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THE SCHOOL OF LAW

Professor Tyrrell Williams has completed his work in connection with the preparation of Missouri Annotations to the American Law Institute's Restatement of the Law of Contracts.

Professor Israel Treiman is now engaged in the conduct of an investigation into the practice in receivership suits in the Circuit Court of the City of St. Louis. This work is under the joint auspices of the St. Louis Bar Association and of Washington University. Its purpose is to collect statistics to determine how receivership suits are actually handled in the local courts.

Notes

HOLDING COMPANY REGULATION THROUGH THE STATUTORY INHIBITION AGAINST STOCK ACQUISITION

Utility holding company regulation has become in recent years a focal point for public interest and discussion. The Insull debacle and other failures have raised a hue and cry for regulation that is seemingly irresistible. What reflection this clamor will find in the opinions of the public service commissions and courts throughout the country cannot yet be told. It is to be expected however that the almost unbelievable multiplication of utility holding companies will not be repeated. The Supreme Court of Missouri has very recently said that it is against the public policy of Missouri to allow foreign holding companies to acquire more than ten per cent. of the capital stock of a local utility.¹

¹ Not yet reported, decided Sept. 18, 1932. Rehearing denied January, 1933.

Opportunity for the articulation of public sentiment is presented in the interpretation of statutes requiring commission consent to the acquisition of stock in gas, electric, and street railway corporations by utilities operating in the same field and/or stock corporations, foreign or domestic.

These statutes in general are of two distinct types. There is first the statute which is found in Illinois. "With the consent and approval of the commission, a public utility may acquire, take or hold stock, stock certificates, bonds, notes, or other evidence of indebtedness of another public utility."² In *State Public Utility Commission ex rel. Clow v. Romberg*,³ the Supreme Court of Illinois held that this statute did not violate the prohibition in the Illinois Constitution against monopolies. The *Romberg* case is of further interest in that it approves the acquisition of stock in an Illinois utility by American Telegraph and Telephone Co. and one of its subsidiaries in the face of a statute⁴ which forbids a transfer to a foreign corporation of the right to own, operate, manage, or control a "public utility", the court saying that "public utility" means the physical plant itself which the local company still owns, in spite of a contrary definition contained in a previous section.⁵ This decision would seem to indicate that under no possible construction could such a statute apply to holding companies.⁶ Therefore states having statutes regulating acquisition of utility stock by utilities are without any such regulation over holding companies.⁷

² R. S. Ill. (Cahill 1927) ch. 111A, sec. 27, Ind. Ann. St. (Burns 1926) sec. 12767 is of substantially similar purport, and further, "no corporation foreign or domestic operating a public utility shall purchase, acquire, take or hold, directly or indirectly more than 10% of the total capital stock" of domestic utilities. District of Columbia, Act of March 4, 1913, P. A. No. 435, sec. 11, N. J. Laws 1911 ch. 195, sec. 19. Many other states have similar statutes.

³ (1917) 275 Ill. 432, 114 N. E. 191. Although the constitutionality of this statute has not otherwise been questioned so far as this writer is aware, the enormity and exclusive nature of American Telegraph & Telephone Co. (which was involved in the *Romberg* case) indicates that the other courts of the nation are in agreement.

⁴ R. S. Ill. (Cahill 1927) ch. 111 A sec. 28.

⁵ Sec. 10 defines a public utility as every corporation, company, association, etc., engaged in certain businesses, gas, electric, etc.

⁶ *New York-New Jersey Superpower Connecting Corp. v. Public Service Commission* (1926) 215 App. Div. 578, 214 N. Y. S. 294; *Re Tri-State Consolidated Telephone Co.* (Minn. R. R. 1931) P. U. R. 1932 A, 397; *Re Utilities Power and Light Co.* (Mo. P. S. C. 1930) P. U. R. 1930 B, 354.

⁷ *Re Madison Light and Power Co.* (Ind. P. S. C. 1924) P. U. R. 1924 C, 517; *Re Eastport Water Co.* (Mo. P. S. C. 1929) P. U. R. 1929 E, 136; *Borough of Brookville v. Solar Electric Co.* (Pa. P. S. C. 1928) P. U. R. 1928

Yet, under a statute similar in purport to the Illinois law, but couched in negative terms, the Maryland Commission reached an opposite conclusion.⁸ A local holding company possessed a charter authorizing it to perform the functions of a gas company. It owned the stock of a foreign corporation which in turn owned the stock of a local operating company. The local holding company applied for permission to issue and sell new stock to a Delaware holding company which owned all its previously issued stock. It was held that all the stock owning companies involved were participants in control of the gas plant of the local operating company and were therefore subject to the jurisdiction of the commission as gas corporations; "control can also be predicated of any Maryland gas corporation in an interconnected series of gas corporations that by reason of interlocking stock ownerships is capable of either originating or passing on a corporate movement which eventually asserts a directing influence over the workings of a gas plant within the state of Maryland." A further interpretation is found in *Re Bangor Railway and Electric Co.*,⁹ in which the Maine Commission allowed the transfer of stock of a Maine corporation formed as a holding company for Maine utilities, saying that although the company is not strictly a public utility, the commission will so treat it for this purpose. Of all the various holdings set out, this last has most to recommend itself. In reviewing the events of the past decade the necessity of some form of control over the purchase of utility stock by holding companies appears obvious. The *Bangor* method is forthright, simple, and cannot

B, 612, allowed a sale of stock to an individual in the interest of a non-resident holding company also owning the stock of another resident utility which was previously refused permission to buy the stock in question; *Re Washington Gas Light Co.* (D. C. P. U. C. 1932) P. U. R. 1932 D, 47. Likewise, in absence of a statute, *Re San Jose R. R.* (Cal. R. R. C. 1917) P. U. R. 1917 C, 939.

⁸ Md. Code Ann. (Bagby 1924) art. 23, sec. 394; *Re Central Public Service Corporation* (1929) P. U. R. 1930 A, 32. It will be noted that in thus increasing its potency, the commission did not do so by disregarding entities or by any other indirect means, it simply interpreted the statute according to the literal meaning of its words. The former means was employed in an Ohio rate case decided in 1922. *Ohio Mining Co. v. Public Utilities Commission* (1922) 106 Ohio St. 138, 140 N. E. 143. Too much reliance should not be placed on this case in view of the ease with which this result was evaded, i. e. by merely transferring the stock of the local company to the holding company's stockholders. *Southern Ohio Power Co. v. Public Utilities Commission* (1924) 110 Ohio St. 246, 143 N. E. 700.

⁹ (Me. P. U. C. 1925) P. U. R. 1925 E, 705. See also for a variety of holdings with the same trend: *Re Bridgeport Hydraulic Co.* (Conn. P. S. C. 1916) P. U. R. 1917 D, 271; *Re Continental Gas and Electric Corporation* (Neb. R. R. C. 1926) P. U. R. 1926 D, 711.

adequately be contested save on the ground of expediency, which argument is answered by our tragic experience with unregulated holding companies.

The other type of statute referred to *supra* is one which expressly declares that no stock corporation, foreign or domestic, may acquire more than a specified percentage, usually ten per cent., of the capital stock of a local utility without the approval of the commission. The Missouri provision is typical.

No railroad corporation, or electrical corporation, domestic or foreign, shall hereafter purchase or acquire, take or hold, any part of the capital stock of any railroad corporation or street railroad corporation or other common carrier organized or existing under or by virtue of the laws of this state unless authorized so to do by the commission; and save where stock shall be transferred or held for the purpose of collateral security, no stock corporation of any description, domestic or foreign, other than a railroad corporation, street railroad corporation, or electrical corporation, shall, without the consent of the Commission, purchase or acquire, take or hold, more than ten per centum of the total capital stock issued by any railroad corporation or street railroad corporation or other common carrier organized or existing under or by virtue of the laws of this state, except that a corporation now lawfully holding a majority of the stock of any railroad corporation or street railroad corporation may with the consent of the commission acquire and hold the remainder of the capital stock of such railroad corporation, or street railroad corporation or any portion thereof. Nothing herein contained shall be construed to prevent the holding of stock heretofore lawfully acquired, or to prevent, upon the surrender or exchange of said stock pursuant to a reorganization plan, the purchase, acquisition, taking or holding of a proportionate amount of stock of any new corporation organized to take over, at foreclosure or other sale, the property of any corporation whose stock has been thus surrendered or exchanged. Every contract, assignment, transfer or agreement for transfer of any stock by or through any person or corporation to any corporation in violation of any provision of this act shall be void and of no effect, and no such transfer or assignment shall be made upon the books of any such railroad corporation or street railroad corporation, or shall be recognized as effective for any purpose.¹⁰

¹⁰ R. S. Mo. (1929) sec. 5177; R. S. Mo. (1929) sec. 5195 (applying to gas, electric, and water companies), R. S. Mo. (1929) sec. 5219 (applying to telephone companies). C. S. N. Y. (Cahill 1930) ch. 49 sec. 70. Massachusetts

This type of statute is of especial significance today. It is one of the few regulatory instruments specifically relating to holding companies.¹¹ How effective its enforcement has been, and the questions arising thereunder for determination are matters of grave importance in the formulation of future guide-posts by the light of the mourning candles of our past experience.

An interesting and unique question of construction and interpretation arose in New York in 1928. The local company had a capitalization of 10,000 shares of voting common stock and 90,000 shares of non-voting preferred stock. The particular sub-holding company involved already held 5,400 shares of the common stock, which gave voting control of the local company, but was less than 10% of the total outstanding stock. It had acquired this without the consent of the commission. It now applied for permission to acquire the rest of the common stock and the entire issue of preferred stock. The commission refused to allow the sub-holding company to acquire it, declaring that it had violated the statute in the first instance; that the statute by any reasonable construction is not limited to 10% of the *total* capital stock in its literal meaning, but was intended to relate to actual control, and therefore the sale of *voting* stock was limited to 10%.¹² On appeal the Supreme Court¹³ reversed the commission, saying that the limitation refers to total capital stock, and voting power does not affect the question; that "public policy is not involved if there has been compliance with the law." This case materially weakens the power of the statute considered. If a holding company having control over a utility can obtain permission to change its capital structure and limit the numbers of shares bearing voting power to an amount twenty per cent. or less of its total capital structure, it has the right to convey a controlling interest to another system without commission approval, thus removing from commission jurisdiction entirely the question of expediency in holding company control. The difficulty of any other construction, however, is manifest in view of the clear and unequivocal expression of the statute.

One of the most troublesome questions raises an issue of fundamental policy. Is consolidation or acquisition of a controlling

has the same type of statute except that the legislature must approve. G. L. Mass. (1921) ch. 156, sec. 5; Md. Code Ann. (Bagby 1924) art. 23, sec. 394.

¹¹ Bonbright and Means, "The Holding Company" (1932), 206; Lilienthal, Regulation of Public Utility Holding Companies (1929) 29 Col. L. Rev. 404; note (1932) 45 Harv. L. R. 732.

¹² P. U. R. 1928 D, 247.

¹³ New York State Electric Corporation v. Public Service Commission (1929) 227 App. Div. 18, 236 N. Y. S. 411.

stock interest¹⁴ to be approved if it shall appear that it would have no detrimental effect on the public interest, or shall it be refused unless it appears that the public interest will be benefited thereby?

There is a clear split of authority on the point, with perhaps the majority of the states holding to the negative test in the interests of preserving the integrity of private property.¹⁵ This position is admirably indicated in a series of Maryland cases. In 1927, an application was filed by a Delaware holding company to acquire the stock of four Maryland utilities at a price in excess of the reproduction cost of the property represented by the stock by some \$245,000.00. The stock acquired was to be pledged with other stock of the applicant as collateral on a proposed bond issue of \$4,000,000.00. The Commission refused its approval because it could not see any advantage to the public.¹⁶ This was affirmed by the Circuit Court, but reversed on appeal to the Maryland Court of Appeals which said:

In the case of an owner of the stock of such a company is it within the rule of reason to hold that he may not sell his stock to a corporation unless it can be shown that the public will be benefited by the sale? Or may permission be refused merely because the only consideration moving the parties is one of financial investment which the parties believe to be for their mutual advantage? We think not. . . . To prevent injury of the public in the clashing of private interest with the public good in the operation of public utilities is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be benefited as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the

¹⁴ If the local management is friendly, and the voting stock wide-spread, 10% of the voting stock will be sufficient for ordinary working control. A few of the larger holding systems now work upon this principle and concentrate on minority holdings. In any event the legislatures evidently considered 10% as giving such influence as to be potentially harmful.

¹⁵ Re Northwestern Telephone Exchange Co. (Minn. P. U. C. 1916) P. U. R. 1916 D, 534; Re General Waterworks and Electric Corp. (Ala. P. S. C. 1929) P. U. R. 1930 A, 354; Re Raymond-Webbs Mills Telephone Co. (Me. P. U. C. 1916) P. U. R. 1916 F, 749; Re Concord Gaslight Co. (N. H. P. U. C. 1921) P. U. R. 1921 C, 169; Re Franklin Light & Power Co. (N. H. P. U. C. 1928) P. U. R. 1929 D, 678. There is some uncertainty in Indiana. Re Winona Telephone Co. (Ind. P. S. C. 1927) P. U. R. 1928 B, 829 (no detriment); Re Associated Telephone Co. (Ind. P. S. C. 1927) P. U. R. 1927 C, 577 (must show benefit to the public).

¹⁶ Re Electric Public Utilities Co. P. U. R. 1927 E, 609.

public detriment. In the public interest in such cases can reasonably mean no more than not detrimental to the public.¹⁷

The case was remanded to the commission which again refused the transfer on the ground that it would be detrimental to the public interest. This was reversed by the Circuit Court which held that the consolidation of public utilities cannot be denied by the commission on grounds of over-capitalization or excessive purchase price for controlling stock as being detrimental in view of the complete jurisdiction of the commission both as to rates and services of the operating company.¹⁸ It is readily seen that the effectiveness of the Maryland statute is thus to a large measure, if not entirely, eliminated since the collapse of holding company structure which has occurred in recent years may be traced in no small measure to excessive prices paid for stock of local companies.¹⁹

The other and better rule requiring the showing of public benefit is found in Missouri, New York, Illinois, Nebraska, and possibly California.²⁰ Which rule should be followed depends largely on the fundamental conception of the proper office and functions of the public utility in the social arrangement, i. e. whether utilities are operated in the interests of the public primarily, and from which private profits may be made, or whether they are primarily private enterprises. Following a line of cases which had involved the purchase of assets,²¹ the Alleghany Corporation (one of the Van Sweringen holding companies) was allowed to acquire the controlling stock of the Missouri Pacific Railroad Company, without making any showing that such acquisition would be in the public interest. The commission said, "In the absence of a show-

¹⁷ *Electric Public Utilities Co. v. West* (1928) 154 Md. 445, 140 Atl. 840.

¹⁸ *Electric Public Utilities Co. v. Public Service Commission* (1928) P. U. R. 1928 E, 854.

¹⁹ Perhaps the most powerful factor contributing to the downfall of certain holding companies may be termed a faulty balance of the "financial lever". This is not properly "overcapitalization," but is a dangerous form of capitalization. Ripley, *Main Street and Wall Street* (1927).

²⁰ *Re Consolidated Gas Co.* (N. Y. P. S. C. 1928) P. U. R. 1928 E, 19; *Re East Bay Water Co.* (Cal. R. R. C. 1928) P. U. R. 1929 A, 620; *Re Continental Gas & Electric Corp.* (Neb. R. R. C. 1926) P. U. R. 1926 D, 711; *Re Chicago Tunnel Co.* (Ill. Com. C. 1916) P. U. R. 1916 E, 268.

²¹ *Re Kansas City Telephone Co.* (1927) P. U. R. 1927 C, 101; *Re Liberal Light & Power Co.* (1930) P. U. R. 1930 B, 282. For many purposes the purchase of assets and the purchase of stock may involve dissimilar problems, but in the consideration of what is fundamentally a general rule of policy, cases involving the purchase of assets are quite as informative as the others.

ing that such acquisition of stock would be detrimental to the public, it is the duty of the commission to grant the prayer of the applicant."²² In all of these cases, however, the commission illogically inserted in the formal order, a clause to the effect that the transaction is in the public interest. In 1929, however, when a Delaware holding company sought to acquire the stock of the St. Louis Public Service Company, the commission was thoroughly consistent in saying that, "the basis of our decision should be, is such transfer detrimental, injurious, or harmful to the public and the public welfare."²³ This case went up on appeal by the City of St. Louis, and minority stockholders to the Supreme Court of Missouri which handed down its decision in September, 1932, and only recently denied a motion for a rehearing.²⁴ The Court reversed the commission, and, after reviewing the Public Service Act as an entirety, declared that the whole tenor of the Act and its very purpose was to afford not only protection in existing conditions to the public, but to insure to it a benefit, and in the absence of a showing of such benefit, there exists no reason for approval of a change in the status quo. Several writers have indicated that this controversy really centers about a distinction without a difference, and that it is of little practical importance. However, under the Maryland holding cited *supra*, it is to be noted that the commission must give its approval in the absence of a finding of detriment. This places the burden on an already overworked commission to investigate independently and prove to its own satisfaction the absence of possible injury. Naturally, the heavily taxed commission²⁵ cannot consider the question with thoroughness, and the tendency is to disregard important factors if not introduced by the applicant who will not reveal them if contrary to his interest. Under the New York and Missouri holding, the petitioner must show affirmatively that the public will be benefited; this relieves the commission and places the responsibility of showing benefit on him who must give that benefit. The adoption of this interpretation might conceivably reduce the possibility of an unforeseen calamity.

It is possible that under a proper administration of the statute under consideration requiring the approval of the commission of a transfer of stock, the uneconomic placement of controlled utili-

²² Re Alleghany Corporation (1930) P. U. R. 1930 D, 47.

²³ Re City Utilities Co. (1929) 17 Mo. P. S. C. 265.

²⁴ See note 1 *supra*.

²⁵ Of course, it is quite possible that local public officials would take this burden upon themselves willingly. The commission could make and enforce a rule that they should be notified. How effectual this would be is questionable, for in all probability the public officials would not be as passionately zealous of their interests as are the utility advocates now.

ties would have been prevented in the past. The commissions have rarely, however, interfered in this matter, leaving the prerogative in the hands of those business men whose driving impulse is accumulation of profits, rather than possessing themselves of this privilege with a view to public efficiency. They are prone to approve a plan which apparently affords some betterment of existing method, although that plan proposed is not the best possible.²⁶ It is only fair, however, to add that the commissions are not entirely to blame, for it is certainly beyond their power under this or any other statute to say that one particular holding company more favorably situated shall acquire, or to order such acquisition. The most that they can do is to refuse the acquisition by a holding company, less favorably situated, and this is utterly inconsistent with human tendency to grasp at some benefit for fear of losing all. Notwithstanding this there have happened those rare instances where commissions have exercised their prerogative in planting the seed for ultimate public good by refusing to approve geographically uneconomic consolidations. In *Re Genesee Valley Gas Company Incorporated*, the commission said,

It is true that the commission has granted a number of petitions having for their purpose the expansion of existing systems and better coordination of different operating utilities. In all these cases the properties acquired have either formed a logical unit or have extended such units. The present proposition does not come within this class of cases. The Ticonderoga Company is remote from other properties of the petitioner, and the only consideration seems to be one of financial investment. We do not see how the public interest is to be served thereby and therefore this petition is to be denied.²⁷

There are other cases tending along the same lines.²⁸ On a related subject, the commissions have refused the sale and purchase of utility property because it might provide an obstacle for municipal acquisition.²⁹

Perhaps the most controversial question, arising under consolidation statutes, is centered about the payment of excessive prices in the purchase of utility stock. In the situation where a

²⁶ *In re Cumberland County Power and Light Co.* (Me. P. U. C. 1916) P. U. R. 1917 C, 274; *contra*, *Re Ridgefield Electric Company* (N. Y. P. S. C. 1925) P. U. R. 1925 D, 328.

²⁷ (N. Y. P. S. C. 1926) P. U. R. 1927 B, 600.

²⁸ *Re Pennsylvania Water Service Co.* (Pa. P. S. C. 1927) P. U. R. 1927 E, 656; *Re Interstate Utilities Co.* (Mich. P. U. C. 1928) P. U. R. 1922 C, 589.

²⁹ *Re M. A. Erickson* (N. D. P. U. C. 1927) P. U. R. 1927 C, 861; *Re Cambridge Gas Light Co.* (Mass. P. S. C. 1930) P. U. R. 1930 D, 263.

holding company seeks to purchase the stock of an operating company, and to pay therefor a price in excess of the fair value of the stock, the natural expectation (commissions insisting as they do, that they have no jurisdiction over the holding company), would be a complete disregard by the commissions of this factor on the theory that for the purpose of rate-fixing and supervision over service the commission did not lose jurisdiction over the physical property of the local company and the capitalization of the holding company would be of no consequence in protecting consumers. Strangely enough only a few cases give their approval to payment of high prices, and this only where a rate reduction appears imminent because of a technological improvement.³⁰ On the other hand, a considerable number of cases refuse to allow the holding company to pay grossly excessive prices in an evident attempt to protect not only the consumer but the investor as well.³¹ A representative instance is the case of *Re Metropolitan Edison Company*³² in which the petitioner sought to acquire from a Delaware holding company the stock of eleven Pennsylvania operating companies, the purchase price agreed on being the cost to the holding company plus interest from the date of acquisition by the holding company to the date of approval by the commission. The price thus computed would be in the aggregate 1.3 times the book equity after reflecting appraised values. The commission held that inflated costs should not be placed as a burden upon either the public or the operating company.

Admitting that gross overcapitalization affects the investing public adversely, and waiving the question of whether or not commissions should regard it as their duty to protect investors, what deleterious effect can the capitalization of a holding company have upon the consumers? It is true that the operating property is still subject to the jurisdiction of the commission, and that no amount of capitalization by the company owning its stock equities will increase the value of the property itself so as to allow a rate increase; nor can the service be impaired, the commission still having jurisdiction. The effect upon rates must therefore be

³⁰ *Re Columbia Gas & Electric Corp.* (N. Y. P. S. C. 1930) P. U. R. 1930 B, 472; *Re Great Lakes Utilities Corp.* (N. Y. P. S. C. 1927) P. U. R. 1927 E, 409; *Re Power & Electric Securities Co.* (N. Y. P. S. C. 1925) P. U. R. 1926 A, 855; *Electric Public Utilities Co. v. West* (1928) 154 Md. 445, 140 Atl. 840.

³¹ *Re Columbia Gas & Electric Corp.* (N. Y. P. S. C. 1931) P. U. R. 1931 C, 247; *Re Niagara Hudson Power Corp.* (N. Y. P. S. C. 1932) P. U. R. 1932 C, 486; *Re Niagara Hudson Power Corp.* (N. Y. P. S. C. 1931) P. U. R. 1931 B, 343; *Re New York Power & Light Corp.* (N. Y. P. S. C. 1928) P. U. R. 1928 E, 721; *Re Pennsylvania Public Service Corp.* (Pa. P. S. C. 1925) P. U. R. 1926 B, 791; *Re Northern Light & Power Co.* (N. Y. P. S. C. 1923) P. U. R. 1924 B, 813.

³² *Re Metropolitan Edison Co.* (Pa. P. S. C. 1927) P. U. R. 1927 E, 639.

indirect, subtle, evasive. It is conjecturable that a commission having before it a top-heavy holding company structure with a large amount of fixed obligations would hesitate before lowering the rates of the subsidiary. There is, however, a noxious effect more certain to occur. It is considered good business policy to reduce prices for the sake of an ultimate increase in profits resulting from stimulated usage and mass distribution. The same profitable possibility exists in the utility field, and a good many companies have made beneficial use of this principle. Where, however, the operating company is under pressure to feed the avaricious interest and dividend seekers of a parent company with an inflated capital structure, this principle cannot be practiced,³³ and the management must refrain from lowering rates in circumstances where a conservatively capitalized company could take the plunge with a view to future increased returns.

The consumers may also be affected with regard to service rendered. It is not to be expected that the service of electric, gas, and traction companies have reached their final state of perfection. There should, and undoubtedly will be, constant progress in the development of new improvements and extensions. The operating company would inevitably be prohibited from making any improvements not yielding an immediate and large profit.³⁴

³³ As a matter of practice, this is not entirely true. If the utility has a number of large consumers, it can for the purpose of stimulating business and enjoying a "long-run" profit put into effect "block rates". This merely means that to those increasing their consumption a certain amount, the company offers lower rates on a sliding scale. This the local company may do without in any way causing an immediate drain on its resources.

³⁴ In *re Wisconsin Utilities Co.* (Wis. R. R. C. 1923) P. U. R. 1923 B, 855, operating company sought to mortgage its property for purpose of securing bonds to be issued by a foreign holding company—denied. This is an example of the ill effects which a weak parent may have on its subsidiary. Far from being a tower of financial strength, it sometimes must borrow from the underlying companies. *Re Green Mountain Power Corporation* (Vt. P. U. C. 1931) P. U. R. 1932 A, 130; *Re Arizona Edison Co.* (Ariz. Corp. C. 1931) P. U. R. 1932 A, 238. Mr. Bonbright indicates in "The Holding Company", p. 180, what part the service contract may play in mulcting a subsidiary. See *Re New York State Railways* (N. Y. P. S. C. 1932) P. U. R. 1932 D, 479. However, this situation would afford no means of permanently helping a financially embarrassed holding company in a time of depression. In the absence of a rate increase ordered by the commission, which is unlikely, an increase in service charges would be of no avail. Such funds must come out of surplus which could otherwise be used to pay dividends on the common stock of the subsidiary which the holding company owns. If there is no such surplus, then such charges will merely hasten a default on the senior securities of the subsidiary which will oust the holding company's control and will destroy the value of common stock, which is usually the holding company's sole interest in the subsidiary.

Thus it will be seen, that there are very real dangers attendant upon the sanction of purchase prices largely in excess of the value of the property indirectly to be controlled; it is gratifying to note that the more recent decisions have not only been aware of them, but have thwarted them.

In view of the vast, national character of the great holding company systems of America, a last question of interpretation becomes a matter of grave importance, in the determination of whether or not the legislatures of states having the "ten per cent." statutes were laying down a primary policy directed against the foreign holding company by which to guide the commissions. It is surprising that the expediency of allowing foreign stock corporations to acquire local utility stock has been so infrequently questioned and so uncertainly adjudicated. The Supreme Court of Missouri has determined that public policy as indicated by the statute in question and others opposes holding company acquisition, especially foreign holding company acquisition.³⁵

In New York where the statute is substantially similar, the state of the law is uncertain, and there has been vacillation from one point of view to the other since 1917, when the case of *South Shore Natural Gas and Fuel Company*³⁶ was decided by the commission. It held that the stock of three gas corporations might be acquired by a Delaware holding company which Henry Doherty and Company held an option to purchase. It decided that the commission's power of management over the properties was not lessened. A dissenting commissioner called attention to the fact that because the commission would have no jurisdiction over the capital issues of the foreign corporation, it thereby would lose supervision over the security issues of the domestic companies; that the purpose of the statute was to inhibit holding companies and prevent the exploitation of the utility field. He, however, gave no attention whatsoever to the increased difficulty of regulation as to expenses by reason of intercorporate contracts relating to services. In the case of *Re Power and Electric Securities Company*, the majority in approving the transfer of stock to a foreign holding company, said that the ownership of stock gives no advantage to the holding company in the fixation of rates, nevertheless it has misgivings because it possesses no jurisdiction over the issuance of stocks. "When it is possible to secure earnings to justify prices paid for operating utilities, represented in the capital issues of these holding companies no harm is done, but there are possibilities of great future loss to the investing public because of the unregulated power of such holding companies to issue their securities and because of the misapprehension of the investing public with regard to those securities," calling attention

³⁵ See note 1 *supra*.

³⁶ P. U. R. 1917 C, 274.

to the failure of the legislature to provide for the regulation of capital issues of holding companies which control domestic utilities.³⁷

The court in *New York State Electric Corp. v. P. S. C.*³⁸ indicated that to prevent a foreign company acquiring control is unreasonable since the operating company is subject to the regulatory powers of the commission. There was a dissenting opinion which stressed the loss of control effected by the acquisition by the Delaware holding company. Here then we find a holding by a court of law in direct opposition to the decision of the Missouri Supreme Court. It is to be noted in this connection that the Missouri court in emphasizing especially the undesirability of foreign holding companies, did not fail to indicate that it also did not look with favor upon domestic holding companies. Had this not been done, it would, of course, have been possible to avoid entirely the objections of the court by interposing a domestic holding company between the utility, and the foreign corporation. This would only serve to increase the indirection and uncertainty already attendant upon the system as it now stands. Commissions would have no greater control over the stock issued by domestic holding companies since they are not normally included in the category of public utilities than it would over the issue of a foreign company. The factor of access to the books of a domestic holding company and its availability for service of process constitute the only effectual and material difference between it and a foreign company not amenable to jurisdiction. Even this is minimized to a certain extent by difficulties caused when the books of the domestic company are not kept within the state. The Missouri court then pursued its course logically and consistently. The New York commission which follows the same course as does the Missouri court with reference to foreign stock corporations, did not object, however, to the domestic holding company.

In 1931 the New York Commission denied an application by a foreign company to purchase utility stock using these words:

The Columbia Gas and Electric Corporation is a foreign holding corporation over which the commission has little if any jurisdiction or control. It has been stated by those appearing for foreign holding corporations that inasmuch as the commission had jurisdiction and control of the operating company it was of little interest who owned or held the stock. We believe that this is a fallacious theory, and that the prac-

³⁷ (1925) P. U. R. 1926 A, 855. See, however, *Erie Power Corporation* (1925) P. U. R. 1926 A, 707; *Re Brooklyn Union Gas Co.* (1930) P. U. R. 1930 D, 255.

³⁸ See note 13 *supra*.

tical working out of such acquisition is not in all cases favorable to the public interest. It is difficult for the commission where the holding company is a *foreign* corporation to trace and ascertain the justice and equitableness of intercompany charges and transactions. . . . However we believe that it is not for the best interest of the public that the stock of domestic operating companies be acquired by foreign corporate holding companies.³⁹

Excepting to the omission of domestic holding companies by the commission, the writer otherwise thoroughly agrees with it.

In imposing this statutory limitation upon stock sale and acquisition the legislature undoubtedly meant that before granting approval, the commission should inquire most diligently into the expediency of the transaction from the standpoint of public welfare, not from the standpoint of the feasibility of great private gain without appreciable and obvious public detriment. And even if the legislature had no such intention it should be the policy of the commissions which are within the hearing of the tremendous furore now surrounding holding companies to proceed with care lest the public be further injured.

It is felt by several writers of distinction that the type of statute under discussion is largely ineffective. "The most that can possibly be said for it is that it is a little better than nothing."⁴⁰ It is true of course, that the statute has no retroactive effect; but is it true that under the statute, the commissions have no control over consolidations which have proven harmful both to the public and to investors? The statute *supra* reads, "No stock corporation . . . shall, without the consent of the commission, purchase or acquire, take or *hold* more than ten per centum. . ." In this word, *hold*, the author believes, lies a possible panacea for the evils which have resulted in certain instances. Is it not feasible that under this wording, and in the absence of other regulation on the holding company, a commission may hail before it a utility not operating successfully, demand it to divulge its shareholders, and upon ascertaining that a holding company not desirable from the standpoint of economy and efficiency *holds* more than ten per cent. of the stock, order that the holding company appear before it to obtain its approval to a further *holding* of the stock? If the holding company fails to establish facts showing a benefit to the public, there appears to be no reason, save a fear of being accused of temerity, why the

³⁹ See note 31 *supra*.

⁴⁰ Bonbright and Means, "The Holding Company" (1932) 215; Lilienthal, Regulation of Public Utility Holding Companies (1929), 29 Columbia L. Rev. 404; note (1932) 45 Harv. L. Rev. 732.

commission may not order a surrender or disposal of the stock held in excess of ten per cent. by the holding company. Naturally this could not apply to stock acquired before the statute was enacted, but it is an historical fact that most holding companies grew up after that date. Such a construction of the statute has never been attempted. It is submitted that, with public opinion in its present state, such an attempt in the near future might and should be received favorably by the courts.

To admit the statute's ineffectiveness at the present time however, as even a partial remedy to the ills of holding company control can hardly be avoided. Yet this statute has other teeth which should they be furnished up and utilized, would prove a very definite clamp on the cauldron of parent subsidiary relationships. Courts and commissions should keep in mind the danger of an unbridled holding company. The most stringent tests should be employed. Public benefit must be the overwhelming factor in passing approval upon a foreign holding company. Under this should be considered exhaustively not only purchase price, and the imminence of rate reductions, but the financial set-up of the holding company itself, its capacity to render valuable services, and its desire to render them at cost, further and most important to the future development of this quasi-public industry must be considered a proper and schematic territorial integration with a consequent elimination of the widely scattered and resultantly weak tentacles with which some of the holding systems now operate. With an increasing use of conditions imposed to fortify these ends upon the granting of applications and petitions,⁴¹ this statute may assume undreamed of efficacy in the absence of other regulatory measures, but even with the enactment of further laws, the statute should for the purposes of guaranteeing a well-integrated system of physically connected utility properties, and a scheme of management service which assures to the public, rather than to the stockholders, the primary advantages of centralized management and control, remain the original and basic cog in the proposed straitjacket. Missouri has taken a step in the right direction.

STANLEY M. RICHMAN, '33.

⁴¹ A note on consolidation, merger and sale setting out a few conditions that have been imposed in the past may be found in P. U. R. 1918 C, 80. See also *Re Public Utilities Consolidated Corporation* (Vt. P. S. C. 1929) P. U. R. 1929 B, 492; *Re Empire Telephone Co.* (Cal. R. R. C. 1919) P. U. R. 1920 B, 664. The most common may be thus summarized: 1 preservation of future right of city to purchase; 2 plan of book entries relative to purchase price be submitted for approval; 3 consolidation must be effectuated through a corporation organized under the laws of that state.