issued by the holding company itself. The investment account was reduced here to the highest appraisal figure offered by company witnesses.

In Eastern Minnesota Power Corp., Holding Company Act Release No. 7441 (1947), the holding company proposed to distribute its assets and dissolve. Here the Commission did take the initiative and reduced the investment account to the underlying book value of stock to be received on recapitalization of a subsidiary.

Where the Commission relies on a consolidated balance sheet covering the holding company and its subsidiaries, and where all of the outstanding subsidiary securities are owned by the parent holding company, the procedure in determining the property investment of the security holders is exactly the same as where the Commission is dealing only with a subsidiary company.[36] But where some subsidiary securities are publicly held a question arises as to their relative position as a claim against assets. Publicly held subsidiary debt is ranked ahead of holding company debt securities[37] while subsidiary preferred and common stock come in ahead of holding company preferred.[38] Otherwise, consolidated capitalization and assets are adjusted in the same fashion as the corporate capitalization and assets of a subsidiary company.[39]

B. *Determining the Relationship of the Securities with Voting Control to the "Earning Capacity" of the Company*

The Commission has found an unfair distribution of voting power without considering the relation of corporate earnings to the stock carrying voting control[40] but in most cases such a finding is made only after a comparison of the controlling stock's equity in earnings as well as assets. Where the Commission is proceeding on its own initiative to investigate voting power distribution and where the company involved

[36] Kings County Lighting Co., Holding Company Act Release No. 7060 (1946); Virginia Public Service Co., 14 S.E.C. 406 (1943); Ogden Corp., 13 S.E.C. 340 (1943); Puget Sound Power & Light Co., 13 S.E.C. 226 (1943). However, where a consolidated balance sheet is used but not all of the subsidiaries are consolidated, there is still an investment account to be considered. Federal Water and Gas Corp., 12 S.E.C. 766 (1943); National Power & Light Co., Holding Company Act Release No. 8445 (1948). Even where all subsidiaries are consolidated, the holding company may have investments in nonsubsidiaries. National Power & Light Co., ibid.; International Utilities Corp., 13 S.E.C. 206 (1943).

[37] Central Public Utility Corp., Holding Company Act Release No. 7691 (1947). Holding company debt was apparently unsecured here.

[38] International Utilities Corp., 13 S.E.C. 206 (1943); Central Public Utility Corp., Holding Company Act Release No. 7691 (1947); Ogden Corp., 13 S.E.C. 340 (1943); Republic Service Corp., 12 S.E.C. 852 (1943); North Continent Utilities Corp., 14 S.E.C. 656 (1943); Niagara Hudson Power Corp., 16 S.E.C. 139 (1944). *Contra:* United Gas Corp., 16 S.E.C. 531 (1944); Utah Power and Light Co., 14 S.E.C. 764 (1945).

[39] See cases cited in preceding note.

[40] This has occurred where the Commission was dealing with subsidiary operating companies, Pennsylvania Power & Light Co., Holding Company Act Release No. 6167 (1945); Mississippi River Power Co., 19 S.E.C. 65 (1945), and with holding companies which were primarily operating companies. Pennsylvania Edison Co., Holding Company Act Release No. 6723 (1946); Kings County Lighting Co., Holding Company Act Release No. 7060 (1946). Cf. New England Gas and Electric Assn., Holding Company Act Release No. 6729 (1946), involving a voting trust agreement which took away control from the stockholders.

has not proposed a voluntary plan to change its present allocation of voting power, the Commission's position is that the prospective earning power of the company is not in issue so past earnings, as shown in the company's income statements, may be relied on even though "historical earnings are not conclusive on the question of prospective earnings."[41] But if a company voluntarily submits its own plan for ensuring a fair distribution of voting power it frequently offers estimates as to future earnings and the Commission considers these as well as historical earnings in determining whether the changes proposed in the company's plan are necessary.[42]

1. *Subsidiary Operating Companies.* Where only historical earnings are considered, the Commission is interested in whether earnings have been sufficient to cover debt and preferred stock requirements and still leave a substantial share for the common stockholders or whether, due to a poor earning record, there have been debt defaults, an accumulation of preferred stock dividend arrearages, or a thin equity left for the common stock.[43] Here the Commission is generally willing to rely on the figures given in the income statements,[44] but where historical earnings are being used as a basis for forecasting future earnings certain adjustments must be made. If the trend of operating revenues during the period studied is upward but this is due to unusual

[41] Commonwealth & Southern Corp., 11 S.E.C. 138 at 169-170 (1942); Long Island Lighting Co., Holding Company Act Release No. 8449 (1948). But cf. Tide Water Power Co., 16 S.E.C. 445 (1944), and Niagara Hudson Power Corp., 16 S.E.C. 139 (1944).

[42] Where the past record is very poor, the Commission sometimes relies on this alone and disregards company estimates. Georgia Power and Light Co., 18 S.E.C. 89 (1945); Midland Utilities Co., Holding Company Act Release No. 7054 (1946); Virginia Public Service Co., 14 S.E.C. 406 (1943); Utah Power & Light Co., 14 S.E.C. 764 (1943); Community Power and Light Co., 6 S.E.C. 182 (1939). If a company submitting a voluntary plan does not attempt to estimate future earnings, the Commission generally considers only past earnings. United Corp., 13 S.E.C. 854 (1943); North Continent Utilities Corp., 14 S.E.C. 656 (1943); Federal Water and Gas Corp., 12 S.E.C. 766 (1943); Ogden Corp., 13 S.E.C. 340 (1943); Great Falls Gas Co., 14 S.E.C. 377 (1943); Electric Power & Light Corp., 15 S.E.C. 1048 (1944); United Gas Corp., 16 S.E.C. 531 (1944). But in County Gas Co., Holding Company Act Release No. 7948 (1947), and Memphis Street Railway Co., Holding Company Act Release No. 8942 (1949), the Commission made its own appraisal of earning prospects.

[43] Spokane Gas & Fuel Co., 16 S.E.C. 565 (1944); Midland Utilities Co., Holding Company Act Release No. 7054 (1946); Kewanee Public Service Co., Holding Company Act Release No. 6797 (1946); Georgia Power and Light Co., 18 S.E.C. 89 (1945); Electric Power & Light Corp., 15 S.E.C. 1048 (1944); Great Falls Gas Co., 14 S.E.C. 377 (1943); Utah Power & Light Co., 14 S.E.C. 764 (1943); Federal Water and Gas Corp., 12 S.E.C. 766 (1943); Ogden Corp., 13 S.E.C. 340 (1943).

[44] However, if the company admits inadequate depreciation accruals in the past, this factor is noted by the Commission in appraising the earnings record. Utah Power and Light Co., 14 S.E.C. 764 (1943); Great Falls Gas Co., 14 S.E.C. 377 (1943). Also see Electric Power & Light Corp., 15 S.E.C. 1048 (1944).

conditions, such as increased business during World War II, such trends are discounted.[45] If during the period studied there has been an important change in the nature of the company's operations, the record of earnings since that change is entitled to the most weight in determining future earnings.[46] The effect of a recent rate increase[47] or a construction program[48] in increasing revenues may be considered but past earnings attributable to abandoned property must be deducted.[49] Operating revenue deductions must be restated to reflect the impact of recent increases and anticipated increases in labor and material costs, federal income taxes and depreciation accruals.[50]

After adjusted gross income is obtained by deducting adjusted operating expenses from adjusted operating revenues past deductions from gross income are considered. If certain unusual deductions have been made in the past and are not likely to recur or if certain items, such as abandoned property, were being amortized over a period but are now to be written off completely, these deductions are disregarded in determining future income.[51] Contrariwise, if Account 100.5 items have been found in the plant account, these are usually amortized, rather than written off immediately, and such new deductions from gross income must be considered.[52] Increased interest

[45] "Projections into the future which assume that revenues in wartime are likely to persist after the war . . . are, we think, unwarranted. We believe that substantial recognition must be given to the pre-war level of operations as an indication of probable post-war levels." Southern Colorado Power Co., 14 S.E.C. 115 at 127 (1943). The former may be increased somewhat, however, if war production activities have left a permanent population increase in the service area. Seattle Gas Co., Holding Company Act Release No. 7128 (1947); Jacksonville Gas Co., 11 S.E.C. 449 (1942).

[46] Seattle Gas Co., Holding Company Act Release No. 7128 (1947). Cf. Memphis Street Railway Co., Holding Company Act Release No. 8942 (1949), where a change in the nature of the company's business plus other factors made historical earnings of little value and the Commission concluded that a precise estimate of future earnings was not feasible.

[47] Memphis Street Railway Co., Holding Company Act Release No. 8942 (1949).

[48] Eastern Minnesota Power Corp., Holding Company Act Release No. 7822 (1947); Green Mountain Power Corp., Holding Company Act Release No. 10524 (1951).

[49] Tide Water Power Co., 16 S.E.C. 445 (1944). Properties which cannot be operated at a profit must be valued on a liquidation-in-operation basis and any operating revenues obtained from them must be disregarded in determining long range levels. Southern Colorado Power Co., 14 S.E.C. 115 (1943).

[50] Eastern Minnesota Power Corp., Holding Company Act Release No. 7822 (1947); Minnesota Power & Light Co., 19 S.E.C. 376 (1945); Southern Colorado Power Co., 14 S.E.C. 115 (1943); Memphis Street Railway Co., Holding Company Act Release No. 8942 (1949). In Indiana Hydro-Electric Power Co., 15 S.E.C. 941 (1944), the Commission increased past depreciation accruals to the amounts claimed for federal income tax purposes.

[51] Tide Water Power Co., 16 S.E.C. 445 (1944); Southern Colorado Power Co., 14 S.E.C. 115 (1943).

[52] Tide Water Power Co., 16 S.E.C. 445 (1944); Minnesota Power and Light Co., 19 S.E.C. 376 (1945).

charges due to financing of new construction[53] and decreased charges through anticipated debt refunding at lower interest rates[54] require additional adjustments.

Adjusted net income remaining is compared with current preferred dividend requirements plus any existing arrearages in determining whether common stockholders may expect future dividends.[55]

2. *Holding Companies.* Where the Commission relies on the past earnings of a holding company, the approach is the same as with subsidiary operating companies, whether corporate or consolidated income statements are used.[56] Where an attempt is made to forecast future earnings from past corporate income statements, there is an additional problem of estimating non-operating revenue from investments in subsidiaries.[57] If consolidated income statements are used as a basis for forecast, besides adjustments of the sort described above in connection with subsidiary operating companies,[58] the Commission occasionally attempts to determine how much of the consolidated net income produced by each subsidiary company may be drawn up by the holding company so as to be available for payment of dividends on the holding company stock.[59]

[53] Seattle Gas Co., Holding Company Act Release No. 7128 (1947); Eastern Minnesota Power Corp., Holding Company Act Release No. 7822 (1947).

[54] Southern Colorado Power Co., 14 S.E.C. 115 (1943).

[55] E.g., Minnesota Power & Light Co., 19 S.E.C. 376 (1945); Seattle Gas Co., Holding Company Act Release No. 7128 (1947).

[56] Long Island Lighting Co., Holding Company Act Release No. 8449 (1948); Community Power and Light Co., 6 S.E.C. 182 (1939); United Corp., 13 S.E.C. 854 (1943); Federal Water and Gas Corp., 12 S.E.C. 766 (1943); Ogden Corp., 13 S.E.C. 340 (1943); Virginia Public Service Co., 14 S.E.C. 406 (1943); Peoples Light & Power Co., Holding Company Act Release No. 6000 (1945).

[57] In York County Gas Co., 17 S.E.C. 644 (1944), the company estimated a receipt of $12,000 a year from its investment in one company and no income from another. The Commission considered the earnings records of both companies for the past five years and several factors which might affect future earnings but no specific adjustments were made. However, when future earning estimates were based on an untried change in methods of operation, no provision was made for future increased costs of operation, yet the estimates were substantially higher than in past years, the Commission concluded that the estimates were unduly optimistic and lowered them to a figure slightly above the average for the past nine years. The Commission assumed the percentage of net income paid out to the holding company would be the same as in the past. United Gas Improvement Co., Holding Company Act Release No. 7913 (1947).

[58] Central Public Utility Corp., Holding Company Act Release No. 7691 (1947); Utah Power & Light Co., 14 S.E.C. 764 (1943); Puget Sound Power & Light Co., 13 S.E.C. 226 (1943); Columbia Gas & Electric Corp., 12 S.E.C. 218 (1942); National Power and Light Co., Holding Company Act Release No. 8445 (1948); Niagara Hudson Power Corp., 16 S.E.C. 139 (1944); Standard Gas and Electric Co., 17 S.E.C. 279 (1944).

[59] In Central Public Utility Corp., Holding Company Act Release No. 7691 (1947), the holding company had estimated that 80 percent of the available income of its subsidiaries would be drawn up but admitted that this would not be true of all subsidiaries since some would need to keep most of their earnings for future developments. Hence, the Commission discounted the company's estimates.

C. *What Amounts to an Unfair Distribution of Normal Voting Power?*

1. *Between Common and Preferred Stockholders.* The clearest case of an unfair distribution of normal voting power among the holders of common and preferred stock is where the Commission finds that the common stock with voting control represents no investment in adjusted net assets and has no chance of sharing in prospective earnings.[60] As mentioned above,[61] the Commission is willing to rely on the past earnings record of a company, irrespective of its future earning power, so voting control in a common stock with no equity in assets and none in past earnings also violates section 11(b)(2).[62] Emphasizing the congressional mandate concerning control through "disproportionately small investment,"[63] the Commission has relied on the absence of any claim to assets as alone sufficient to show that the common stock should not have voting control.[64] This is true even where the Commission has studied the past earnings records or future estimates which showed a substantial claim to earnings.[65]

[60] County Gas Co., Holding Company Act Release No. 7948 (1947); Utah Power & Light Co., 14 S.E.C. 764 (1943); Southern Colorado Power Co., 14 S.E.C. 115 (1943); Indiana Hydro-Electric Power Co., 15 S.E.C. 941 (1944); Federal Water and Gas Corp., 12 S.E.C. 766 (1943). Cf. Market Street Railway Co., Holding Company Act Release No. 9376 (1949), where the prior preferred stock had the only equity in the company yet subordinate issues of preferred stock combined with the common stock had voting control.

[61] Note 41 supra and accompanying text.

[62] In these situations preferred stock dividend requirements had not been earned in the past 6 to 13 years. International Utilities Corp., 13 S.E.C. 206 (1943); Ogden Corp., 13 S.E.C. 340 (1943); Kewanee Public Service Co., Holding Company Act Release No. 6797 (1946); Eastern Minnesota Power Corp., Holding Company Act Release No. 7441 (1947); Long Island Lighting Co., Holding Company Act Release No. 8449 (1948); United Gas Corp., 16 S.E.C. 531 (1944); Peoples Light & Power Co., Holding Company Act Release No. 6000 (1945).

[63] See note 4 supra and accompanying text.

[64] Kings County Lighting Co., Holding Company Act Release No. 7060 (1946); Pennsylvania Edison Co., Holding Company Act Release No. 6723 (1946); Pennsylvania Power & Light Co., Holding Company Act Release No. 6167 (1945).

[65] In Federal Water and Gas Corp., 12 S.E.C. 766 (1943), there were no present preferred dividend arrears and corporate net income for the past 5 years averaged twice the preferred dividend requirement. In the other cases where past earnings were considered, preferred dividend requirements had not been earned in most of the years studied, Georgia Power and Light Co., 18 S.E.C. 89 (1945); were barely covered, Tide Water Power Co., 16 S.E.C. 445 (1944); Electric Power & Light Corp., 15 S.E.C. 1048 (1944); or earnings applicable to the common stock could not be paid out in dividends because of a surplus deficit, Midland Utilities Co., Holding Company Act Release No. 7054 (1946); or debt restrictions on payment of dividends, Virginia Public Service Co., 14 S.E.C. 406 (1943).

In Minnesota Power & Light Co., 19 S.E.C. 376 (1945), there were no existing preferred dividend arrears and future net income would cover preferred stock dividend requirements 1.4 times. In the other cases, some with greater coverage of the preferred dividend requirements, it would take 5 to 35 years to pay off existing preferred dividend

In the cases where voting control in a common stock with some claim in adjusted assets was still unfair to the preferred stockholders, the claim of the latter has been at least twice as great.[66]

2. *Between Holders of Equity and Holders of Debt Securities.* Ordinarily, debt securities carry no normal voting power because of an assumption that they have no justifiable interest in the conduct of ordinary corporate affairs.[67] It is the Commission's position, however, that "when debt is so insufficiently protected by assets and earnings that the creditors bear part of the speculative risk of the enterprise, a distribution of voting power which leaves the creditors disenfranchised is inequitable."[68] When the stockholders have no equity in assets or earnings, the creditors are the real owners of the company and must be given control.[69] Where debt amounted to 87.8 percent of the adjusted net property, and earnings for the past ten years averaged 1.6 times debt interest, the Commission ordered improvement of these ratios.[70]

arrears. Georgia Power & Light Co., 18 S.E.C. 89 (1945); Eastern Minnesota Power Corp., Holding Company Act Release No. 7822 (1947); York County Gas Co., 17 S.E.C. 644 (1944); Puget Sound Power & Light Co., 13 S.E.C. 226 (1943). Also see Green Mountain Power Corp., Holding Company Act Release No. 10524 (1951); Long Island Lighting Co., Holding Company Act Release No. 8449 (1948); Central Public Utility Corp., Holding Company Act Release No. 7691 (1947); Community Power & Light Co., 6 S.E.C. 182 (1939). Cf. Seattle Gas Co., Holding Company Act Release No. 7128 (1947), where the second preferred would be entitled to participation after arrears on the first preferred were paid off during the next 20 to 61 years. Also see Standard Gas and Electric Co., 17 S.E.C. 279 (1944).

66 The strongest common stock claim to assets was found in Mississippi River Power Co., 19 S.E.C. 65 (1945), where the common stock represented 12.72% of the net assets after elimination of inflationary items but the preferred stock represented 2.4 times as much. Prospective net income would cover preferred stock dividend requirements 2.3 times. Also see Niagara Hudson Power Corp., 16 S.E.C. 139 (1944), where the preferred stock represented approximately 2.5 times as much assets and past earnings showed a slender margin of earnings for the common stock. In the three other cases where the common stock had some claim to assets, the preferred stock represented from 4 to over 9 times as much. United Corp., 13 S.E.C. 854 (1943); Memphis Street Railway Co., Holding Company Act Release No. 8942 (1949); Columbia Gas and Electric Corp., 12 S.E.C. 218 (1942).

67 That this assumption may have been true in the past but is so no longer, see DEWING, CORPORATION SECURITIES 236-238 (1934).

68 Southern Colorado Power Co., 14 S.E.C. 115 at 131-132 (1943).

69 Jacksonville Gas Co., 11 S.E.C. 449 (1942); Long Island Lighting Co., Holding Company Act Release No. 8449 (1948); Spokane Gas & Fuel Co., 16 S.E.C. 565 (1944); Utah Power & Light Co., 14 S.E.C. 764 (1943). Cf. Great Falls Gas Co., 14 S.E.C. 377 (1943), and Ogden Corp., 13 S.E.C. 340 (1943), where the debt securities exceeded adjusted assets and claimed most, if not all, of the earnings.

70 Tide Water Power Co., 16 S.E.C. 445 (1944). In other cases, the ratio of debt to property ranged as high as 98 percent. Ogden Corp., 13 S.E.C. 340 (1943); York County Gas Co., 17 S.E.C. 644 (1944); Federal Water and Gas Corp., 12 S.E.C. 766 (1943); New England Gas and Electric Assn., Holding Company Act Release No. 6729 (1946); Midland Utilities Co., Holding Company Act Release No. 7054 (1946); Long Island Lighting Co., Holding Company Act Release No. 8449 (1948).

Even where bond interest would be earned 2.63 times according to earning estimates but debt would constitute 80 percent of adjusted net property, the latter ratio was so high as to cause an unfair distribution of voting power unless the company provided for a systematic debt retirement program which would improve the ratio rapidly.[71] In another case where the ratio of debt to net property was 79.4 percent of adjusted net property and income deductions had been covered meagerly in the past, the Commission ordered the elimination of open account advances from the parent holding company, those advances constituting approximately one-third of the total debt.[72] Voluntary plans to retire immediately a substantial amount of debt securities have been approved as appropriate where the ratio of debt securities to adjusted net property was as low as 75 percent[73] and the Commission has emphasized the importance of sinking fund provisions in the debt securities where the debt was less than 60 percent of net property.[74]

III

METHODS USED TO CURE AN UNFAIR DISTRIBUTION OF NORMAL VOTING POWER WITHIN A COMPANY

A. *Recapitalization*

When the Commission finds that the common stock represents little or no equity in the company's assets or earnings and, hence, that the company belongs in substance to the preferred stockholders, one possible solution would be to shift normal voting power from the common stockholders to the preferred stockholders. But the Commission has refused to approve this proposal for a number of reasons. It would leave outstanding a common stock with neither value nor voting power which could serve no other purpose than to snare uninformed investors; it would leave the company with an overcapitalized structure and tend to prevent voluntary rate reductions; voting power would be vested in a stock with only a limited return and, if the common stockholders had any remaining equity in the company, it

[71] Southern Colorado Power Co., 14 S.E.C. 115 (1943).

[72] Long Island Lighting Co., Holding Company Act Release No. 8449 (1948). Also see Long Island Lighting Co., Holding Company Act Release No. 9473 (1949).

[73] Scranton-Spring Brook Water Service Co., Holding Company Act Release No. 6458 (1946); Florida Power and Light Co., 15 S.E.C. 85 (1943); Georgia Power and Light Co., 18 S.E.C. 89 (1945).

[74] North Shore Gas Co., discussed at p. 92 infra. Although, all new bond issues must contain sinking fund provisions. S.E.C., THIRTEENTH ANNUAL REPORT 89 (1947).

would be endangered.[75] Transferring the common stock itself to the preferred stockholders is considered equally objectionable since there is no assurance that the preferred stockholders would not resell it.[76] Nor is purchase of the outstanding preferred stock by the sole common stockholder appropriate since this does not cure the cause of the unfair distribution of voting power, control by a common stock with insufficient equity in the company. The latter method was allowed only on the condition that the preferred stock acquired would be converted into a common stock.[77]

Where the common stock has no realistic claim to assets or earnings, the Commission considers it appropriate for the company to cancel its common stock and reclassify the preferred stock, including any dividend arrears; into new common stock. Such reclassification "merely constitutes recognition of the true character of the preferred stock and has no material effect upon the rights of preferred stockholders."[78] Even where the common stock had an equity in future earnings, though not in present earnings or assets, the Commission has approved plans for recapitalization on an all-common stock basis, the new common to be fairly and equitably distributed among present preferred and common stockholders.[79]

Where a company proposes to recapitalize to cure an unfair distribution of voting power, the Commission has generally, but not always, refused to allow the issuance of new preferred stock along with

[75] These reasons were first advanced against a proposal to shift normal voting power from the common stockholders to the bondholders who really owned the company. Jacksonville Gas Co., 11 S.E.C. 449 (1942). But they have also been used to justify a refusal to shift normal voting power from common to preferred stock. See Utah Power & Light Co., 14 S.E.C. 764 (1943) and cases cited therein.

[76] Ibid.

[77] Electric Power & Light Corp., 15 S.E.C. 1048 (1944).

[78] North Shore Gas Co., 10 S.E.C. 504 at 519 (1941); Federal Water and Gas Corp., 12 S.E.C. 766 (1943); Southern Colorado Power Co., 14 S.E.C. 115 (1943). Also see Seattle Gas Co., Holding Company Act Release No. 7128 (1947) and New England Gas and Electric Assn., Holding Company Act Release No. 6729 (1946), where the Commission considered only the lack of any equity in assets.

The Commission also approved a plan to cancel existing common stock and convert existing preferred into new common where it was "questionable" whether the old common had any equity in earnings, since preferred arrears would not be paid off for 34 years, and there was clearly no equity in assets. York County Gas Co., 17 S.E.C. 644 (1944). Cf. Green Mountain Power Corp., Holding Company Act Release No. 10524 (1951), where existing common stock with only a marginal claim to earnings was cancelled in consideration of the company's giving up certain claims against the holding company parent, the sole common stockholder.

[79] Eastern Minnesota Power Corp., Holding Company Act Release No. 7822 (1947); Laclede Gas Light Co., 16 S.E.C. 26 (1944); Community Power and Light Co., 6 S.E.C. 182 (1939); Scranton-Spring Brook Water Service Co., Holding Company Act Release No. 6458 (1946).

new common stock. The Commission's original position seems to have been that recapitalization on an all-common stock basis was the "most efficient and effective way of ensuring attainment" of a fair distribution of voting power.[80] Later, the Commission's reasoning seemed to be that if the capital structure was unbalanced because of a preferred stock investment which was much greater than that of the common stockholders, recapitalization must be on an all-common stock basis.[81] At present, a large amount of debt securities in the capital structure is the chief reason for the Commission's refusal to allow preferred stock in the recapitalized company. It is the Commission's opinion that retention of preferred stock below a heavy debt structure would put the new common stock in "a position of extreme leverage" and result in a continuance of control through disproportionately small investment.[82] Long-term debt totalling 68 percent of the adjusted capitalization and 74 percent of adjusted net property necessitated replacing outstanding preferred and common with a single class of stock.[83] The same result was called for where long-term debt represented 62.2 percent of adjusted capitalization and 67.7 percent of adjusted net property.[84] A smaller percentage of debt plus a poor earnings record also indicates the inappropriateness of preferred stock in a company's capital structure.[85] Thus, where long-term debt was 54.3 percent of a partially adjusted capitalization and 57.5 percent of partially adjusted net property, the Commission required recapitalization on an all-

80 Commonwealth and Southern Corp., 11 S.E.C. 138 at 165 (1942). Even if preferred stockholders were given the right to vote this would not necessarily cure an unfair distribution since this group, "limited to a fixed rate of dividends and a fixed liquidation preference, may well take only a limited interest in the management of the company's business. As long as their specific interests appear to be protected, they may be tempted to leave the management in the hands of the more vitally interested holders of common stock and thus, through inaction, permit control to be exerted solely by this smaller group of investors. Moreover, there are many practical difficulties in determining what precise allocation of voting power of different kinds would be fair and equitable between different classes of security holders." Ibid.

81 Columbia Gas & Electric Corp., 12 S.E.C. 218 (1942), where the preferred stock investment was over 10 times that of the common stockholders.

82 Long Island Lighting Co., Holding Company Act Release No. 8449, p. 12 (1948).

83 Ibid. Also see Midland Utilities Co., Holding Company Act Release No. 7054 (1946).

84 Utah Power & Light Co., 14 S.E.C. 764 (1943). But cf. Pennsylvania Power & Light Co., Holding Company Act Release No. 6167 (1945).

85 A poor showing on earnings was relied on by the Commission in addition to a large amount of debt in Memphis Street Railway Co., Holding Company Act Release No. 8942 (1949); Georgia Power and Light Co., 18 S.E.C. 89 (1945); Spokane Gas & Fuel Co., 16 S.E.C. 445 (1944); Virginia Public Service Co., 14 S.E.C. 406 (1943); Eastern Minnesota Power Corp., Holding Company Act Release No. 7441 (1947).

common stock basis.[86] The earnings record for the past nine years showed that preferred dividends had never been earned during this period and gross income did not cover fixed charges during the last three years. In *County Gas Company*,[87] existing debt amounted to 45 percent of the adjusted capitalization. The company proposed a partial retirement which would reduce the debt to 40.71 percent and also a recapitalization on an all-common stock basis. The Commission considered these steps "clearly necessary" and was undoubtedly influenced by the failure of earnings to match preferred stock dividend requirements in 13 out of the last 14 years while fixed charges were not covered during six years of this period.[88]

But where the earnings record is better and debt does not exceed 60 percent of the capitalization, retention of a limited amount of preferred stock has been permitted.[89] Where preferred stock is allowed the Commission does not require that the preferred stockholders have any normal voting power. Preferred stockholders are deemed adequately protected if they have the power to elect a majority of the directors when preferred stock dividends have not been paid for a year, plus the right to veto certain corporate actions, such as the issuance of prior preferred stock, which might adversely affect their interests.[90]

B. *Reorganization*

In cases where the Commission finds an unfair distribution of normal voting power affecting the holders of debt securities, it has not shown the same aversion toward retention of debt securities in the

[86] Kewanee Public Service Co., Holding Company Act Release No. 6797 (1946). Although the Commission considered it desirable to eliminate certain items from the plant accounts, thereby increasing the foregoing percentages, no adjustments were made since the accounts were subject to the jurisdiction of a state commission which had not acted on them yet.

[87] Holding Company Act Release No. 7948 (1947).

[88] Where the Commission decides that preferred stock must be eliminated from the capital structure, the common stockholders may prefer to retire the outstanding preferred rather than convert it into common since the latter procedure may result in existing common stockholders losing control of the company. This procedure is permissible where the common stockholders make an additional investment in the company so as to increase the common stock equity to a satisfactory amount. Georgia Power and Light Co., 18 S.E.C. 89 (1945); Florida Power & Light Co., 15 S.E.C. 85 (1943); Great Falls Gas Co., 14 S.E.C. 377 (1944).

[89] Plans involving retention of preferred stock which have been approved by the Commission are discussed in detail at pp. 94-96 infra.

[90] Puget Sound Power and Light Co., 13 S.E.C. 226 (1943). These limited voting rights are described in detail and evaluated in Leary, "Voting Rights in Preferred Stock Issues under the Public Utility Holding Company Act of 1935," 27 TEX. L. REV. 749 (1949).

capital structure that it does with respect to preferred stock.[91] In only one case has the Commission indicated that all debt securities should be converted into common stock. The company has proposed to retire all debt securities through cash payments or cash plus preferred stock in an affiliate company and then convert its own preferred stock into common. These debt securities constituted 81.6 percent of the adjusted capitalization and the Commission stated that any plan to distribute voting power fairly "must include provisions for the modification or elimination of its debt . . . the company has chosen an appropriate method . . . an attempt to retain any portion of the existing debt in the structure would have raised serious problems in view of the speculative character of the business of Transit and the unsatisfactory nature of the indenture."[92]

When a company belongs, not to the preferred stockholders, but to the holders of debt securities, the Commission is not satisfied with a transfer of normal voting power to the debt securities. Instead, there must be "changes in the corporate structure, involving the issuance of new securities."[93] The most appropriate method here is a reorganization in which a portion of the debt securities are converted into new common stock and all of the securities junior to the debt are cancelled. When the debt securities were publicly held, the Commission approved a plan to set up a new corporation, transfer all assets to it, and have the new company issue bonds and common stock which would go to the bond and debenture holders of the old company.[94] If the company belongs to its creditors but all of its securities, both debt and equity, are owned by the holding company parent, the latter may simply contribute a portion of the debt securities to the company being reorganized and this will result in an increase in the common stock equity.[95]

[91] "For an operating company, . . . a ratio of even 66 percent debt and no preferred stock may well be more conservative than a ratio of 50 percent debt plus 25 percent preferred stock." Jacksonville Gas Co., 11 S.E.C. 449 at 472 (1942).

[92] National Power & Light Co., Holding Company Act Release No. 8445, p. 14 (1948). The company operated a local transportation system which included a deteriorated and obsolete railway system in urgent need of replacement. Earnings were of such a marginal and fluctuating nature that estimates of future earnings were not practicable.

[93] Jacksonville Gas Co., 11 S.E.C. 449 at 458 (1942).

[94] Ibid.

[95] In Utah Power & Light Co., 14 S.E.C. 764 (1943), a wholly owned subsidiary company had $3,884,000 in bonds and a $1,500,000 demand note outstanding. The parent proposed to contribute $1,200,000 of the note and $2,059,203 of the bonds and then cause the subsidiary to restate its capitalization at 58.6% debt and 41.4% common stock. The Commission considered this plan "appropriate to achieve compliance with the provisions of Section 11(b)(2)." Id. at 785. Cf. Spokane Gas & Fuel Co., Holding Company Act

Where the equity securities have some interest in assets and earnings, but not enough to support the existing debt structure, the Commission does not insist upon an immediate reduction of the debt but instead allows the company to bring in proposals for retiring a portion periodically until satisfactory ratios are achieved.[96]

After a reorganization or a recapitalization resulting in a new class of common stockholders, the Commission generally lays down a procedure to be followed in the nomination and election of directors in order to free the company from control by the old directors and common stockholders when the latter receive little or no recognition in the new security structure.[97] This procedure has involved the company's filing the names, addresses, and holdings of the new common stockholders in the offices of the Commission;[98] notice of the filing of a list to be sent by the company to the stockholders of record, along with an invitation to nominate directors; restrictions on the power to nominate and elect directors;[99] and the company's sending out an election notice accompanied by "impartial proxies."[100]

Release No. 6065 (1945), where the parent proposed to contribute all of the debt securities held by it, two-thirds of the total, in exchange for all of the new common stock to be issued. This plan was also approved.

96 Appropriate plans involving systematic debt retirement programs are discussed infra at pp. 92-94.

97 Republic Service Corp., Holding Company Act Release No. 6820 (1946); Peoples Light and Power Co., Holding Company Act Release No. 6000 (1945); Commonwealth & Southern Corp., Holding Company Act Release No. 5825 (1945); International Utilities Corp., 15 S.E.C. 435 (1944); Southern Colorado Power Co., 14 S.E.C. 115 (1943); Puget Sound Power & Light Co., 13 S.E.C. 226 (1943); Southern Union Gas Co., 12 S.E.C. 116 (1942); Jacksonville Gas Co., 11 S.E.C. 449 (1942).

98 This list could be inspected and copies by any of these stockholders or their representatives.

99 Generally, each holder of new common stock could cast one nominating vote for each share held, but no candidate was deemed a nominee unless he received a certain minimum (500 to 1000) of nominating votes. However, where a holding company, which had previously controlled the company being recapitalized, was to receive 1.1% of the new common stock, the Commission held the holding company ineligible to make nominations. Southern Colorado Power Co., 14 S.E.C. 115 (1943). In a substantially similar situation, the holding company was barred from voting its common stock for the nomination or election of any director. Puget Sound Power & Light Co., 13 S.E.C. 226 (1943). When a holding company received no securities in the reorganized company, the existing management, previously elected by the holding company, was forbidden to nominate any directors. Jacksonville Gas Co., 11 S.E.C. 449 (1942). In the last two cases cited, only a minority of the new board could consist of past or present directors, officers of employees of the holding company or any of its subsidiaries (including the one changing its corporate structure). In the Southern Colorado case, 14 S.E.C. 115 (1943), no member of the board could be affiliated with the parent holding company.

100 Examination of the solicitation material authorized by the Commission in connection with such elections shows that the proxy material sent out by the company management described the background of each candidate but did not urge the election of any particular nominee. But the Commission did allow other interested parties to mail, at their own expense, material advocating election of certain candidates. Letter from Harry G. Slater, former Chief Counsel, Public Utilities Division, S.E.C. (Nov. 28, 1947).

C. *Merger or Consolidation*

Merger of a subsidiary into a parent, as a means of clearing up an unfair distribution of voting power among the subsidiary's security holders, has been required by the Commission when the subsidiary's properties form such an integral part of the parent's properties that the former cannot be operated independently nor can their earning power be independently evaluated.[101] A lesser degree of integration plus a conflict of interest resulting from such integration when a minority interest in the subsidiary's common stock is publicly held makes merger of the subsidiary into the parent the only method, other than liquidation,[102] which will eliminate the unfair distribution of voting power that exists when the minority stockholders are widely scattered and, "as a practical matter, disenfranchised."[103]

Consolidation of a holding company parent and its subsidiaries into one surviving company has been proposed by a holding company seeking to continue unified operation of the system's properties where separate recapitalization to cure unfair voting power distributions in the subsidiaries would result in the holding company losing control of them. The Commission considered such a plan especially appropriate since separate operation would be more inefficient and, hence, more costly.[104]

101 Utah Power & Light Co., 14 S.E.C. 764 (1943), where the subsidiary's property had been leased to the parent, only the parent made provision for depreciation and this in the form of an unsegregated amount covering the properties of both companies, and rental payments under the lease were adjusted so as to cover only the fixed charges of the subsidiary. Cf. Indiana Hydro-Electric Co., 15 S.E.C. 941 (1944), where the Commission approved a plan to merge a subsidiary company into a non-affiliate company, the latter having leased the subsidiary's property for a number of years so that the subsidiary appeared to be an unnecessary corporate entity with no operating personnel.

102 See note 111 infra and accompanying text.

103 Sioux City Gas and Electric Co., Holding Company Act Release No. 9303, p. 9 (1949). The common stockholders of the subsidiary company would receive common stock in the holding company. Also see Mississippi River Power Co., Holding Company Act Release No. 5776 (1945); North Shore Gas Co., 10 S.E.C. 504 (1941).

104 Long Island Lighting Co., Holding Company Act Release No. 9473 (1949). Also see Peoples Light and Power Co., Holding Company Act Release No. 6000 (1945). Cf. Midland Utilities Co., Holding Company Act Release No. 7054 (1946), where the Commission approved acquisition of the common stock of an operating company by a non-affiliate upon the condition that the subsidiary would be merged into the purchasing company and thereby cure an unfair distribution of voting power in the subsidiary.

Even where a holding company must divest itself of certain subsidiaries, in order to comply with other provisions of the act, and an unfair distribution of voting power must be cleared up before the subsidiaries are disposed of, merger of several interconnected subsidiaries into one of them makes a more attractive company for sale purposes. The Commission approved such a plan in Empire District Electric Co., 16 S.E.C. 322 (1944).

D. *Liquidation*

No decisions have been found in which the Commission ordered a holding company or a subsidiary to liquidate in order to cure an unfair distribution of voting power among its own security holders,[105] but in several cases the Commission has indicated that dissolution was more appropriate than recapitalization.

In *Market Street Railway Company*,[106] the company had previously sold its operating properties and now proposed to pay off creditors' claims, distribute its remaining assets to its preferred stockholders and dissolve. The Commission considered this plan appropriate and probably would have ordered such steps if the company had not proposed them since the Commission noted that "the assets of Market Street are almost wholly liquid and it has no income producing property except as it derives income from its holdings of government securities. In fact, since the sale of its operating properties, Market Street's expenses have exceeded its income and such deficits will in all likelihood continue until dissolution."[107]

In another case a holding company proposed to liquidate since it was unable to refund its maturing bond issue. A preferred stockholders' committee proposed recapitalization instead but the Commission concluded that this would be only a temporary expedient causing unnecessary expense and delay and that liquidation was more feasible since the system consisted of an uneconomic combination of properties, the costs of keeping the holding company and the system service company in existence were high and the break-up value of the subsidiaries was greater than the value of the holding company's assets on a going-concern basis.[108] Where a holding company had disposed of scattered properties, in order to comply with the integration requirements of the act, and remaining properties could not be integrated, separate operation would be at high costs, and the holding company could not carry out any necessary construction program, the Commission found a proposed liquidation program appropriate.[109]

Liquidation as a method of curing an unfair distribution of voting power has been favored by management over recapitalization where the

105 But see the cases discussed at pp. 105-106 infra, where the continued existence of a holding company caused an unfair distribution of voting power among the security holders in the holding company system.

106 Holding Company Act Release No. 9376 (1949).

107 Id. at p. 3.

108 North Continent Utilities Corp., 14 S.E.C. 656 (1943). Also see Great Lakes Utilities Co., 11 S.E.C. 87 (1942).

109 Ogden Corp., 13 S.E.C. 340 (1943).

latter would raise complex problems and prohibitive expenses. In such cases the Commission considers a liquidation plan appropriate.[110] Where recapitalization of a subsidiary would leave the parent with working control and the remainder of the common stock widely distributed, a conflict of interest problem would arise since the subsidiary was part of an integrated system. In such a situation the management's choice of liquidation was considered a proper method.[111]

IV

WHEN IS NORMAL VOTING POWER "FAIRLY AND EQUITABLY" DISTRIBUTED AMONG A COMPANY'S INVESTORS?

Plans offered by companies seeking to comply with the requirement that normal voting power be fairly and equitably distributed are of value, when approved by the Commission, in determining when a corporate structure fairly distributes voting power, at least in those cases where the Commission allows the company to continue in existence or where the company surviving a merger or consolidation is examined for compliance with the requirements of section 11(b)(2).

If a company is not required to lose its identity through merger, consolidation, or liquidation,[112] a reorganization which eliminates all preferred stock and debt securities so that the company emerges with only common stock outstanding, each share carrying one vote, clearly effectuates a fair distribution of normal voting power.[113]

Where plans proposing a debt-common stock structure are submitted, the Commission is concerned with the problem of whether the common stock equity appears to provide adequate protection, both as to assets and earnings, for the debt securities. The common stock would have "a real equity in the enterprise" when debt securities would amount to slightly more than 31 percent of net property adjusted to eliminate all items in the plant account exceeding original cost and prospective gross income would cover interest requirements more than two times.[114] Debt securities amounting to 49 percent of net property were deemed appropriate where gross income would be more than twice

110 Eastern Minnesota Power Corp., Holding Company Act Release No. 7441 (1947); Columbia Gas & Electric Corp., 12 S.E.C. 218 (1942).

111 Pennsylvania Edison Co., Holding Company Act Release No. 6723 (1946).

112 See pp. 89-90 supra.

113 National Power & Light Co., Holding Company Act Release No. 8445 (1948).

114 County Gas Co., Holding Company Act Release No. 7984 (1947). No mention was made of any sinking fund provisions in the remaining debt, which was not being refunded at the time.

fixed charges even though the plant accounts were not properly stated and the depreciation reserve appeared to be inadequate.[115] A voluntary plan submitted by a wholly-owned subsidiary proposed debt consisting of an unsecured note, payable to the parent holding company in four years, amounting to 57 percent of net property after adjustments to eliminate excess over original cost and reflecting a substantial increase in the depreciation reserve. Interest would be earned 2.75 times, according to earnings estimates. This plan was approved as bringing about a fair distribution of voting power.[116] But where a subsidiary company proposed to refund its debt through sale of bonds and serial notes to the public and the new debt would amount to 58.97 percent of net property adjusted to original cost, the ratio was considered high and the Commission noted that the company proposed to retire all serial notes, over 15 percent of total debt, during the next seven years and thereafter nearly 2.5 percent of the bonds each year.[117]

Generally, when debt securities ranged from 60 to 73 percent of adjusted net property, the Commission emphasized the fact that these ratios would improve through the operation of sinking fund provisions in the bond indentures.[118] A different method of increasing the cushion

[115] The company had previously agreed with the state public utility commission to restate its accounts in accordance with the Uniform System of Accounts of the N.A.R.U.C. Seattle Gas Co., Holding Company Act Release No. 7128 (1947). Again, no mention was made of sinking fund provisions although the bonds, when originally issued, provided for payments for 1½% of the maximum amount outstanding. Seattle Gas Co., Holding Company Act Release No. 6341 (1945). Cf. Midland Utilities Co., Holding Company Act Release No. 7054 (1946).

[116] Great Falls Gas Co., 14 S.E.C. 377 (1943).

[117] North Shore Gas Co., 10 S.E.C. 504 (1941). Interest would be covered more than two times.

Cf. United Gas Corp., 16 S.E.C. 531 (1944), where the Commission considered debt securities amounting to 53.32 percent of consolidated net assets, after adjustments to eliminate estimated inflationary items, as rather high for a holding company engaged to a large extent in natural gas and oil operations. Revenues from these activities had fluctuated widely in the past although consolidated gross income for the past year covered debt interest well over three times. The Commission, in approving this amount of debt, emphasized the last year's earning coverage plus sinking fund provisions which would retire 80% of the bonds by the time the issue matured in 17.5 years.

[118] Jacksonville Gas Co., 11 S.E.C. 449 (1942) (debt would amount to 60 percent of net property adjusted to estimated original cost, depreciation reserves would be adequate, interest would be earned somewhat less than 2 times); Spokane Gas & Fuel Co., Holding Company Act Release No. 6065 (1945) (debt would constitute 62.9 percent of net property after elimination of all known inflationary items from the plant accounts and a substantial improvement in depreciation reserves, interest would be earned more than 2 times); Utah Power & Light Co., 14 S.E.C. 764 (1943) (debt would equal 67 percent of net property after elimination of known inflationary items from the plant account and some increase in the depreciation reserve, interest would be earned 1.78 times); Georgia Power and Light Co., 18 S.E.C. 89 (1945) (debt would amount to 68.9 percent of net property stated at original cost, depreciation reserves would be adequate on a straight-line basis, and interest would be earned more than 2 times); Laclede Gas Light Co., 16 S.E.C.

below the debt securities was required by the Commission where debt was 69.7 percent of net property stated at original cost, without adjustments for probable deficiencies in the depreciation reserve, and estimated gross income would cover income deductions more than twice. Here the Commission ordered the company to sell more common stock to improve this ratio.[119] The unwillingness of the Commission to rely on sinking fund provisions here might be due to the fact that the company had no specific plans for refunding existing debt but it was more likely due to the fact that the state commission had found depreciation reserves inadequate by 10 millions. If this amount was taken from surplus and added to the depreciation reserve, the debt securities would then equal 77 percent of net property. For when an operating company, and also a holding company, with an adequate depreciation reserve proposed to refund its debt through the issuance of bonds and serial notes equal to 80 percent of its net plant, 76 percent of total net assets including investments in subsidiaries and 75 percent of the proposed capitalization, the Commission was not satisfied with a debt retirement program which would reduce the debt to 63 percent of the capitalization in ten years. In addition, the Commission required a buildup of the common stock equity through freezing earnings equal to the amount of debt retired each year, less any additions to the capital account during this time.[120]

When ratios are very unfavorable, the company apparently has a choice of rapidly reducing them or else suffering a restriction on dividend payments. Thus, a proposal by an operating-holding company to retain outstanding bonds amounting to 83 percent of adjusted net plant stated at estimated original cost plus the present value of invest-

26 (1944) (debt would constitute 63.6 percent of net property stated at original cost but the depreciation reserve was materially inadequate so the Commission required the diversion of a higher amount of operating revenues into a maintenance and improvement fund than the company had proposed, interest would be earned 3.7 times); Memphis Street Railway Co., Holding Company Act Release No. 8942 (1949) (debt would amount to 73 percent of net property stated at original cost and the depreciation reserve seemed adequate, no precise estimate of future income was made since the company had recently converted to bus transportation and past earnings had fluctuated widely).

119 Long Island Lighting Co., Holding Company Act Release No. 9473 (1949).

120 Estimated gross income would cover debt interest more than two times. Southern Colorado Power Co., 14 S.E.C. 115 (1943). But cf. Florida Power and Light Co., 15 S.E.C. 85 (1943), where debt securities consisting of bonds, sinking fund debentures, and serial notes totalling 75.4 percent of a net plant containing sizable amounts of Account 100.5 items and 74 percent of the proposed capitalization were allowed since it was estimated that the debt retirement program would reduce the net property ratio to 63 percent in ten years. The depreciation reserve was considered acceptable and estimated gross income would cover interest requirements almost 2.5 times.

ments in subsidiaries[121] was unacceptable to the Commission unless any dividend payments were banned or the company set up a systematic debt retirement program. The Commission was satisfied with a proposal to retire enough debt so that the latter would equal 60 percent of net plant plus investments after nine years.[122] But in the case of an operating-holding company proposing to replace bonds and sinking fund debentures amounting to 84.41 percent of a consolidated net plant containing sizable amounts of Account 100.5 items, since this ratio would not be reduced to 60 percent for 15 years, the Commission also imposed a restriction on dividends until the common stock equity in total net assets reached 25 percent.[123]

Plans involving retention of preferred stock in a company's security structure are analyzed to determine whether the equity of the common stock in assets and earnings is sufficient protection not only for the debt securities but also for the preferred stock. Only six of such plans have been approved.

The largest common stock equity in any of the approved plans amounted to 34.25 percent of the total capitalization. However, this constituted only a per books figure since no analysis was made of the plant account or the depreciation reserve.[124] This was due to the fact that the company set up a pro forma balance sheet reflecting a proposed merger of two companies but no definite plan had been presented to the Commission. Earning ratios appeared to be adequate, after adjustments reflecting the merger,[125] but the Commission reserved jurisdiction to take such future action as might be appropriate when a definite plan was presented, even though it stated that the merger would result in a fair distribution of voting power.[126]

[121] Debt would equal 92 percent of net plant alone.

[122] The depreciation reserve appeared to be adequate and interest would be covered about 2 times. York County Gas Co., 17 S.E.C. 644 (1944).

[123] There was some doubt as to the adequacy of the depreciation reserve and earnings were not quite double the interest requirements. Virginia Public Service Co., 11 S.E.C. 415 (1942) and 14 S.E.C. 406 (1943). Also see Tide Water Power Co., 17 S.E.C. 776 (1944) where an operating company proposed a similar restriction since debt would equal 91.38 percent of the total capitalization and 87.45 percent of net property stated at original estimated cost, although sinking fund provisions would reduce the debt to 69 percent of the total capitalization in 10 years. Interest would be covered more than two times. The plan was approved by the Commission.

[124] Preferred stock and debt would be 16.97 and 48.78 percent, respectively. Secured debt was 52.84 percent of net property and the depreciation reserve 23.87 percent of gross plant according to book figures.

[125] Gross income for the past nine months, adjusted to reflect the merger, was 4.18 times debt interest, 2.01 times total income deductions, and 1.72 times total income deductions plus preferred stock dividend requirements.

[126] Midland Utilities Co., Holding Company Act Release No. 7054 (1946).

That a corporate structure may fairly distribute voting power even though its accounts are not satisfactory is also illustrated in *Puget Sound Power & Light Company*.[127] There a common stock equity of 30.8 percent was considered adequate support for preferred stock and debt amounting to 13.2 and 56 percent, respectively, of the total capitalization even though one-fifth of the common stock equity was represented by items which should have been segregated in Account 100.5. However, all Account 107 items would be eliminated under the proposed plan and the depreciation reserve was substantially increased to an acceptable but not necessarily adequate amount.[128] Estimated gross income would be more than twice fixed charges and more than 1.5 times fixed charges plus preferred stock dividend requirements.[129]

Where the state commission had already required the company to restate its plant account at original cost and increase its depreciation reserve to the amount required on a straight-line basis and gross income would cover income deductions 2.89 times and income deductions plus preferred stock dividend requirements 1.90 times, the Commission had no difficulty in approving a capitalization consisting of 26.4 percent common stock equity, 25.3 percent preferred and 48.3 percent debt securities. However, the Commission did note that the company proposed to amend its charter so as to restrict dividend payments whenever the common stock equity dropped below 25 percent of the total capitalization.[130]

Sinking fund provisions in the debt securities plus a common stock dividend restriction designed to achieve and maintain a 25 percent common stock equity bolstered a plan with an initial common stock equity of considerably less than 25 percent to a point where the Commission could label it "a satisfactory means of effectuating compliance with the requirements of Section 11(b)(2)."[131] The company pro-

[127] 13 S.E.C. 226 (1943).

[128] The company's accounts were subject to the regulation of a state commission which had not acted as yet on the Account 100.5 items or the depreciation reserve.

[129] Cf. Scranton-Spring Brook Water Co., Holding Company Act Release No. 6458 (1946), where the Commission approved a capitalization consisting of 28.6 percent common stock, 20.7 percent preferred stock and 50.7 percent debt. A major share of the company's property consisting of water properties, was not stated at original cost because the state commission, according to the company, did not require such properties to be carried at original cost. The Commission itself did not attempt to assert jurisdiction over such property. Interest would be earned 2.83 times and interest plus preferred stock dividend requirements 1.73 times.

[130] King County Lighting Co., Holding Company Act Release No. 7060 (1946). Such restrictions are uniformly required whenever a company issues new preferred stock, as was done in this case. See Leary, "Voting Rights in Preferred Stock Issues under the Public Utility Holding Company Act of 1935," 27 TEX. L. REV. 749 at 769-770 (1949).

[131] Pennsylvania Power & Light Co., Holding Company Act Release No. 6167 (1945).

posed to sell additional common stock and use the proceeds to retire a portion of the preferred stock. Common stock would then constitute 13.75 percent, preferred stock 22.36 percent and debt securities 63.89 percent of a capitalization adjusted to eliminate Account 107 items but containing Account 100.5 items nearly equal to the common stock equity. The company proposed to amortize the latter items over a fifteen year period and income deductions, including amortization charges, would be covered 1.79 times while these deductions plus preferred stock dividend requirements would be covered 1.33 times.[132]

V

WHEN DOES THE CORPORATE STRUCTURE OF A HOLDING COMPANY UNFAIRLY DISTRIBUTE VOTING POWER AMONG INVESTORS IN THE HOLDING COMPANY SYSTEM?

The preceding sections of this paper have been concerned with the problem of the security structure of a corporation, either a holding company or a subsidiary operating company, causing an unfair distribution of voting power among its own investors. But section 11(b) (2) also contemplates the possibility of a holding company's corporate structure causing an unfair distribution of voting power not only among its own investors but also among the security holders of the subsidiary companies in the system. Where this is the issue before the Commission a number of different approaches, sometimes alone, sometimes in combination, have been used in deciding this question.

A. *Emphasis on Holding Company Structure Alone*

It is the Commission's position that where the corporate structure of a holding company unfairly distributes voting power among the company's own investors there is also an unfair distribution of voting power among the security holders of the system as well when control of the holding company means, because of its investment in subsidiary voting stocks, control of the system.[133] It would logically follow then

[132] Also see Minnesota Power & Light Co., Holding Company Act Release No. 5850 (1945), where a common stock equity of 16.2% was acceptable even though it was more than balanced by Account 100.5 items that were to be amortized over a 15 year period. Income deductions, including amortization charges, plus preferred stock dividend requirements would be covered 1.27 times. The Commission emphasized a proposed dividend restriction designed to achieve a 25 percent common stock equity and, also, that the company would continue subject to the jurisdiction of the Commission so that further action could be taken if the dividend restriction didn't work out as anticipated.

[133] International Utilities Corp., 13 S.E.C. 206 (1943).

that the Commission might confine its investigation to the security structure of the holding company, at least when it found an unfair distribution of voting power among the holding company's own security holders. And where the holding company's corporate balance sheet shows that net assets do not cover debt securities and corporate income statements show that the common stock, there being no outstanding preferred, has no present equity in earnings since large amounts of accrued interest must be paid first, such evidence has been held sufficient to show that the holding company's corporate structure unfairly distributed voting power among the system security holders.[134]

It might be expected that in less aggravated cases the Commission would make the same sort of study and in *Commonwealth & Southern Corporation*[135] the Commission, after adjusting the corporate capitalization for preferred arrears, found the common stock and surplus represented only 42.35 percent of the total capitalization and surplus while the preferred stock at stated value plus arrears represented 52.63 percent. Corporate net income had not been sufficient to cover preferred stock dividend requirements for the last nine years. From this the Commission concluded that the holding company's corporate structure unfairly distributed voting power among system investors. But the Commission explained that this conclusion was based on corporate history alone without reference to comparable figures on a consolidated basis "because complete up-to-date figures on a consolidated basis are not presently available."[136] When these figures were available, they were relied on[137] and all other cases found, except the two referred to above, have relied in whole or in part on consolidated figures.

B. *Emphasis on Corporate Balance Sheet, Corporate and Consolidated Earnings*

In three cases where an unfair distribution of voting power was found to exist among system investors the Commission seemed to consider only the corporate balance sheet when investigating the common stock's equity in assets. After some adjustments such as restating preferred stock at its involuntary liquidation preference, including preferred arrears, reducing investments in subsidiaries to their underlying book values, or eliminating inflationary writeups of invest-

[134] North American Gas and Electric Co., 12 S.E.C. 750 (1943). Also see North American Light & Power Co., 17 S.E.C. 148 (1944).

[135] 9 S.E.C. 609 (1941).

[136] Id. at 613n.

[137] Commonwealth and Southern Corp., 11 S.E.C. 138 (1942).

ments and assets of no present value which the company proposed to write off, there was nothing left for the common stock.[138] But in considering whether the common stock had any equity in earnings the Commission in one case relied on corporate and consolidated income statements in evaluating a company estimate that preferred arrears could not be paid off for at least thirty years[139] and in the other cases relied just on consolidated earnings statements.[140]

C. *Emphasis on Consolidated Balance Sheets and Income Statements, in Whole or in Part*

In all the other cases where holding company structures have been found to distribute voting power unfairly among system investors, the Commission has relied on consolidated figures, in whole or in part. In cases where both corporate and consolidated balance sheets were used, the Commission came to the same result on both instruments. After adjustments for dividend arrears on holding company preferred stock, there were no assets for the common stock on either basis.[141] In these

[138] Middle West Corp., 11 S.E.C. 533 (1942); International Hydro-Electric System, 12 S.E.C. 999 (1943); Community Power and Light Co., 6 S.E.C. 182 (1939).

[139] While consolidated net income in the past might justify such a prediction, corporate net income would not since preferred arrears on the preferred stock of certain subsidiary companies had prevented the holding company from drawing up all available consolidated net income. The Commission concluded that there was little, if any, equity in earnings for the common stock. Middle West Corp., 11 S.E.C. 533 (1942).

[140] In International Hydro-Electric Co., 12 S.E.C. 999 (1943), the Commission found that only 9.9 percent of the average consolidated gross income for the last five years was applicable to the common stock. In Community Power and Light Company, 6 S.E.C. 182 (1939), preferred dividend requirements had been earned only in 3 of the last eight years and the excess in those three years was "not such as to indicate a possibility of eliminating the present preferred arrears within a reasonable time, even if all of such earnings could feasibly be distributed." Id. at 190.

[141] American Utilities Service Corp., 16 S.E.C. 173 (1944); General Gas & Electric Corp., Holding Company Act Release No. 5950 (1945); United Public Utilities Corp., Holding Company Act Release No. 6908 (1946); Standard Gas and Electric Co., Holding Company Act Release No. 8773 (1949); Pennsylvania Gas & Electric Corp., Holding Company Act Release No. 8490 (1948). Cf. International Hydro-Electric System, 8 S.E.C. 485 (1941), where the company used four different methods of evaluating its investments but the Commission concluded that there were no assets left for the common stock under any of the methods.

[142] In General Gas & Electric Corp., Holding Company Act Release No. 5950 (1945), neither corporate nor consolidated net income had covered preferred requirements in the last 13 years. In Pennsylvania Gas & Electric Corp., Holding Company Act Release No. 8490 (1948), corporate net income had not covered preferred requirements in the last 11 years. Consolidated net income covered them only in the last year and then only 1.03 times. In Standard Gas & Electric Co., Holding Company Act Release No. 8773 (1949), corporate net income was insufficient in one year while consolidated net income had always covered preferred requirements, but there were large preferred arrears so the Commission concluded there was no foreseeable income for the common stock. In United Public Utilities Corp., Holding Company Act Release No. 6908 (1946), consolidated net income had covered the preferred requirements in 4 of the last 9 years but since sale of a subsidiary

same cases, the Commission considered both corporate and consolidated income statements. In most of the cases there was no substantial difference so far as coverage of preferred stock dividends was concerned,[142] but in one of the cases there was.[143] The discrepancy in the latter case was due to the need of the subsidiary companies for construction funds and the holding company's lack of incentive to draw up earnings because of its capital deficit which precluded payment of dividends.

In seven cases the Commission relied on consolidated balance sheets alone when searching for common stock equity in assets. In three of these cases, after elimination of inflationary items from the book assets or restating the preferred stock at its liquidating preference, consolidated net assets did not cover securities senior to the common stock.[144] Both corporate and consolidated income statements were relied on in these same three cases and the Commission found no equity for the common stock on either basis.[145] In the other four cases the common stock equity in consolidated net assets ranged from 2.77 per-

it was now insufficient. Corporate net income was always below the preferred requirements during this period.

143 In American Utilities Service Corp., 16 S.E.C. 173 (1944), corporate net income had not covered preferred requirements in the last five years but consolidated net income had in four of those years. On the basis of the latter it was estimated that arrears could be paid off in nine years.

144 In Community Gas and Power Co., 13 S.E.C. 532 (1943), combined net utility plant account per books was adjusted to eliminate 11 millions of Account 100.5 and 107 items. After deducting publicly-held subsidiary securities from adjusted net assets, holding company debt was more than twice as much as the remaining property base. There was no outstanding preferred stock here. In American & Foreign Power Co., Holding Company Act Release No. 7815 (1947), the company proposed to write down consolidated book assets more than 231 millions from the book figure of 541 millions. Thirty-five millions of this difference was admitted to be inflationary and 6 millions consisted of unamortized debt discount and expense. The remaining assets would not cover publicly-held subsidiary securities plus holding company debt. In International Utilities Corp., 13 S.E.C. 206 (1943), adjustment of the consolidated capitalization for arrears on holding company preferred stock left 4.24% of the total capitalization for the common stock but when deferred charges were excluded from consolidated net assets and the preferred stock was restated at its liquidating preference, the property base did not cover the preferred stock by 1 million. There were no holding company debt securities here.

145 In American and Foreign Power Co., Holding Company Act Release No. 7815 (1947), there had been no income applicable to the common stock on either basis for the last sixteen years and no future prospect of any. In International Utilities Corp., 13 S.E.C. 206 (1943), no income had been available for the common stock on either basis for the last six years. In Community Gas and Power Co., 13 S.E.C. 532 (1943), the holding company structure consisted of debt and common stock. Corporate income apparently had not covered fixed charges in the eight years since the company had been reorganized. Consolidated income for the last year had been almost 1½ times fixed charges but the holding company had not received enough income from its investments to pay them because of working capital requirements and dividend restrictions of the subsidiary companies.

cent to 13.7 percent after adjustments.[146] In one of these cases the Commission indicated that the corporate structure had always caused an unfair distribution of voting power among system investors even though the common stock at one time represented 16.3 percent of the total capitalization.[147] When the common stock equity in consolidated net assets was only 2.77 percent the Commission concluded that the corporate structure needed revision even if existing preferred arrears could be paid off within a reasonable time.[148] In the other cases where there was a larger equity in assets, the common stock's equity in earnings was also considered but did not change the Commission's conclusions even where there had been consolidated income applicable to the common stock during the past six years and consolidated earned surplus was more than eight times existing arrears on the holding company preferred stock.[149]

D. *Emphasis on Non-Consolidated Subsidiary Figures, in Whole or in Part*

While the Commission has used consolidated figures more frequently than any others when investigating voting power distribution among system investors, in some cases the Commission has relied on figures obtained by combining the figures obtained from separate subsidiary balance sheets. In *Northern New England Company*,[150] the Commission found that the common stock had no equity in corporate assets after adjusting for preferred arrears and was entitled to no earnings on a corporate or consolidated basis but then it considered the percentage of total subsidiary securities held by the holding company

[146] Commonwealth & Southern Corp., 11 S.E.C. 138 (1942) (2.7% of consolidated net assets after adjustments for preferred stock arrears and elimination of inflationary items); Eastern Gas and Fuel Associates, Holding Company Act Release No. 9633 (1950) (3.7% of consolidated capitalization as adjusted to reflect preferred arrears and elimination of inflationary items); International Hydro-Electric System, 11 S.E.C. 888 (1942) (7.7% of consolidated capitalization after adjustment for preferred arrears); Niagara Hudson Power Corp., 16 S.E.C. 139 (1944) (13.3% of consolidated capitalization and 13.9% of consolidated net assets after adjustment, in both cases, for preferred arrears).

[147] Niagara Hudson Power Corp., 16 S.E.C. 139 (1944).

[148] Corporate net income did not cover preferred stock dividend requirements but consolidated net income did. Commonwealth & Southern Corp., 11 S.E.C. 138 (1942).

[149] Niagara Hudson Power Corp., 16 S.E.C. 139 (1944), where the Commission seemed to rely solely on consolidated income statements plus the actual amount of dividends paid on holding company preferred stock. In Eastern Gas and Fuel Associates, Holding Company Act Release No. 9633 (1950), the Commission relied on consolidated figures and found that preferred arrears would not be paid off for a substantial number of years. In International Hydro-Electric System, 11 S.E.C. 888 (1942), there had been consolidated net income applicable to the common stock in 5 out of the last 6 years but no corporate net income during this period.

[150] 9 S.E.C. 224 (1941).

(15.1 percent) before it concluded that the holding company structure caused an unfair distribution of voting power among system investors. But even where the Commission has relied on consolidated figures concerning assets and earnings and found no equity in either for the common stock, it has on occasion double-checked this conclusion by combining net assets on the subsidiaries' books and eliminating inflationary items from these assets, then finding no assets left for the common stock, before concluding that the holding company structure needed revision.[151]

The non-consolidated approach has been used most often where the Commission was dealing with a sub-holding company and examining the top holding company's investment, through its sub-holding company, in subsidiaries of the latter. Here the sub-holding company's capitalization is adjusted to reflect elimination from the investment account of any excess over underlying book value and the percentage of this adjusted capitalization represented by the top holding company's investment in the sub-holding company is then computed. This percentage is multiplied into the underlying book value of the sub-holding company's investment in its subsidiary companies. The product is then compared with the combined capitalizations of the subsidiary operating companies in order to determine what percentage of the combined capitalization is represented by the top holding company's investment in the sub-holding company. Where the top holding company's investment represented an interest of 28.8 percent of the adjusted capitalization of the sub-holding company but only 6.65 percent of the combined capitalizations of the subsidiary operating companies, the Commission held that the corporate structures of the sub-holding company which enabled the top holding company to control the operating companies with such a small investment unfairly distributed voting power among system investors.[152] The same conclusion was reached where the top holding company owned senior securities equal to 57.98 percent of the sub-holding company's capitalization after adjustments for preferred arrears which eliminated the common stock from the capital-

[151] Republic Service Corp., 12 S.E.C. 852 (1943).

[152] Electric Bond and Share Co., 9 S.E.C. 978 (1941). Other sub-holding companies in the Bond and Share system have caused an unfair distribution of voting power among the system investors. Bond and Share owned securities in American Power & Light Company which were only equal to 3.68 per cent of American's adjusted capitalization and 3.42 percent of the combined capitalization of American's subsidiaries. Ownership of securities equal to 9.14 percent of Electric Power and Light Company's adjusted capitalization gave Bond and Share an investment of only 8.72 percent of the combined capitalizations of Electric Power & Light's subsidiaries. Electric Bond and Share Co., 11 S.E.C. 1146 (1942).

ization[153] but only 9.35 percent of the combined subsidiary company capitalizations.[154] Even where the top holding company's investment in senior securities of the sub-holding company equalled 17.7 percent of the combined capitalizations of the subsidiary companies, the corporate structure of the sub-holding company unfairly distributed voting power among system investors but here the Commission seemed to rely primarily on the fact that control was actually exerted through a common stock which had no equity in corporate assets or consolidated earnings.[155]

In two cases involving top holding companies, each controlling several sub-holding company systems, the Commission relied on figures obtained by combining the separate consolidated capitalizations of each sub-holding company system.[156] In *United Corporation,*[157] the Commission compared the amount of common stock and surplus on the top holding company's corporate balance sheet, after deducting preferred arrears and restating investment accounts at underlying book values, with combined consolidated book assets of the sub-holding company systems and found that $1 of such common stock equity controlled about $54 in book assets of the sub-holding company systems. After also finding that the common stock equity in earnings was but a small fraction of combined consolidated system operating revenues and gross income,[158] the Commission concluded that the top holding company's corporate structure unfairly distributed voting power among system investors. In *Electric Bond and Share Company,*[159] the Commission counted only the voting securities which the top holding company owned in domestic sub-holding companies[160] and found they repre-

153 Preferred stock arrears were charged against earned surplus, creating a deficit which was wiped out by a charge which completely eliminated the book value of the common stock and even a portion of the preferred. No adjustments had to be made in the investment accounts since the investments were carried at their underlying book value.

154 Middle West Corp., 14 S.E.C. 250 (1943).

155 The sub-holding company's corporate balance sheet after adjustments to reflect reduction of the investment account to underlying book value left nothing for the common stock and consolidated net income for the last five years did not cover preferred stock dividend requirements. International Hydro-Electric System, 12 S.E.C. 999 (1943). Cf. the Commission's treatment of American & Foreign Power Company in Electric Bond and Share Co., Holding Company Act Release No. 6121 (1945).

156 Apparently, this approach was used in one case in order to separate utility from non-utility holdings and in the other to enable separate treatment of those sub-holding company systems where the Commission felt the top holding company's investment was too small.

157 13 S.E.C. 854 (1943).

158 Net income applicable to the common stock had varied from 1.197% to 0.377% of gross operating revenues and from 3.867% to 1.399% of combined consolidated gross income.

159 Holding Company Act Release No. 6121 (1945).

160 American and Foreign Power Company, controlling foreign subsidiaries, was excluded since Bond and Share had substantial holdings in the securities of that system.

sented 14.9 percent of the combined capitalizations of the sub-holding companies, after adjustment for preferred arrears, but only 6.2 percent of the combined consolidated capitalizations, again adjusting for preferred arrears, of the sub-holding company systems. In addition, the holding company common stock had not received any dividends in the past eleven years so the Commission held the corporate structure of the top holding company must be revised in order to provide a fair distribution of voting power among system investors.

VI

WHEN DOES THE CONTINUED EXISTENCE OF A HOLDING COMPANY UNFAIRLY DISTRIBUTE VOTING POWER AMONG INVESTORS IN THE HOLDING COMPANY SYSTEM?

In the case of holding companies, as distinguished from subsidiary operating companies, an unfair distribution of voting power may result not only from the corporate structure of the holding company but also by reason of its very existence. Section 11(b)(2) requires the Commission to check this possibility too.

The Commission has most often found a violation of this aspect of section 11(b)(2) when investigating sub-holding companies. If the Commission concludes that a top holding company, through use of a sub-holding company as a pyramiding device, controls a group of subsidiary operating companies through a disproportionately small investment, the Commission considers the continued existence of such a sub-holding company the cause of the unfair distribution of voting power among system investors. The disproportionately small investment is found in practically all cases by a consideration of the percentage of the combined capitalizations of the subsidiary operating companies represented by the top holding company's investment in the sub-holding company. When this percentage ranges between 2.6 percent and 17.7 percent the leverage created by the existence of the sub-holding company has helped to disenfranchise the contributors of such a large percentage of the combined capitalizations that the continued existence of the sub-holding company causes an unfair distribution of voting power.[161] In one case the Commission dealt with

[161] The highest and lowest percentages were found among the sub-holding companies of the International Hydro-Electric System, 12 S.E.C. 999 (1943). The percentage in sub-holding companies of the Electric Bond and Share System ranged from 3.42 to 17.65 percent. Electric Bond and Share System, 9 S.E.C. 978 (1941) and 11 S.E.C. 1146 (1942). One of the sub-holding companies in the Middle West Corporation system enabled Middle West to control subsidiary companies with an investment representing 9.35 percent of their combined capitalizations. Middle West Corp., 14 S.E.C. 250 (1943).

a top holding company which used a sub-holding company plus direct investments to control another sub-holding company, the latter being the only subsidiary of the first sub-holding company. The top holding company's investment in both sub-holding companies represented 19.8 percent of the capitalization shown on the first sub-holding company's consolidated balance sheet. The Commission held that this investment was so small that the continued existence of the first sub-holding company caused an unfair distribution of voting power among system investors.[162] In most of these cases the Commission's conclusions have been based solely on the top holding company's small investment in system assets and there has been no mention of its claim to system earnings. In the few instances where the latter has also been checked, claims of 4.1 percent and 16.8 percent of the aggregate subsidiary operating companies' earnings have been too small.[163]

In one case the Commission has found that the continued existence of the top holding company itself causes an unfair distribution of voting power among system investors because of its disproportionately small investment in the system. The capital structure of International Hydro-Electric System constituted 15.5 percent of the consolidated capitalization. No attempt had been made to value International's assets but its earnings record showed its capitalization was substantially in excess of the value of its assets. Average corporate gross income for the past ten years amounted to a return of only 2.2 percent of its capitalization. The highest annual gross income during this period was less than 2 percent of consolidated gross income. Hence, the Commission concluded that converting all the holding company's securities to common stock would not give the company a sufficient stake in the system to allow control to remain in the top holding company.[164]

[162] Louisville Gas and Electric Co., Holding Company Act Release No. 7789 (1947). Also see Community Gas and Power Co., 13 S.E.C. 532 (1943). A still different approach was used in dealing with Rhode Island Public Service Company, a sub-holding company in the International Hydro-Electric system. The ill effect of this sub-holding company was evidenced from the fact that the top holding company spent 42 millions acquiring control of a group of operating companies, then organized Rhode Island and, by selling large amounts of non-voting securities in the sub-holding company to the public and writing up property accounts of the operating companies, the top holding company was able to recoup all but 12 millions of its original investment of 42 millions. International Hydro-Electric System, 12 S.E.C. 999 (1943). Also see American Water Works and Electric Co., 2 S.E.C. 972 (1937).

[163] International Hydro-Electric System, 12 S.E.C. 999 (1943).

[164] International Hydro-Electric System, 11 S.E.C. 888 (1942). In the only other case involving a top holding company, the voting stock of an operating company was put in a voting trust and the trustees formed a corporation issuing non-voting stock to the beneficial owners of the operating company. This had been done to prevent out-of-state interests

VII

CURING AN UNFAIR DISTRIBUTION OF VOTING POWER AMONG SYSTEM INVESTORS

A. *When Caused by the Continued Existence of a Holding Company*

In situations where the continued existence of a holding company causes an unfair distribution of voting power among system investors one possible method of curing this condition would involve the holding company's increasing its disproportionately small investment in the system. Only one case has been found, however, where this method was used. The Commission had previously found that American Water Works Company had too thin an equity in one of its sub-holding company systems and that the sub-holding company, American Communities Company, should be liquidated since it constituted an unnecessary complexity in the system.[165] American Water Works proposed to transfer to American Communities the former's investments in directly owned subsidiary operating companies which were outside the sub-holding company system. Instead of American Communities, American Water Works would then be dissolved. Also, two sub-holding companies would be dissolved after their publicly held securities had been exchanged for common stock in American Communities. Both steps resulted in an increase in American Communities' investment in operating properties so that its common stock equity, after recapitalization on an all-common stock basis, would be 19 percent of consolidated capitalization and consolidated gross income would cover claims prior to the common stock 1.45 times. The Commission found this plan appropriate to meet part of the requirements of section 11(b)(2).[166]

from gaining control of the operating company, an event now unlikely to occur since enactment of the Public Utility Holding Company Act. The Commission held that the continued existence of the trust and the corporation formed in pursuance of it now caused an unnecessary disenfranchisement of the stockholders of the operating company. United Illuminating Trust, 7 S.E.C. 994 (1940). Use of a voting trust over a sub-holding company was held an unnecessary pyramiding device in International Hydro-Electric System, 12 S.E.C. 999 (1943). If, however, the voting trust is set up for a legitimate purpose, there is no violation of section 11(b)(2). United Telephone and Electric Co., 3 S.E.C. 653 (1938).

[165] Section 11(b)(2) forbids unnecessary corporate complexities as well as unfair voting power distributions. American Water Works and Electric Co., 2 S.E.C. 972 (1937).

[166] American Water Works and Electric Co., Holding Company Act Release No. 7091 (1946). The Commission did not expressly state that American Communities investment would be large enough and it did note that many of the subsidiary companies had not made original cost studies yet.

In most of the other cases the Commission, finding that continued existence of the holding company also unduly complicated the holding company system, has ordered dissolution of the holding company as the most effective method for complying with the requirements of the act.[167] Before the dissolution order can be carried out, the holding company must normally rehabilitate any subsidiaries with defective corporate structures before distributing their securities to public investors.[168] A dissolution order contemplates the possibility of setting up a new holding company to hold together a geographically integrated group of operating companies,[169] and the order may be modified to allow the original holding company to continue in existence if it retains only those subsidiaries in which it has a substantial investment.[170] In one case the Commission did modify its dissolution order where the holding company had disposed of all interests in public utility companies[171] but all the other companies subject to such an order have either distributed their assets and liquidated[172] or are in the process of so doing.[173]

[167] Electric Bond and Share Co., 9 S.E.C. 978 (1941) and 11 S.E.C. 1146 (1942); International Hydro-Electric System, 11 S.E.C. 888 (1942); Community Gas and Power Co., 13 S.E.C. 532 (1943); Middle West Corp., 14 S.E.C. 250 (1943); Louisville Gas and Electric Co., Holding Company Act Release No. 7789 (1947).

In one case the Commission ordered the elimination of certain sub-holding companies as holding companies in the system. International Hydro-Electric System, 12 S.E.C. 999 (1943). Apparently this meant they need not be dissolved if they became operating companies through a merger or consolidation with subsidiary companies.

[168] International Hydro-Electric System, 11 S.E.C. 888 (1942) and Holding Company Act Release No. 9535 (1949); Electric Bond and Share Co., 12 S.E.C. 392 (1942) and Holding Company Act Release No. 9359-A (1949).

[169] In Electric Power & Light Corp., Holding Company Act Release No. 8889 (1949), Electric proposed the setting up of a new holding company over four subsidiary operating companies. The capitalization of the new company would consist of common stock only and would represent 32.5 percent of consolidated capitalization after elimination of inflationary items from the accounts of the subsidiary companies. Estimated consolidated net income would equal $1.78 per share of holding company stock. The plan was approved by the Commission. Also see American Power & Light Co., Holding Company Act Release No. 6158 (1945).

[170] One holding company contemplated making such a partial divestment but later gave up the idea. Electric Bond and Share Co., Holding Company Act Release No. 9359-A (1949); American Power & Light Co., Holding Company Act Release No. 9948 (1950). Also see Electric Bond and Share Co., 11 S.E.C. 1146 (1942).

[171] Electric Bond and Share Co., Holding Company Act Release No. 10640 (1951).

[172] Community Gas and Power Co., Holding Company Act Release No. 6436 (1946); Electric Power & Light Corp., Holding Company Act Release No. 8889 (1949); Middle West Corp., Holding Company Act Release No. 7905 (1947); Louisville Gas and Electric Co., Holding Company Act Release No. 7789 (1947).

[173] American Power & Light Co., Holding Company Act Release No. 9948 (1950); International Hydro-Electric System, Holding Company Act Release No. 9535 (1949).

The sub-holding companies subject to an order to cease being part of their parent's system (note 166 supra) proposed to consolidate with their parent into a new corporation with a debt-common stock structure. The common stock would represent 27.3 percent of

B. *When Caused by the Corporate Structure of a Holding Company*

In a number of cases the Commission has found that both the continued existence and the corporate structure of a holding company cause an unfair distribution among system investors. Since a dissolution order is the usual remedy to cure an unfair distribution of voting power caused by the continued existence of a holding company, it is used in these cases where there is also a defective corporate structure.[174] Where only the holding company's corporate structure has been found the cause of an unfair distribution of voting power, dissolution has also been ordered where the holding company has been found to perform no useful function in the holding company system.[175] In such a situation, a voluntary plan to liquidate the holding company is, of course, an appropriate method for complying with section 11(b)(2).[176] The same is true even where the holding company is not a useless entity and the corporate structure could be readjusted in such a way as to distribute voting power fairly.[177] But where the holders of debt securities are secure in their claims and the preferred stockholders are found to have most, if not all, of the equity in the company, the usual order is for recapitalization on an all-common stock basis.[178] Recapital-

the consolidated capitalization after elimination of inflationary items and estimated consolidated gross income would cover fixed charges 2.22 times. The Commission approved this plan after expressly finding that the new common stock would represent the "real equity" in the system. New England Power Assn., Holding Company Act Release No. 6470 (1946).

174 In International Hydro-Electric System, 11 S.E.C. 888 (1942), the Commission discussed the possibility of a reorganization of the capital structure but found this method was not feasible since International would still have too small an investment in the system. But in International Hydro-Electric System, 12 S.E.C. 999 (1943), the Commission seemed to rely chiefly on the finding that the holding company was an unnecessary corporate complexity for its conclusion that dissolution should be ordered.

175 International Utilities Corp., 13 S.E.C. 206 (1943); North American Gas and Electric Co., 12 S.E.C. 750 (1943).

176 North American Light & Power Co., 17 S.E.C. 148 (1944). Cf. General Gas & Electric Corp., Holding Company Act Release No. 5950 (1945), where a sub-holding company was allowed to retire all publicly-held securities and convert those remaining into common stock prior to resolution of the issue concerning the continued existence of the company.

177 United Public Utilities Corp., Holding Company Act Release No. 8352 (1948); Northern New England Co., 9 S.E.C. 224 (1941) and Holding Company Act Release No. 7511 (1947); Commonwealth & Southern Corp., Holding Company Act Release Nos. 7615 (1947) and 8633 (1948).

178 American Utilities Service Corp., 16 S.E.C. 173 (1944); Commonwealth & Southern Corp., 11 S.E.C. 138 (1942) and 19 S.E.C. 242 (1945); Electric Bond and Share Co., Holding Company Act Release No. 6121 (1945); American & Foreign Power Co., Holding Company Act Release No. 9044 (1949); Middle West Corp., 11 S.E.C. 533 (1942); Pennsylvania Gas & Electric Corp., Holding Company Act Release No. 8490 (1948).

izations which result in a common stock equity of from 25 to 34 percent of the consolidated capitalization, after adjustments to eliminate known inflationary items, have been approved as giving the common stock a sufficient investment in the system to justify control.[179] There seems to be a possibility that a smaller common stock equity would be permissible if the holding company eliminated its debt as well as its preferred stock.[180] But even where the common stock equity is large enough to justify its control of the system, senior securities are not allowed in the holding company structure where there are large amounts of senior securities in the subsidiary company structures.[181] This policy seems to be based on the Commission's belief that senior securities in a holding company over senior securities in the subsidiary companies would unduly and unnecessarily complicate the holding system.[182]

Conclusions

The Commission's basic premise is that voting power attached to equity securities should be in proportion to the investment represented by those securities. This seems to accord with congressional intention

Sometimes the recapitalization order is based in part on the necessity of eliminating corporate complexities. Niagara Hudson Power Co., 16 S.E.C. 139 (1944).

As an alternative to recapitalization on an all-common stock basis, the holding company is permitted to form a consolidated corporation with some of its subsidiaries so long as the corporate structure of the consolidated corporation does not unfairly distribute voting power. In Buffalo, Niagara and Eastern Power Corp., Holding Company Act Release No. 6083 (1945), the Commission approved a plan to set up such a consolidated corporation where the common stock equity would be 24.75 percent of the consolidated capitalization after elimination of estimated inflationary items in the plant accounts and increasing deficient depreciation reserves.

179 American & Foreign Power Co., Holding Company Act Release No. 7815 (1947); Commonwealth & Southern Corp., Holding Company Act Release No. 7615 (1947); Middle West Corp., Holding Company Act Release No. 6606 (1946); Eastern Gas and Fuel Associates, Holding Company Act Release No. 9633 (1950); Niagara Hudson Power Corp., 16 S.E.C. 139 (1944). Cf. American Water Works and Electric Co., 2 S.E.C. 972 (1937), where a recapitalization resulting in a common stock equity of 19 percent was held to improve voting distribution.

180 Community Gas and Power Co., 13 S.E.C. 532 (1943), where the Commission stated that where only 16.4 percent of the adjusted consolidated net assets were applicable to holding company securities, including debt, this represented the maximum leverage compatible with the standards of the act.

181 Standard Gas and Electric Co., Holding Company Act Release No. 8773 (1949); Commonwealth and Southern Corp., 11 S.E.C. 138 (1942).

In the two cases where a holding company was allowed to retain preferred stock in its corporate structure there appeared to be no subsidiary preferred stock outstanding. Niagara Hudson Power Corp., 16 S.E.C. 139 (1944); Eastern Gas and Fuel Associates, Holding Company Act Release No. 9633 (1950). In the one case where the Commission sanctioned a sizable amount of debt securities, there were no subsidiary senior securities. Republic Service Corp., Holding Company Act Release No. 6820 (1946). But cf. American and Foreign Power Co., Holding Company Act Release Nos. 7815 (1947) and 9044 (1949).

182 Commonwealth & Southern Corp., 11 S.E.C. 138 (1942).

in enacting the voting power provision of the Holding Company Act, although in apparent conflict with the policy reflected in state corporation statutes which allow shareholders only such voting rights as are provided in the articles of incorporation. The difference is due to the fact that state corporation statutes are largely enabling acts rather than regulatory legislation so far as voting rights for stockholders are concerned, while the Holding Company Act, like state blue sky laws, is designed to protect investors against the issuance of certain types of corporate securities. The latter type of statute is, of course, bottomed on the assumption that at least some corporate investors are unable to protect themselves because of lack of intelligence, inertia, or limited financial strength.

Assuming that voting power should be limited to the financial interest of the voter, application of the principle to actual corporations involves at least two administrative problems. One is to define voting power. In this paper, the term has been restricted to the right to vote on all matters which the directors are required to submit to stockholders generally. The Commission has not attempted an exact definition of the term but seems to have this sort of concept in mind when comparing voting rights with investments. The other and more serious problem is to determine the stockholder's investment. Here the Commission has adopted an original cost approach in determining the stockholders' claim to assets. Although it is difficult to find any clear congressional intent on this point and the original cost concept has been severely criticized by many economists, this method of measurement does have considerable convenience for the Commission since it allows reliance on original cost studies required and approved by the Federal Power Commission and state regulatory commissions. Any inequities resulting from the use of this approach are mitigated somewhat when the Commission's decisions are based in part on stockholders' claim to earnings. Also, when a corporation is recapitalized or reorganized in order to distribute voting power more fairly, the Commission requires a fair distribution of the new securities and recognizes future corporate earning power as the primary test of fairness.[183]

Assuming that the Commission accurately determines the stockholder's voting power and his financial contribution to the company, the ratios allowed by the Commission seem quite liberal. It may be doubted whether the voting power distribution allowed a particular company has any substantial value as precedent when another com-

[183] Southern Colorado Power Co., 14 S.E.C. 115 (1943).

pany's structure is before the Commission for decision. Plans approved by the Commission have varied greatly in the amount of debt securities allowed, the common stock equity, and the degree to which the company's accounts adhere to the original cost method of accounting. The Commission seems to prefer a flexible approach in this area. Such a view militates against the building up of stable rules of law as a guide to future action. The Commission may feel, however, that its decisions here would in any case be of very limited value as precedent. Companies that divorce themselves from a holding company system are no longer subject to the Holding Company Act. Those holding companies that remain subject to the act will be controlled as to any future security issues. In determining whether a company should be allowed under sections 6 and 7 to issue new securities, the Commission can control the amount of debt and preferred stock and thus prevent the unfair distribution of voting power against which section 11(b)(2) is aimed. Only in the event of another major economic catastrophe resulting in serious reductions in utility earnings is there a likelihood of another major revamping of a utility's corporate structure. It is also unlikely that the Commission's decisions in this area would be helpful outside of the utility field where the original cost concept is most widely used.