

## CHAPTER 1

# Introduction to Integration

**A**T HIS trial for use of the mails to defraud Samuel Insull explained to the jury his early association with Thomas A. Edison in the electric light business. On one occasion Edison requested Insull to take charge of Edison General Electric Company, the forerunner of the present General Electric Company. The inventor's instructions were as follows: "Now, you go back up there and run the institution. And whatever you do, Sammy, make either a brilliant success of it or a brilliant failure."<sup>1</sup> History has closed the record of Samuel Insull, and it reveals that he was both a brilliant success *and* a brilliant failure. At the age of 50 Insull had Chicago in his vest pocket. He was known as the "Maecenas of the Middle West" and the "uncrowned king of Illinois." One writer dubbed his city "Insullopolis."<sup>2</sup> In connection with raising capital for his companies Insull was one of the few men who did not ask the bankers. He told them. During the decade of the 1920's bankers begged him to accept loans and genuflected when he consented. A Chicago reporter once remarked that it was worth a million dollars to any man to be seen talking to Sam Insull in front of the Continental Bank.<sup>3</sup> The only man who approached him in the field of public utilities was Sidney Z. Mitchell, the financial genius of the Electric Bond and Share Company system. These two men were rated by the industry as the Titans of electric power. They were deemed to be the industry's "Alpha and Omega." Subsequent events proved that the "Alpha" was Insull.<sup>4</sup>

<sup>1</sup> Busch, Francis X., *GUILTY OR NOT GUILTY?* 168 (1952).

<sup>2</sup> Ramsay, M. L., *PYRAMIDS OF POWER*, 56 (1937).

<sup>3</sup> *Id.* at 221.

<sup>4</sup> *Id.* at 44-45.

Intoxicated with the power growing out of a long career of apparent success, Insull expanded his enterprises far beyond the realm of economic reason and the resultant crash brought his empire tumbling down upon him like a house of cards. The reverberations of his collapse led to the demoralization of other utility holding companies and caused general consternation in the utilities securities market. The stock of Insull's Middle West Utilities Company depreciated in market value from a high in 1929 of \$57 per share to a low in 1932 of 25¢. His Midland United Company stock had declined from a high of \$47 in 1930 to a low of \$1 in 1932. People's Gas Light and Coke Company declined from \$435 in 1929 to \$40 in 1932. Commonwealth Edison Company stock went from \$450 in 1929 to \$50 in 1932. The securities of other holding company systems did likewise.<sup>5</sup> Insull lost his entire fortune estimated at about \$100,000,000.00; he surrendered his life insurance and his country estate valued at \$3,400,000.00. He had more than fulfilled the admonition of Edison. "I have gone from the bottom to the top, and now to the bottom again," he is reported to have said in 1932.<sup>6</sup> Over 100,000 stockholders of his companies lost large sums, the total loss being estimated as high as \$4,000,000,000.00.<sup>7</sup> The Insull debacle impressed upon the public the need for some sort of regulation to prevent the recurrence of such financial slaughter and was thus the prime causative factor in the enactment of the Public Utility Holding Company Act of 1935.

Insull's predecessor in public utility holding company infamy was Wilbur B. Foshay, who built his empire of utility and other odds and ends in thirteen states, Canada, Alaska,

<sup>5</sup> Cities Service Company stock fell from \$68.12 to \$1.25; Electric Bond & Share Company stock went from \$189 to \$5. Ramsay, *op. cit.*, note 2, 81.

<sup>6</sup> Thompson, Carl D., CONFESSIONS OF THE POWER TRUST, 247-248 (1932).

<sup>7</sup> *Id.* at 248.

and Central America. It sank ingloriously into receivership on November 1, 1929, at the beginning of the stock market panic, and left as relics a 32-story tower in Minneapolis designed after the Washington Monument and the reassuring slogan, "All your money—All the time—On time." The loss to the public was approximately \$29,000,000.00. The Foshay technique involved the writing up or "appreciation" of assets with a corresponding credit to surplus account at times when such account would otherwise have shown a deficit, and the increase in the surplus account would then be credited to income at times when the net income would otherwise have shown a loss. Monthly dividends were paid almost continuously during the 12 year life of the business. The necessary cash to pay the dividends was derived from successive sales of securities by the company.<sup>8</sup> Foshay was convicted and imprisoned upon mail fraud charges. Although his manipulations through the medium of the public utility holding company were lesser in magnitude than those of others, the publicity attendant upon his collapse added fuel to the fire.

The crown prince of corporate jazz was Howard C. Hopson of the Associated Gas & Electric Company system. He succeeded and exceeded both Foshay and Insull in holding company legerdemain. Proof of his superiority in this field lies in the fact that his companies, although on the brink of insolvency (if not actually over the line) beginning in 1931, were not placed in bankruptcy until 1940 by the Securities and Exchange Commission. As early as 1927 the capital structure of A. G. & E. was characterized as "a financial nightmare."<sup>9</sup> Its securities were held by a quarter-million investors, and its

<sup>8</sup> Ramsay, *op. cit.*, *supra*, note 2, 80; Thompson, *op. cit.*, *supra*, note 6, 267.

<sup>9</sup> Ripley, Wm. Z., *MAIN STREET AND WALL STREET*, 322-323 (1927). Also see Bonbright, J. C., and Means, Gardiner C., *THE HOLDING COMPANY* (1932).

"A" stock which sold for \$72.62 at the market peak went to 62¢ in 1932.<sup>10</sup> Hopson assembled the Associated system from a \$7,000,000.00 base in 1922 to a \$1,000,000,000.00 pyramid in 1940. There was at least \$400,000,000.00 of water in the latter figure. He had created or acquired holding, subholding, electric, gas, water, ice, streetcar, bus, real estate management service and investment companies under 1,800 different names in 26 states, two Canadian provinces, and the Philippine Islands. The securities of the system included nonvoting common stock, debentures convertible into stock at the option of either the holder or the company, preferred stocks labeled as bonds, and certificates that paid different interest under different contingencies and were convertible into practically anything the holder wanted. Hopson, a lawyer, C.P.A., and one-time key man in the Public Service Commission of New York, was not interested in money for its own sake, but he became more and more fascinated by the power that went with control over money. He and John I. Mange acquired the Associated System in 1922 by a complicated set of maneuvers whereby they emerged with 100% control of Associated Gas and Electric Company plus a cash profit to themselves of \$218,000.00<sup>11</sup> Hopson originally drew no salaries from the Associated companies but derived his income by means of sixteen service companies operated by him. His method of operation has been described in the following manner:

"By the utility promotion standards of the times, there was nothing particularly illegal and few things that were novel in Hopson's corporate and financial pyramiding during the twenties. Hopson simply carried to an extreme holding-company practices that have since been

<sup>10</sup>Ramsay, *op. cit.*, *supra*, note 2, 81.

<sup>11</sup>"Through the Wringer with A.G. & E.," FORTUNE MAGAZINE, 165, 202 (December, 1945).

condemned. Other promoters paid too much money for operating properties, wrote them up on the books, and issued excessive amounts of securities on the strength of the write-ups; Hopson paid more than even his most extravagant competitors were willing to pay, and made his system top-heavy with securities that were just a little more freakish than anybody else's. Other systems occasionally juggled their operating companies around among subholding companies; Hopson kept his in perpetual motion. Others high-pressured employees and customers into buying their stocks and bonds; Hopson's 'customer ownership' campaigns were the biggest and most flamboyant ever staged. Other holding companies relied on service charges to pump operating-company earnings up to the top of the system; Hopson siphoned off his service-company profits into his personal bank account. . . .

\* \* \*

"Actually, it was Hopson's extracurricular activities as the self-appointed spokesman for unregulated holding-company enterprise that caused his downfall. As any newspaper reader of the mid-thirties knows, Hopson was probably the main reason for the passage of the Utility Holding Company Act and its so-called 'death sentence' provisions. The horrific examples of Associated's extravagant financing, write-ups, and service-company abuses—plus Associated's inept lobbying activities (which included a flood of telegrams to Congress from the graveyard), plus Hopson's dodging of House and Senate subpoenas—undoubtedly supplied the votes to pass the Wheeler-Rayburn bill."<sup>12</sup>

The most ardent and effective supporter of regulatory legislation for public utility holding companies was President Franklin D. Roosevelt. As Governor of New York his prin-

<sup>12</sup> *Id.* at 202, 205, and 216.

cial achievement was a partial settlement of the hydroelectric question on the basis of public development of the St. Lawrence waterpower. Part of his political philosophy was the theory that the masses of economic power represented by the utility holding companies should be broken up and that for regulation to have a chance the power of the regulatory body should be at least equal to that of the institution to be regulated.<sup>13</sup> Undoubtedly at his insistence, the 1932 platform of the national Democratic Party advocated regulation to the full extent of federal power of holding companies which sold securities in interstate commerce.<sup>14</sup> The vote in favor of the Wheeler-Rayburn bill, which became the Public Utility Holding Company Act of 1935, was also inspired to a considerable extent by the blind adherence of many Congressmen to the wishes of the president.<sup>15</sup>

Another important factor giving rise to the enactment of the holding company legislation was the investigation of the subject by the Federal Trade Commission begun in 1928.

The Commission had made a prior investigation covering the situation as it existed, at the close of 1924. In this earlier investigation the Commission was instructed to inquire particularly into the extent of the control of the utility industry by the General Electric Company. The report of the Commission upon that matter, submitted in 1927, stated that neither General Electric Company nor any other company had secured or was securing a substantial monopoly in the electric industry.<sup>16</sup> Although General Electric did control the largest utility interest in 1924, it promptly disposed of Electric Bond & Share Company and thereby removed itself as a monopolistic threat in the utility field. The investigation be-

<sup>13</sup> Ramsay, *op. cit.*, *supra*, note 2, 266.

<sup>14</sup> 79 CONG. RECORD 10836 (1935).

<sup>15</sup> 79 CONG. RECORD 10657 (1935).

<sup>16</sup> "Electric Power Industry, Control of Power Companies," Doc. No. 213, 69th Cong., 2d Sess., p. 50.

gun in 1928 was a different matter. It was not completed until 1937, although the serious import of the so-called "power trust" was evident from preliminary reports as early as 1932.<sup>17</sup> The Federal Trade Commission examined 18 top holding companies, 42 subholding companies, and 91 operating companies in the electric and gas industry. The revelations of this survey formed the basis of the indictments of the electric and gas holding company systems set forth at length in Section 1(b) of the Public Utility Holding Company Act of 1935,<sup>18</sup> hereinafter often referred to as the "Act." The early disclosures of the Federal Trade Commission study also induced several states, notably New York, Massachusetts, and Pennsylvania, to undertake investigations of holding companies and their relation to public utility regulation.<sup>19</sup>

Warning notes were also sounded by some of the leading economists of the nation. Probably the first of these was Professor William Z. Ripley of Harvard University in his work entitled *Main Street and Wall Street*.<sup>20</sup> He noted, *inter alia*, that the country was faced with a development precisely parallel to that through which it had passed with respect to railroads, telegraphs, and telephones, and he posed the problem of ascertaining whether or not electric public utilities belonged in the same class and should be subjected to the same administrative control. There were other economists who were alarmed at the abuses of the holding company device, some of the more notable ones being Arthur Stone Dewing,<sup>21</sup>

<sup>17</sup> Thompson, *op. cit.*, *supra*, note 6.

<sup>18</sup> 49 Stat. 803 (1935), 15 U.S.C.A., Sec. 79a. Pursuant to H. Res. No. 59, 72nd Cong., 1st Sess. (1932), and H.J. Res. No. 572, 72nd Cong., 2d Sess. (1933), the House Committee on Interstate and Foreign Commerce published a six volume study entitled "Relation of Holding Companies to Operating Companies in Power and Gas Affecting Control" (1932-1933).

<sup>19</sup> Buchanan, Norman S., "The Public Utility Holding Company Problem," 25 CALIF. L.R. 517 (1937). Cf. comment, "Section 11(b) of the Holding Company Act: Fifteen Years in Retrospect," 59 YALE L.J. 1088 (1950).

<sup>20</sup> *Op. cit.*, *supra*, note 9.

<sup>21</sup> Author of *THE FINANCIAL POLICY OF CORPORATIONS* (3rd Ed., 1934).

William A. Prendergast,<sup>22</sup> and J. C. Bonbright and Gardiner C. Means.<sup>23</sup> Their roles in bringing about the holding company legislation, although indirect, were substantial.

Still another factor giving rise to this legislation was the occurrence of the great depression beginning in 1929. It is true that some of the holding company systems, such as that of W. B. Foshay, collapsed before the depression really began, and that others, such as that of Howard C. Hopson, weathered the depression only to fail at a later date. It is also true that most of the systems survived the storm intact despite great declines in the market values of their securities. Furthermore, it proved to be generally true that operating utilities, as distinguished from utility holding companies, survived the crash in better shape than most other types of business. However, the depression served to remove the gilt and the glitter from the holding company device and to reveal it in its true light. The success of the methods employed by Insull and others in the 1920's depended upon a continual increase in the values and earnings of utility properties in order ultimately to justify the high prices originally paid for such properties. Rapid and continuous increases were the order of the day in the twenties, but the cycle was completely reversed at the beginning of the thirties. The functions of holding companies could then be studied in the cold light of adverse conditions and, when weighed in the balance, they were found wanting.

And, finally, in this brief review of events and personalities leading up to the enactment of the Public Utility Holding Company Act of 1935, mention should be made of the report of the National Power Policy Committee on Public Utility Holding Companies.<sup>24</sup> This committee was appointed by

<sup>22</sup> Author of *PUBLIC UTILITIES AND THE PEOPLE* (1933).

<sup>23</sup> Authors of *THE HOLDING COMPANY* (1932).

<sup>24</sup> Public Utility Act of 1935, Senate Report No. 621, 74th Cong., 1st Sess., 55-60.

President Roosevelt in 1934 and it was composed of Harold L. Ickes, Secretary of the Interior and chairman, Frank R. McNinch, Elwood Mead, T. W. Norcross, Morris L. Cooke, Robert E. Healey, David E. Lilienthal, and Edward M. Markham. All of these men were government officials concerned with power problems. The conclusions of the committee were, briefly, that legislation should be forthcoming eliminating within a reasonable time the holding company where it served no useful and necessary purpose, placing federal control of the holding company problem in the hands of an administrative commission, encouraging geographically and economically related systems, prohibiting holding companies from engaging in nonutility and speculative ventures and other undesirable practices, and requiring periodic and uniform financial reports. The report of the committee was transmitted to Congress on March 12, 1935, by the President along with his message urging favorable action upon the holding company bill then pending. It therefore served as the keynote for the proponents of this legislation.

#### ADVANTAGES AND DISADVANTAGES OF PUBLIC UTILITY HOLDING COMPANIES

The earliest approach to the modern holding company was the predecessor of United Gas Improvement Company.<sup>25</sup> This company was incorporated in Pennsylvania in 1882 for the purpose of introducing water gas in the manufactured gas industry. The older method of manufacturing illuminating gas from the distillation of coal was so difficult to displace that the company at first leased gas works in various parts of the country and later acquired their stocks. This acquisition of control of disconnected local gas works, beginning in 1884, was perhaps the first attempt to bring under one management

<sup>25</sup> Dewing, Arthur Stone, *THE FINANCIAL POLICY OF CORPORATIONS*, 858 ff. (3rd Ed., 1934).

a number of independent and geographically separated public utilities. In the 1890's imitators appeared on the horizon in the form of The North American Company, the United Electric Securities Company, and the Philadelphia Company, and, in 1900, American Light & Traction Company was formed. From that time until World War I many varieties of holding companies were organized by banking and engineering firms. A striking phenomenon of the twenties, however, was the great increase in new utility combinations and in substantial enlargements of existing systems.<sup>26</sup> The formation of far-flung territorial combinations became one of the most popular corporate activities of the decade. The feeling was prevalent that the leaders of the electrical industry intended eventually to form a company in the power field similar to American Telephone & Telegraph Company in the telephone field.<sup>27</sup> The era of "superpower" was at hand, and the vehicle used to promote superpower was the holding company.

What, then, were the advantages and the disadvantages of that vehicle from a general point of view? The advantages were roughly four in number, as set forth below.

1. The basic economic advantage of holding companies, according to the opponents of the holding company bill, was the diversification provided by such companies for investors, both as to geographical location and as to variation of activities.<sup>28</sup>

2. Small utility systems were thereby provided with the finest engineering, administrative, legal, accounting, auditing, purchasing, and other services which would otherwise have been available only to large systems.

<sup>26</sup> Ripley, *op. cit.*, *supra*, note 9, 280.

<sup>27</sup> Thompson, *op. cit.*, *supra*, note 6, 31.

<sup>28</sup> Willkie, Wendell L., "The Future of the Holding Company," 11 JOURNAL OF LAND AND PUBLIC UTILITY ECONOMICS 234 (1935); H. Hearings on H. R. 5423, 74th Cong., 1st Sess. (1935), p. 2175; S. Hearings on S. 1725, 74th Cong., 1st Sess. (1935), p. 311.

3. Financial strength was given small systems by virtue of the facilities of the parent for providing capital and selling securities upon advantageous terms.

4. The holding company was in a better position to handle matters of public relations and regulation than the individual small operating companies.

The reply of the proponents of the bill to the first argument in favor of holding companies was that (a) in practically no instance could it be proved that diversification of investment was an original corporate purpose, the argument being merely a rationalization in retrospect; (b) diversification should be provided either by the individual investor or by an investment company, not by a utility holding company; (c) considerable diversity of risk could be obtained by an integrated system concentrated in one large area; (d) in most of the existing systems the risk was very unevenly distributed geographically; and (e) the so-called "diversified" systems suffered the largest losses during the depression.<sup>29</sup> The answers to the second and third arguments were that the advantages of a centralized management organization which supervised at a distance the operations of a chain of local properties became less and less as the size of each local unit grew greater, and that when the operating companies reached a certain size they became able to afford the best talent without holding company assistance and to finance their own operations. At some point, which was being approached by many operating companies, the disadvantages of absentee management from Wall Street or LaSalle Street would outweigh the advantages of the centralized organization. The answer to the last argument was that although the holding companies had been a great factor in the development of efficient electrical systems in this country and although their

<sup>29</sup> Cf., Douglas, Wm. O., "Scatteration v. Integration of Public Utility Systems," 24 A. B. J. 800 (1938).

freedom from regulation during the pioneer days of formation was a substantial advantage, and permitted their rapid growth, the pioneering days were over and the time had come when a lower premium should be paid for speed of development and a much higher premium for carefully evolved plans of coordination dictated in the interests of engineering, efficiency and of the requirements of the communities concerned, rather than primarily in the interest of large profits for utility financiers.<sup>30</sup>

The justification of the holding company, of course, lies in its use and not in its abuse. An impartial study of both holding company systems and independent systems would probably have revealed that a substantial number of holding company systems were better managed than the vast majority of independent operating companies. Also, there were system companies which had much poorer management than the average independent company. The antagonism between the proponents and the opponents of the holding company bill prevented an unbiased consideration of the matter, however.<sup>31</sup>

The weaknesses and defects charged against the utility

<sup>30</sup> Bonbright and Means, *op. cit.*, *supra*, note 23, 221-222.

<sup>31</sup> Dewing, *op. cit.*, *supra*, note 25, 883-884. For such a study at a later date, see Waterman, Merwin H., "Economic Implications of Public Utility Holding Company Operations," 9 MICHIGAN BUSINESS STUDIES, No. 5 (1941). Prof. Waterman reached the following conclusions: (1) There was no evidence that independent utilities were better than subsidiaries of public utility holding companies as to (a) costs of electricity to consumers, (b) economy in management, (c) soundness of financial management, or (d) protection of operating company investors; (2) residential electricity customers found benefits related to increasing size as measured by the weighted average typical electricity bills which decreased steadily as the size of the operating company increased and also as the size of the holding company system increased; (3) mere distance of operating companies from the main office of their respective holding companies in and of itself did not tend to be related in any way to the character or quality of the protection afforded to the investors in the securities of such operating company, nor did this variable show any connection with any of the other objectives of the Act; and (4) the indications were that state regulation of holding company subsidiaries was, at the time of the study, as efficient and effective as state regulation of independent utilities.

holding company device were much more numerous. Those listed below were the most glaring at the time the holding company bill was under consideration in Congress.

1. The corporate structures of many systems were unduly complex and unwieldy with excessive layers of holding companies stacked upon a few operating companies; and not only were the corporate structures of such systems complex in a static sort of way, they were often complex dynamically. That is, as in the case of Associated Gas & Electric Company, the corporate structures were being rapidly changed from day to day.

2. By the use of the holding company device a relatively small investment could result in control of properties with values many times greater than the investment of the controlling party. This was the pyramiding process which disfranchised the mass of the investors in many systems.

3. Inflation of the capital account or even the earnings account by write-ups, better known as stock watering, was prevalent.<sup>32</sup> Other types of financial manipulation too numerous to mention were also indulged by the holding companies.

4. Upstream loans from subsidiaries to parent companies were frequent.

5. The obfuscation of accounts and accounting records was a common practice to the utter confusion of regulatory authorities, investors, consumers, and the public.

6. Many holding company systems were guilty of "scatteration." Their operating properties were not grouped in economically sound nor geographically contiguous units, but were spread all over the map in defiance of all principles of engineering efficiency.

<sup>32</sup> The reports of the Federal Trade Commission indicated that this practice was commonly employed by systems both large and small, and resulted in tremendous inflations of property values. Thompson, *op. cit.*, *supra*, note 6, 136-137.

7. Most of the systems owned subsidiaries or operated properties engaged in nonutility and speculative enterprises in no way connected with their utility operations.<sup>33</sup>

8. By the use of a holding company or holding companies a system could render ineffective all state and local regulation. The large systems were superior to local politics.<sup>34</sup>

9. Local utility operations were controlled, managed and directed from a home office often far distant. For example, absentee management of Engineers Public Service Company in New York City controlled operating properties in the State of Washington 3,100 miles away.<sup>35</sup>

10. Some of the systems were dominated by engineering or service companies which extracted exorbitant fees for their assistance. Others were controlled by investment bankers who were more interested in the sales of securities than in the proper conduct of the utility business.

11. Transactions were often entered into among parent companies and their subsidiaries and affiliates without arm's length bargaining, resulting in detriment to one or more of the parties, usually the operating company.

12. Excessive prices were paid for additional properties on a number of occasions which received wide publicity. Both Insull and Hopson were notorious in this respect.

The foregoing disadvantages of the utility holding company form and method of operation present the state of affairs

<sup>33</sup> The investigations of the Federal Trade Commission showed that utility holding companies also controlled and operated such diverse businesses as paper mills, spinning mills, fertilizer companies, chemical production, banking, insurance, bus lines, ice plants, water works, real estate promotions, and coal mines. Thompson, *op. cit., supra*, note 6, 47-48. The evils of such unrelated operations were demonstrated by the failure of The Middle West Utilities Company, discussed by Dewing, *op. cit., supra*, note 25, 877, footnote v.

<sup>34</sup> See, e.g., H. Hearings on H.R. 5423, 74th Cong., 1st Sess. (1935), p. 1693.

<sup>35</sup> See "Charts Showing Location of Operating Electric and/or Gas Subsidiaries of Registered Public Utility Holding Companies, 1939," a report of the Public Utilities Division, Securities & Exchange Commission.

in 1935 as seen by the proponents of the holding company bill. Not all of these alleged evils existed in every large system and some of them were perhaps unobjectionable from many points of view. The President, however, expressed his views in this manner:

“. . . It is time to make an effort to reverse that process of the concentration of power which has made most American citizens, once traditionally independent owners of their own businesses, helplessly dependent for their daily bread upon the favor of a very few, who, by devices such as holding companies, have taken for themselves unwarranted economic power. I am against private socialism of concentrated private power as thoroughly as I am against government socialism. The one is equally as dangerous as the other; and destruction of private socialism is utterly essential to avoid governmental socialism.”<sup>36</sup>

### LEGISLATIVE HISTORY OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

The original provisions of the holding company bill, introduced in the House of Representatives by Sam Rayburn and in the Senate by Burton K. Wheeler on February 6, 1935, were written by two young lawyers, Thomas G. Corcoran and Benjamin V. Cohen, both graduates of Harvard

<sup>36</sup> Message of President Franklin D. Roosevelt to Congress, 79 CONG. RECORD 3425 and 3469 (March 12, 1935). Some, perhaps, considered the President's allusion to governmental socialism an unfortunate comparison. Another advocate of the bill expressed his sentiments in more colorful language: "The stables of Augeus, left unclean for 30 years, were not as foul, as corrupted and contaminated as holding company methods, whose contagion of crookedness jeopardized the welfare of an entire nation of 126,000,000 people. A cleansing river torrent is needed to wash away the unfathomable muck of wide-spreading financial frauds that threaten our Republic and its democratic processes, just as the Augean stables were cleaned by a river, purposely changed in its course, as the fable relates." S. Hearings on S. 1725, 74th Cong., 1st Sess. (1935), p. 1079.

Law School and proteges of Felix Frankfurter.<sup>37</sup> It is probable that the revisions and amendments to the bill were also drawn by Corcoran and Cohen, although this is not shown in the record. Corcoran was counsel for the Reconstruction Finance Corporation and Cohen worked for Public Works Administration and the National Power Policy Committee. During the pendency of the bill, however, it appeared that they devoted most of their time to supervising its progress through the legislative channels.<sup>38</sup>

The storm of protests against the holding company bill was centered around the provisions of its Section 11, popularly referred to as the "death sentence" clause. It was so labeled because it called for the elimination of holding company systems which were not "geographically and economically integrated," and also provided for the removal of unnecessary tiers of holding companies. No definition of geographical and economic integration was given in the bill, and there was a great deal of confusion as to its meaning. Witnesses before both the House and Senate committee hearings evidenced an inability to reach a common understanding of the term as applied to the electric, manufactured gas, and natural gas utilities included within the scope of the bill.<sup>39</sup> The only logical conclusion to be drawn was that an almost unlimited discretion would be given to the Securities and Exchange Commission to determine whether geographical and economic integration existed in each particular case. This, of course, was contrary to the principles laid down by the Supreme Court of the United States with reference to

<sup>37</sup> 79 CONG. RECORD 10529 (1935); Ramsay, *op. cit.*, *supra*, note 2, 269-272.

<sup>38</sup> 79 CONG. RECORD 10660 and 12273 (1935); Senate Hearings on S. 1725, 74th Cong., 1st Sess. (1935), p. 204.

<sup>39</sup> House Hearings on H.R. 5423, 74th Cong., 1st Sess. (1935), pages 802, 1917-1918, and 2225; Senate Hearings on S. 1725, 74th Cong., 1st Sess. (1935), pages 323 and 935.

the National Recovery Administration and would have been unconstitutional.<sup>40</sup> The object of the sponsors of the bill was to reform scattered and loosely knit systems such as Middle West Utilities Company, Associated Gas & Electric Company, and Electric Bond & Share Company into unified operations like those of Consolidated Edison of New York, Detroit Edison of Detroit, or Commonwealth Edison of Chicago.<sup>41</sup> Their immediate problem was concerned with the wording of this objective in the bill so as to accomplish the desired purpose.

The hearings held by the Committee on Interstate and Foreign Commerce of the House of Representatives on the holding company bill were begun on February 19 and concluded on April 15, 1935. The hearings on the bill held by the Senate Committee on Interstate Commerce extended from April 16 to April 29, 1935. The original bill was replaced by a substitute bill in the House committee, and as amended, was reported favorably.<sup>42</sup> The House bill contained a definition of "integrated public utility system" in substantially the same form as finally enacted. Section 11, the death sentence, had been drastically modified to give the Commission authority to require each holding company system to confine its operations to one integrated public utility system, with the exception that if the Commission found that such a limitation was not necessary in the public interest, it was to require the limitation of the operations of the holding company system to such number of integrated utility systems as it found could be included in the holding company system consistently with the public interest. Further, the Commission was authorized to require divestment of nonutility properties

<sup>40</sup> *Schechter Poultry Corp. v. U.S.*, 295 U. S. 495 (1935).

<sup>41</sup> Ramsay, *op. cit.*, *supra*, note 2, 281-282.

<sup>42</sup> Public Utility Act of 1935, H. R. Report No. 1318, 74th Cong., 1st Sess. (1935).

only where it found that the retention thereof would be inconsistent with the public interest. And the Commission could not require divestment of interests outside of the United States. A minority of the House committee felt that the bill as reported would fatalistically condone and perpetuate the holding company system and that Section 11 had been emasculated so as to defeat completely the President's program.<sup>43</sup> The bill was adopted by the House as reported by a vote of 323 to 81.<sup>44</sup>

In the Senate committee, also, the original bill was replaced by a substitute bill. This latter bill was reported favorably without amendment.<sup>45</sup> The bill passed the Senate by a vote of 56 to 32.<sup>46</sup> The Senate bill did not include a definition of "integrated public utility system." It required each holding company to limit its operations to a single geographically and economically integrated public utility system and to such business as was reasonably incidental or economically necessary or appropriate to the operations of such system. The Senate thus adhered much more closely to the recommendations of the President and the National Power Policy Committee than the House. Senator Wheeler made the following pertinent remarks concerning the two bills:

"... The only difference between the House bill and the Senate bill is that the House bill leaves the 'death sentence' up to the Commission. The Commission could say that the Electric Bond & Share Co. should go out of business because it was against the public interest; they could say that the United Corporation should stay in

<sup>43</sup> *Id.* at 44-45.

<sup>44</sup> 79 CONG. RECORD 10639 (1935).

<sup>45</sup> Public Utility Act of 1935, Senate Report No. 621, 74th Cong., 1st Sess. (1935). Also see the minority report of the Senate Committee, Senate Report No. 621, Part 2, 74th Cong., 1st Sess. (1935), which fulminated against the bill as approved by the majority but offered no concrete suggestions for improvement.

<sup>46</sup> 79 CONG. RECORD 9065 (1935).

business because it was in the public interest; they could say that the Insull Co. was in the public interest and that the Commonwealth & Southern was against the public interest. I say to the Senator that if ever there was an unconstitutional discretion placed in the hands of a commission, that, in my opinion, is a delegation of power which is unconstitutional.”<sup>47</sup>

The two bills were referred to a joint conference committee of the House and the Senate, and by virtue of a compromise attributed to Senator Alben W. Barkley the present Act was evolved.<sup>48</sup> The Senate bill was considerably diluted, principally by the “ABC” clauses permitting the retention of more than one integrated utility system, and the “public interest” phrase in the House bill was replaced by more precise standards. Second degree holding companies were permitted in the compromise bill, whereas the Senate bill had allowed only one layer of holding companies. The Conference Report was adopted on August 24, 1935, by the House by a vote of 222 to 112 and was adopted on a voice vote by the Senate.<sup>49</sup> The bill was signed by the President and became law on August 26, 1935.<sup>50</sup>

#### CONSTITUTIONALITY OF THE ACT

The unfavorable decisions by the Supreme Court of the United States as to the constitutionality of other New Deal legislation, rendered contemporaneously with the passage of

<sup>47</sup> 79 CONG. RECORD 10842 (1935).

<sup>48</sup> 79 CONG. RECORD 14600 and 14620 (1935).

<sup>49</sup> 79 CONG. RECORD 14473 and 14626 (1935).

<sup>50</sup> The foregoing discussion has been with reference to Title I of the Public Utility Holding Company Act of 1935. This Act also included Title II, which amended the Federal Water Power Act so as to encourage voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy under the jurisdiction of the Federal Power Commission. 16 U.S.C.A., Sec. 824a(a). The “voluntary” feature of Title II rendered it ineffective.

the Public Utility Holding Company Act of 1935, caused the majority of holding companies to refrain from complying with the registration provisions of the Act. On September 28, 1935, the Securities and Exchange Commission, hereinafter referred to as the "Commission," published a speech by its Chairman, James M. Landis, in which he exhorted the industry to cooperate with the Commission in solving its various problems under the Act, promising to recognize and respect the constitutional rights of each party.<sup>51</sup> The Commission received a set-back in an early decision which held that all of the provisions of the Act, and particularly the registration provisions, were unconstitutional.<sup>52</sup> On appeal the Circuit Court of Appeals for the 4th Circuit held that the Act did not apply to the holding company involved, since it was not engaged in interstate commerce, but rejected the portion of the decree of the lower court holding that the Act was unconstitutional in its entirety.<sup>53</sup> The registration provisions of the Act were subsequently upheld by the Supreme Court on March 28, 1938.<sup>54</sup> On April 5, 1938, the Commission announced that holding companies controlling approximately 98% of the total book assets estimated to be subject to the Act had been duly registered.

Section 11(b) of the Act required the Commission to commence its integration and simplification proceedings as soon as practicable after January 1, 1938. The Commission, advancing in cautious fashion, sponsored the formation of a committee of utility holding company executives to cooperate

<sup>51</sup> Release No. 3 (Sept. 28, 1935); Release No. 22 (Nov. 22, 1935). All "releases" cited herein are those issued by the Securities & Exchange Commission under the Public Utility Holding Company Act of 1935.

<sup>52</sup> *In Re American States Public Service Co.*, 12 F. Supp. 667 (D. C. Md., 1935).

<sup>53</sup> *Burco, Inc. v. Whitworth*, 81 F. (2d) 721 (C.C.A., 4th Cir., 1936), cert. denied, 297 U. S. 724 (1936).

<sup>54</sup> *Electric Bond & Share Co. v. Securities & Exchange Commission*, 303 U. S. 419.

with the Commission in achieving compliance with Section 11(b). This committee was created on May 5, 1938. The new Chairman of the Commission, William O. Douglas, addressed the annual meeting of the American Bar Association on July 26, 1938, issuing a warning that the Commission was determined to get ahead with its assignment.<sup>55</sup> On August 4, 1938, the Commission made public a letter which it had sent the previous day to the heads of 66 holding companies requesting them to submit to the Commission integration and simplification suggestions, plans, and programs under the Act, even though tentative, not later than December 1, 1938.<sup>56</sup> By the deadline date the Commission had received responses from 64 of the 66 companies contacted.

Speculation as to the constitutionality of Section 11(b) continued to be a lively issue, giving rise to considerable legal comment.<sup>57</sup> The case selected to test the constitutionality of Section 11(b)(1) was that of The North American Company.<sup>58</sup> The North American decision was a comprehensive treatment of the integration problems of a large system and therefore constituted the proper basis for a review of the constitutionality of the integration provisions of the Act. The Circuit Court of Appeals for the Second Circuit held on January 12, 1943, in the North American case that Section 11(b)

<sup>55</sup> Douglas, Wm. O., "Scatteration v. Integration of Public Utility Systems," 24 A.B.J. 800 (1938). Cf., Jome, H. L., "The New Schoolmaster in Finance," 40 MICH. L. R. 625 (1942).

<sup>56</sup> Release No. 1192 (Aug. 4, 1938).

<sup>57</sup> Hamlin, Scoville, "Is the Utility 'Death Sentence' Unconstitutional?" 2 CORPORATE REORGANIZATIONS 95 (1935); note entitled "The Constitutionality of the Public Utility Holding Company Act of 1935," 23 VA. L. R. 678 (1937); Lesser, L. S., "Constitutional Powers of the Securities & Exchange Commission over Public Utility Holding Companies," 8 GEO. WASHINGTON L. R. 1128 (1940); and Davison, Jas. F., "Death Sentences for Public Utility Holding Companies," 8 GEO. WASHINGTON L. R. 1148 (1940).

<sup>58</sup> The North American Company, 11 S.E.C. 194 (1942), and The North American Company, 11 S.E.C. 715 (1942). The Commission, in accordance with its fixed policy, did not undertake to pass upon the constitutionality of the Act.

(1) was constitutional.<sup>59</sup> The contentions of the company that the ownership of securities did not constitute engaging in interstate commerce and that the requirements of Section 11(b)(1) amounted to the taking of property without due process of law in violation of the prohibition of the Fifth Amendment to the Constitution were overruled.

A writ of certiorari was granted by the Supreme Court in this case early in 1943.<sup>60</sup> On the day set for argument Chief Justice Harlan Stone disqualified himself because Charles Evans Hughes, Jr., was present to argue in behalf of North American. Justices Frank Murphy and Robert Jackson disqualified themselves as former Attorneys General of the United States, and Justice William O. Douglas disqualified himself since he had formerly been Chairman of the Securities and Exchange Commission. The withdrawal of four justices prevented the court from having a legal quorum of six justices and the case accordingly was postponed.<sup>61</sup> In May, 1945, Justice Stone decided that he was eligible to hear the case and argument was rescheduled for the following October. In July Justice Owen Roberts resigned and the court was obliged to postpone argument once more. However, Senator Harold Burton was appointed to fill the vacancy on the court created by the resignation of Justice Roberts and he considered that his former connections with two utility systems were too remote to disqualify him from considering the North American case. Accordingly, on November 15, 1945, after a delay of two years and nine months, arguments on the constitutionality of the "death sentence" provisions of the Act were presented to the Supreme Court. By this time, of course, considerable progress had been made towards the

<sup>59</sup> *The North American Company v. Securities & Exchange Commission*, 133 F.(2d) 148 (C.C.A., 2d Cir., 1943).

<sup>60</sup> *North American Company v. Securities & Exchange Commission*, 318 U. S. 750 (1943).

<sup>61</sup> *The Wall Street Journal*, October 29, 1945.

integration of numerous holding company systems and it was impossible to undo the changes already made. However, in view of the previous court decisions involving the Act and the revisions in the personnel of the Supreme Court effected by President Roosevelt, an ultimate holding of constitutionality was practically a foregone conclusion.

The decision of the Supreme Court in *The North American Company* case was finally rendered on April 1, 1946, almost four years after the original order of the Commission.<sup>62</sup> It was limited in its scope to a consideration of the constitutionality of Section 11(b)(1) of the Act. The first contention of North American was that its sole business was that of acquiring and holding for investment purposes stocks and other securities of its subsidiaries, and that therefore its business was essentially intrastate only. The Supreme Court found, however, that North American was more than a mere investor in its subsidiaries and that its influence and domination permeated the entire system. The mails and the instrumentalities of interstate commerce were held to be vital to the functioning of this system, and the acts of the subsidiaries were deemed to be acts of North American as well. The court felt that Congress was within its jurisdiction in imposing relevant conditions and requirements such as those contained in Section 11(b)(1) upon parties using the channels of interstate commerce in order that such channels would not become the means of promoting or spreading evil, whether of an economic nature, as in this case, or of a physical or moral nature.

North American also attacked Section 11(b)(1) on the

<sup>62</sup> *The North American Company v. Securities & Exchange Commission*, 327 U. S. 686. There was no dissent. The opinion was written by Justice Frank Murphy, and the other justices participating in the decision were Chief Justice Harlan F. Stone, Hugo L. Black, Felix Frankfurter, Wiley Rutledge and Harold H. Burton. Justices Reed, Douglas, and Jackson took no part in this case.

ground that it violated the due process clause of the Fifth Amendment to the Constitution. The court held that the rights of the holding company to maintain the status quo were outweighed by the actual and potential damage to the public, the investors, and consumers resulting from the use made of pooled investments. Furthermore, the court concluded, the Act does not contemplate or require the dumping or forced liquidation of securities on the market for inadequate considerations, and consequently the question as to whether there had been a destruction of the values of such property without just compensation could not arise.

Finally, North American claimed that it was guilty of none of the evils specified in Section 1(b) of the Act and that it should be allowed to prove that fact. The court held that Congress had the power to legislate generally, unlimited by proof of the existence of the evils in each particular situation, and that Section 11(b)(1) was not designed to punish past offenders but to remove what Congress considered to be potential if not actual sources of evil. The constitutionality of Section 11(b)(1) was accordingly sustained by the Supreme Court on all counts and the decisions of the Commission and the Circuit Court of Appeals were affirmed. The legal arguments which sounded so cogent to leaders in the industry in 1935 did not shine so brightly a decade later. The Supreme Court decision confirmed their growing suspicion that the Act was here to stay.