

INTERLOCKING DIRECTOR POSITIONS: AN AREA OF CONCERN FOR ELECTRIC UTILITIES

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WHEN CONGRESS PASSED the Federal Power Act¹ in 1935, it sought to remedy the abuses associated with the pyramiding of holding companies in the electric utility industry.² The areas of concern were the use of interlocking arrangements between two electric utilities, between electric utilities and underwriting firms and between electric utilities and firms supplying them with electrical equipment. Congress in Section 305(b)^{2a} expressly made it unlawful for any person to hold such interlocking positions unless a showing could be made upon which the Federal Power Commis-

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¹41 Stat. 1063 (1920), as amended, 16 U.S.C. §§ 791, *et seq.*

²In *John Edward Aldred*, 2 F.P.C. 246 (1940), the Commission wrote (*id.* at 260-261):

It is believed that among the evils sought to be eliminated by the enactment of Section 305(b) were:

1. Control over a large number and geographically widespread public utilities by a small group of individuals with perhaps a minimum of investment.
2. The evasion by means of common control of competition resulting in higher costs and poorer services to consumers.
3. The lack of arm's-length dealings between public utilities and organizations furnishing financial services or electrical equipment.
4. The employment of dummy directors designated solely for the purpose of executing the orders of those in control, and nominal directors who give little time and attention to the affairs of the companies.
5. Violations of laws, ethics, and good business practices by those holding such interlocking positions whereby such relationship is employed for their own benefit or profit, or for the benefit or profit of any other person or persons and to the detriment of the companies, their security holders or the public interest.

^{2a}Section 305(b) reads as follows:

After six months from the date on which this Part takes effect, it shall be unlawful for any person to hold the position of officer or director of more than one public utility or to hold the position of officer or director of a public utility and the position of officer or director of any bank, trust company, banking association, or firm that is authorized by law to underwrite or participate in the marketing of securities of a public utility, or officer or director of any company supplying electrical equipment to such public utility, unless the holding of such positions shall have been authorized by order of the Commission, upon due showing in form and manner prescribed by the Commission, that neither public nor private interests will be adversely affected thereby. The Commission shall not grant any such authorization in respect of such positions held on the date on which this Part takes effect, unless application for such authorization is filed with the Commission within sixty days after that date.

Section 211 of the Public Utility Regulatory Policies Act of 1978, P.L. 95-617, added Subsection (c) which reads:

- (1) On or before April 30 of each year, any person who, during the calendar year preceding the filing date under this subsection, was an officer or director of a public utility and who held, during such calendar year, the position of officer, director, partner, appointee, or representative of any other entity listed in paragraph (2) shall file with the Commission, in such form and manner as the Commission shall by rule prescribe, a written statement concerning such positions held by such person. Such statement shall be available to the public.
- (2) The entities listed for purposes of paragraph (1) are as follows—
 - (A) any investment bank, bank holding company, foreign bank or subsidiary thereof doing business in the United States, insurance company, or any other organization primarily engaged in the business of providing financial services or credit, a mutual savings bank, or a savings and loan association;
 - (B) any company, firm, or organization which is authorized by law to underwrite or participate in the marketing of securities of a public utility;
 - (C) any company, firm, or organization which produces or supplies electrical equipment or coal, natural gas, oil, nuclear fuel, or other fuel, for the use of any public utility;
 - (D) any company, firm, or organization which during any one of the 3 calendar years immediately preceding the filing date was one of the 20 purchasers of electric energy which purchased (for purposes other than for resale) one of the 20 largest annual amounts of electric energy sold by such public utility (or by any public utility which is part of the same holding company system) during any one of such three calendar years;

under that subsection was limited to interlocks between public utilities and "any bank, trust company, banking association, or firm that is authorized by law to underwrite or participate in the marketing of securities of a public utility. . . ." as well as to certain other kinds of interlocks not involving banks. The Commission's interpretation of the limits of its approval power for bank interlocks was based on the wording of the statute and on a letter dated October 24, 1935, from the Comptroller of the Currency informing this agency that under the Banking Act of 1933, as amended by the Banking Act of 1935, national banks had no legal authority to underwrite or participate in the marketing of public utility securities.

Congress took no action on the proposed amendment to Section 305(b).

By adding Section 305(c) to the Federal Power Act, Congress has now imposed reporting requirements where interlocking positions are with "any investment bank, bank holding company, foreign bank or subsidiary thereof doing business in the United States, insurance company, or any other organization primarily engaged in the business of providing financial services or credit, a mutual savings bank, or a saving and loan association." While this amendment to Section 305 does not go as far in expanding Commission authority where interlocks with banks are involved as had been previously suggested by the Commission in 1974, the Commission's ability to obtain reports could form an informational basis for new legislation expanding its jurisdiction.

With respect to interlocking positions involving a public utility and a *securities firm*, the Commission's precedents are consistent—such applications have been denied. In the *Aldred* case, when the Commission considered the applications to hold interlocking positions in the Consolidated of Baltimore system, several applications involved the "securities" clause of Section 305(b). Three individuals, who were partners or employees of the security firm of Aldred and Company, were denied the right to hold interlocking positions with Consolidated and/or its subsidiaries. Although in two instances these men had previously been authorized to hold such positions, the authorization was rescinded after hearing, or the applicants resigned as directors of the public utilities. The same was true of Joseph Gross, a partner in Joseph W. Gross & Company, who previously had been authorized to be a director of subsidiaries of Consolidated.²¹

Fifteen years later, in 1955, the Commission denied Edward O. Boshell's application to hold the position of director of H. M. Byllesby and Company in addition to directorships with Duquesne Light Company and Westinghouse Electric Corporation.²² Boshell included with his application a letter from Byllesby and Company stating that it would agree that, when Boshell served as an officer or director of Byllesby, it would not underwrite or market the securities of a utility in which Boshell was an officer or director. The Commission noted that the Securities and Exchange Commission in approving a reorganization plan pursuant to Section 11(e) of the Public Utility Holding Company Act required that Duquesne Light Company, a former subsidiary of Standard Gas and Electric Company,

²¹*Id.* at 259-262, 279-280.

²²*Edward O. Boshell*, 14 F.P.C. 1003 (1955).

which was controlled by Byllesby through stock ownership in Standard Power and Light Corporation, not have interlocking officers or directors with companies which were then or had been members of the Standard Power holding company system.

Subsequently, the application of Harold P. Woodcock to hold the position of president and director of Woodcock, Hess & Co., Inc. and director of Central Louisiana Electric Company was denied.²³ Woodcock, Hess was authorized by law to underwrite or participate in the marketing of utility securities and, acting as a broker, had purchased and sold the securities of many utilities upon order of its customers. The Commission also found that Woodcock, Hess, acting as a principal, maintained a market for the securities of a number of public utilities, including Central Louisiana.

The Commission did authorize David S. Soliday to be a partner of a securities firm and a Court-appointed director of Mountain States Power Company in a bankruptcy proceeding.²⁴ The authorization would terminate automatically when and if Mr. Soliday ceased to hold the appointment by the Court as director of Mountain States and in any event within 60 days from the termination of the bankruptcy proceedings and the entry of a final decree by the U.S. District Court. With this very limited and unusual exception, there seems little likelihood that the Commission would approve interlocking directorships where a securities firm and a public utility are involved.

Indeed, the Commission's present position was spelled out in several recent orders involving the application of Edwin I. Hatch for authorization to hold interlocking directorships in Georgia Power Company, City Investing Company and City's wholly owned subsidiary, The Home Insurance Company.²⁵ Home Insurance has a subsidiary, Home Capital Service, which participates in underwriting securities and is authorized to underwrite public utility securities. In Opinion No. 67 the Commission found that Mr. Hatch, who at the time the Opinion was issued was an "honorary director" without voting privileges of Georgia Power, performed functions similar to those of a director and therefore he is within the purview of Section 305(b) of the Federal Power Act. In addition, the Commission concluded that Home Capital's investment activities were attributable to Home and/or City so as to bring these entities within the ambit of Section 305(b). The Commission said that Mr. Hatch had failed to show any clear, overriding benefit resulting from the interlocking directorships, *i.e.*, that neither public nor private interests will be adversely affected by his holding of these positions; the Commission denied Mr. Hatch's application.

In a concurring opinion, Commissioner Sheldon expressed concern that, by finding that an "honorary director" is a "director" under Section 305(b), "all outside advisors and consultants working for a public utility and holding a position of 'officer or director of any bank, trust company, banking

²³*Harold Palmer Woodcock*, 16 F.P.C. 1320 (1956).

²⁴*David S. Soliday*, 2 F.P.C. 643 (1940).

²⁵*Edwin I. Hatch*, Opinion No. 67, F.E.R.C. (Nov. 6, 1979).

association, or firm that is authorized by law to underwrite or participate in the marketing of securities of a public utility, or officer or director of any company supplying electrical equipment to such public utility . . ." would be covered and would be required to file a Section 305(b) application.²⁶ Rehearing was requested by Mr. Hatch but, at the time this article was written, no Commission order had been issued.

The amendment to Section 305 effected by Section 211 of PURPA requires reporting by persons serving as directors of an electric utility and "any company, firm, or organization which is authorized by law to underwrite or participate in the marketing of securities by a public utility." In light of the fact that, prior to the passage of PURPA, there were few authorized interlocking directorships between utilities and securities firms, this provision of Section 305 may have little practical significance.

OFFICER OR DIRECTOR OF A PUBLIC UTILITY AND ELECTRIC EQUIPMENT SUPPLIERS

A number of applications involving interlocking directorates where electric equipment suppliers were involved have been considered by the Commission. Although its handling of these applications is somewhat uneven, certain principles emerge.

In denying the application of Lelan F. Sillin, Jr. to be an officer and director of Central Hudson Gas & Electric Corporation and a director of Fargo Manufacturing Company, a manufacturer of electrical connectors,²⁷ the Commission said:

As a general principle, we feel that such interlocking positions should not be permitted where the supplier is in a position to furnish any appreciable amount of the electrical equipment in any category purchased by the utility. In such instances, any possible benefit to the two companies from having an individual serve both of them in a responsible capacity is outweighed by the potential disadvantages to the public utility, its customers and others in the markets in which the utility and the supplier operate.²⁸

While Central Hudson purchased electrical connectors from other suppliers, 70% of its purchases were from Fargo. The Commission concluded that the record of purchases in the past by Central Hudson from Fargo indicated that the holding of interlocking positions in the two companies would involve a potential conflict of interest which adversely affects public or private interests.²⁹

When an electric utility has made substantial purchases from an electrical equipment supplier, the holding in the *Sillin* decision has been adhered to in denying authorization to holding interlocking directorships. In *Ralph A. Weller*,³⁰ Consolidated Edison Company of New York, Inc. purchased \$1.9 million of electrical equipment in 1974 and \$1.2 million for

²⁶*Id.* at

²⁷*Lelan F. Sillin, Jr.*, 33 F.P.C. 1006 (1965).

²⁸*Id.* at 1007.

²⁹*Ibid.*

³⁰*Ralph A. Weller*, Docket No. ID-1775, order issued March 11, 1976.

eleven months in 1975 from United Technologies Corporation. The Commission refused to approve the interlocking directorship, stating:

Considering the size of United Technologies (1974 sales of \$3.3 billion) and Consolidated Edison, the business relationships between the companies could be considered insignificant. However, Consolidated Edison has an option to purchase ten power plants from United Technologies for a total of \$50 million. A purchase and sale of this size would be of significance to both companies. As a director of United Technologies and chief executive officer of one of its principal subsidiaries, the Applicant could be expected to have more than the usual director's interest in the subject transaction.³¹

More recently in *Robert P. Reuss*,³² the Commission likewise denied a Section 305(b) application. In that case, Central Telephone & Utilities Corporation purchased \$177,380 of transformers, switching equipment and related repair and replacement parts from McGraw Edison Company.

On the same day that the Commission rendered its *Reuss* decision, it also denied an application by Charles T. Fisher, III, President of National Detroit Corporation and its subsidiary, The National Bank of Detroit, for authorization to continue to hold interlocking directorships in The Detroit Edison Company and General Motors Corporation.³³ The Commission noted that in 1972 GM sold a transformer to Detroit Edison for \$489, and in 1975, 1976 and 1977 GM sold electric equipment to Detroit Edison in the amounts of \$40,000, \$27,252 and \$14,155, respectively. The Commission said that the actual magnitude and frequency of intercorporate transactions between General Motors and Detroit Edison is not determinative since the prohibitions of Section 305(b) operate prospectively and deal with possibilities. Because GM is potentially large supplier of electric equipment, its corporate interests would conflict with those of customers it supplies or may supply with electric equipment and, based upon the *Sillin* decision, the application was denied. Commissioner Sheldon dissented stating that:

The majority's opinion has adopted a *per se* standard of rejection for any director who seeks Commission approval if this individual is a director of any company which has the "possibility" of supplying electrical equipment. The new standard adds language that effectively undermines Section 305(b).³⁴

Thereafter, the Commission granted rehearing and modified its order granting Fischer authorization to hold the interlocking positions with GM and Detroit Edison.³⁵ Several important findings were made. First, the Commission said that Section 305(b) speaks quite simply of a company supplying electric equipment to the utility and the section contains no quantitative jurisdictional limitation, express or implied. So long as the company has been "supplying electrical equipment" to the utility, the volume of past or potential sales is not determinative. The Commission found that during the years 1975-1978, Detroit Edison's purchases from GM on the average represented .0009% of the utility's plant additions. Citing its

³¹*Id.* at

³²*Robert R. Reuss*, Docket No. ID-1823, order issued June 25, 1979.

³³*Charles T. Fisher, III*, Docket No. ID-1758, order issued June 25, 1979.

³⁴*Id.* at (Footnotes omitted).

³⁵*Charles T. Fisher, III*, Docket No. ID-1758, order issued October 25, 1979.

prior decision in *John G. Haehl, Jr.*,³⁶ the Commission approved the interlock but imposed an annual reporting condition.

The *Haehl* case was the culmination of a series of cases dating from the 1950's. In one, the applicant was permitted to be a director in Atlantic City Electric Company and president and director in Atlantic City Lumber Company, which supplied electric poles to Atlantic City Electric.³⁷ In the other, the FPC approved an application to hold the positions of director of Ohio Edison Company and president and director of Ohio Brass Company, which had supplied quantities of electric insulators and fittings to Ohio Edison.³⁸

In the *Rempe* case discussed earlier,³⁹ the Commission also authorized Mr. Rempe to hold the position of director in Hathaway Instruments, Inc., a small electronics and research company which developed a digital underfrequency relay then being tested by several power systems to automatically and selectively shed load in case of a power supply failure. Hathaway had sold only one underfrequency relay to Sierra Pacific during the preceding year and there appeared to be no probability of any but *de minimis* purchases from Hathaway by Sierra Pacific and Community Public Service in the future. The Commission then said:

Hathaway is therefore a company supplying electrical equipment to the public utilities herein involved but under the circumstances related above it would appear that neither public nor private interests would be adversely affected by Applicant's holding the interlocking directorship in Hathaway.

As a condition to the authorization, the Commission required Mr. Rempe to report each year the quantities and total sales of electrical equipment sold by Hathaway to Sierra Pacific and Community Public Service.

In a subsequent order the Commission authorized Eugene Beesley, Chief Executive Officer and Chairman of the Board of Eli Lilly & Company, to be a director of General Motors Corporation and Public Service Company of Indiana, Inc.⁴⁰ GM's only sale to PSCI involved three diesel electric generating units for peaking power costing \$700,000, which was the low bid submitted to the utility. Approving the application, the Commission imposed the condition that Mr. Beesley report any additional purchases that PSCI made from GM and required that he not participate in any of the Board of Directors' action involving the purchases.

Finally, in 1976, the Commission authorized John G. Haehl, Jr., to hold the positions of President and Director of Niagara Mohawk Power

³⁶*John G. Haehl, Jr.*, Docket No. HD-1788, order issued December 22, 1976.

³⁷*Warren Somers, Jr.*, 9 F.P.C. 417 (1950).

³⁸*George L. Draffan*, 9 F.P.C. 909 (1950). In several other cases, the Commission *denied* authorization. In 1955, the Commission turned down the request of an officer of a supply company (which acted as sales agent for manufacturers of electrical equipment) to be a director of Alabama Power Company. *Alfred M. Shook, III*, 14 F.P.C. 525 (1955). In that case, the electrical supplier sold \$565,000 worth of equipment to Alabama Power and also made substantial sales to the other three Southern Company subsidiaries. Similarly, the president and director of Republic Flow Meters Co., and a director of Allis-Chalmers Manufacturing Co. was not permitted to be a director of Commonwealth Edison Company which made substantial purchases from both manufacturers of electrical equipment. *James D. Cunningham*, 17 F.P.C. 382 (1957).

³⁹*Supra* n. 10.

⁴⁰*Eugene N. Beesley*, Docket No. HD-1578, order issued June 17, 1969.

Corporation and Director of Crouse-Hinds Company.⁴¹ After noting that Crouse-Hinds furnished small electrical supplies directly to the utility only in an emergency, the Commission stated:

Indirect purchases of Crouse-Hinds equipment, through wholesale suppliers, have also been in minor quantities. The Applicant estimates that out of an estimated \$80,000,000 annual outlay for electrical equipment, purchases of equipment identifiable as Crouse-Hinds average \$20,000-\$30,000. These purchases are for routine maintenance, and inventories are maintained for common items produced by many of the manufacturers of such equipment.

In certain instances this Commission has authorized the holding of interlocking positions with the provision that the Applicant annually report business transactions between the interlocked companies. Generally, these qualified authorizations have involved companies that have, or might, furnish miscellaneous equipment, materials and supplies to public utilities or construction firms retained by a public utility on a direct or indirect basis (lumber yards, supply houses or hardware stores).⁴²

The Commission appears to be willing to allow for a *de minimis* purchase exception coupled with a reporting condition where interlocking directorships with electrical suppliers are at issue.

Another line of decisions involving interlocks with electrical equipment suppliers deserves mention. In *Leroy S. Stephens*,⁴³ the President and a director of Stephens-Adamson Manufacturing Company, which manufactured conveying machinery and coal handling equipment, asked for authorization to be a director of Commonwealth Edison Company. Initially, the Commission denied authorization but, on rehearing, concluded that approval was not necessary.⁴⁴ In its order on rehearing,⁴⁵ the Commission found that the coal handling equipment supplied by Stephens-Adamson to Commonwealth Edison was not "electrical equipment" within the meaning of the Act and, therefore, the holding of the interlocking positions was not within the purview of Section 305(b). In his dissent, Commissioner Conrole stated that he saw no functional distinction between equipment manufactured by Stephens-Adamson and other essential parts for a coal burning thermal electric generating station.⁴⁶

More recently, William W. Lindsay, Director of the FERC Office of Electric Power Regulation, exercising his delegated authority, dismissed the application by Arthur R. Ehrnschwender, Vice President of Cincinnati Gas & Electric Company, to hold the position of Director of Cincinnati Electric Equipment Company (CEEC).⁴⁷ CEEC's business with CG and E involved the service of rewinding previously purchased but worn electric motors. Mr. Lindsay's letter said that:

Study of the services provided by the latter entity to your company leads to the conclusion that it does not supply electrical equipment within the meaning of Section 305(b) of the Federal Power Act, therefore the application is not necessary.

⁴¹*Supra* n. 36.

⁴²*Id.* at .

⁴³*Leroy S. Stephens*, 17 F.P.C. 374 (1957).

⁴⁴*Id.* at 375.

⁴⁵*Id.* at 480.

⁴⁶*Id.* at 481.

⁴⁷Docket No. 1D-1491.

The question of what constitutes electrical equipment is a difficult one. As Commissioner Sheldon noted in her dissent in the *Fisher* case:

Electrical equipment is not defined in our Regulations, nor has the majority attempted to clarify this term in their opinion. What can be included in this phrase is ambiguous, at best.⁴⁸

Subsequently, the Commission issued Order No. 75⁴⁹ wherein a definition of "electrical equipment" was adopted only for purposes of implementing Section 305(c) of the Act.⁵⁰ Rejecting a *de minimis* test relating to transactions between an electric utility and an equipment supplier, the Commission also eliminated the problem of small component equipment by defining "electrical equipment" as follows:

any apparatus, device, integral component, or integral part used in an activity which is electrically, electronically, or by legal prescription necessary to the process of generation, transmission, or distribution of electric energy.⁵¹

Any person holding an interlocking position in an electric utility and an electric equipment supplier must report the aggregate revenues received annually by the supplier for equipment sold to the public utility rounded up to the nearest \$100,000 as well as the nature of the business relationship between the utility and supplier.⁵² These requirements do not apply to suppliers of coal, natural gas, oil, nuclear fuel or other fuel to a utility although any interlocks between such suppliers and a utility must be reported.

CONCLUSION

In view of the recent amendment to Section 305 of the Federal Power Act, requiring broad reporting requirements of interlocking positions, it appears that electric utilities may have a more difficult time in getting highly qualified individuals to serve as directors. Whether the increased reporting requirements will lead to further amendments of Section 305(b) remains uncertain at this time. As we have noted above, however, the reports now required by Section 305(c) may be one informational data base for amendments to Section 305(b) extending the Commission's jurisdiction.

⁴⁸*Supra* n. 33.

⁴⁹*Filing Requirements Regarding Interlocking Positions Under Section 211 of the Public Utility Regulatory Policies Act of 1978*, Docket No. RM80-9, issued April 2, 1980. Previously, the Commission issued Order No. 67 on January 11, 1980 in this docket implementing Section 305(c)(2)(F) and requiring electric utilities to report their 20 largest purchasers.

⁵⁰The Commission will institute a rulemaking to provide a definition of "electrical equipment" to be added to Part 45 of its Regulations Under the Federal Power Act.

⁵¹Section 46.2(f), 18 C.F.R.

⁵²Section 46.6(b), 18 C.F.R.