10/24/48

Nos. 226, 227, 243, 266, O.T. 1948
Cert to CCA 3

Securities and Exchange Comm'n v. Central-Illinois Securities Corp.

These petitions present the question of the fairness of a feature of a plan filed in simplification proceedings under § 11 (e) of the Public Utilities Holding Company Act by Engineers Public Service Co. The aspect of the plan in issue is the provision for satisfying the claims of Engineers' preferred stockholders in cash as a preliminary to distributing its remaining assets to common stockholders and dissolving. The issue is whether the SEC correctly applied the "fair and equitable" standard of § 11 (e) to the division of the assets of the company between preferred and commong stockholders.

Engineers had outstanding three series of cumulative prefer stock of equal rank: $5, $5.50, and $6. Each had an involuntar liquidation preference of $100. The $5 series had a voluntary liquidation or call price of $105; the other two series had a ca price of $110. Management formulated a plan providing for the payment of all preferred stockholders at the involuntary liquidation price plus accrued dividends. To insure adequate presentation of the preferred stockholders' viewpoint management desi nated a preferred stockholder to employxx counsel partly at the company expense(Streeter, No. 227). A group of institutional i vestors/holding preferred stock also appeared before the SEC (Home Ins. Co., No. 243). The representatives of the preferred stockholders contended tha they should receive the call price of their shares. Expert wit nesses testified that the "present value or investment worth of these three series of stock, on a going concern basis and apart from the Act, under the prevailing yields applied to comparable securities" was higher than their call prices.

The SEC found that the proposed liquidation was caused by the act "and is in that sense involuntary." But it held that thex involuntary nature of the liquidation did not require the preferred stockholders to accept the charter involuntary liquidation price for their shares; it relied for this view upon Otis & Co. v. SEC, 323 U.S. 624, which held, in a simplification proceeding where both preferred and common stockholders were to receive securities inx a lower level company, that the SEC might evaluate the rights of stockholders "on the basis of a going business and not as though liquidation were taking place." More specifically it held that preferred stockholders were entitled only to a price less than involuntary liquidation price of their shares; the SEC's basis reaching this result, assumed future earning which would place common in a position to receive dividends in 15 years if the co pany were to continue operations, was approved. The SEC, relyi on the Otis case to find that neither the involuntary liquidati price nor the call price was controlling, proceeded to determine whether the plan gave each security holder "from that which is able for the satisfaction of his claim, the equitable equivalen of the rights surrendered." It found that the investment value of the preferred was at least equal to the call price but treat the call price as the ceiling. The call price was then held to be the equitable equivalent of the rights surrendered. The pla was disapproved, but Engineers amended the plan to comply with SEC's ruling. The SEC approved the plan.

The district court revised the plan by fixing the price f the preferred stock at the involuntary liquidation price. Whi it thought that the charter involuntary liquidation price was not dispositive, it disapproved of payment in excess of that price on grounds of "colloquial equity." It considered all the factors involved, including issue price, market history, losses due to divestments in compliance with § 11 (b) of the Act, earnings retained in the system, etc., and concluded that fairness and equity did not require payment of a premium to preferred stockholders. These "colloquial equity" factors and the possibility of future decline in the value of the stock offset the valuation of the stock as an interest in a going concern, a valuation which the court accepted as correct. The court entered an order approving the plan except as it provided for payments in the amount deeme appropriate to the preferred stockholders.

The CCA 3 (Biggs with A.L. Stephens and Maris) vacated the decree and remanded with directions to enter an order disapprov the plan as not being fair and equitable and to return the reco to the SEC ~~xt~~ in order that the agency might proceed in the man designated in the opinion. # The court decided three ~~xxx~~ points: (1) district court could reject but could not amend the plan. By su stituting its valuation of the preferred stockholders' rights for that of the SEC it amended the plan. (2) In reviewing the method of valuation employed by the SEC the district court was rect, since the rule of SEC v. Chenery Corp., 332 U.S. 194, 207, that in reviewing the action of the SEC at the instance of a person agrieved under § 24 (a) of the Act the court cannot disturb the action of the SEC if it "is based upon substantial evidence and is consistent with the authority granted by Congress," is not applicable to review of a plan under § 11 (e). (3) The valuation methods employed by the SEC were wrong. (a) The agency should have ascertained the future earning power of the system and apportioned that earning power between the preferred and common according to their respective claims to income. (b) The SEC should have made a finding as to the value of the common stock. (c) Since the SEC valued the preferred stock as if the Act had not been passed, it should have valued the common stock in the same manner, by determingng, inter alia, the amount of loss suffered by Engineers by reason of the divestitute required by the Act and allocating these losses between preferred and common stock. The court implicitely approved the "colloquial equity" factors enunciated by the district court as worthy of consideration by the SEC.

(1) No. 266 is a petition by the management of Engineers seeking to have reinstated the decree entered by the district court which limited the payment to preferred stockholders at the involunsary liquidation price. Petitioner contends that the court was correct, and indeed followed the practice recomme by the SEC, in approving the plan as modified by its order. ~~It~~ Petition contends that the SEC had ~~adopted~~ given contingent approval to the provision approved by the court as an alternative and had found it fair and equitable sub ject to the review by the district court. It is difficult to perceive how the SEC could have thought ~~the~~ both plans fair and equitable.

(2) Nos. 226, 227, 243, are petitions by the SEC and the representatives of the preferred stockholders, all of whom urge that the plan approved by the SEC was fair and equitable. The CCA is criticised for adopting a different rule, as to scope of review for an 11 (e) court, from the rule applicable to a CCA reviewing the SEC's action under § 24 (a). Section 24 (a) pro-

vides that "The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." Section 11 (e) contains no similar provision but requires the court to approve the plan if it finds it fair and equitable. The SEC urges the anomaly of varying scopes of review in alternative methods of securing judicial review of a plan, and asserts that the decision conflict with Lahti v. New England Power Ass'n, 160 F.2d 845, 858, and Massachusetts Mutual Life Ins. Co. v. SEC, 151 F. 2d 424, 430. However, these two decisions are not clear on this point. They seem to accept the finding as much because it is the district court' as because it is the Commission's. A clear conflict on such a matter is virtually impossible, of course, because the court ma phrase its agreement with the agency findings in terms of scope of review. At any rate the question of scope of review under § 11 (e) seems important enough to be of concern to this Court.

(3) The SEC's approach to valuation was an attempt to app both the doctrine of strict priority and the principle of the Ot case. The "rights of stockholders of a solvent company which is ordered by the Commission to distribute its assets among its stc holders may be evaluated on the basis of a going business and nc as though a liquidation were taking place." 323 U.S. at 633. There are significant difference between Otis and the instant c In Otis preferred and common were to be exchanged for participat in a lower echelone company, while here the preferred is to be paid in cash and only the common will receive participations in another company. In Otis the going concern value of the preferr computed with reference to the interest common was entitled retain because of expectation of future earnings which would even

tually reach the point where there would be something left for common was lower than the involuntary liquidation price; in the instant case the going concern value exceeds the call price.

In Otis the chief factor in evaluation was assumed future earnings of the system; these assumed earnings were apportioned between preferred and common. The SEC says that it is unnecessary to go through this process in the present case, for the preferred will be paid off in cash; all that is necessary is to give the preferred stockholder the "current value of his stock." This answer begs the question. I should have though it a better answer to say that in arriving at going concern or investment value, it was necessary to consider assumed future earnings ~~in connection~~ together with the dividend rate of the stock; that the figure arrived at was a conclusion necessarily based in part on assumed future earnings.

The extent to which notions of "colloquial equities" should modify the rule of strict priorities in simplification proceedings did not receive the attention of the Court in Otis. The situation this case raises the question. I think this Court should determine the correct method of valuation in the circumstances of this case.

I would grant cert.

pwt