

THE EFFECT OF THE BANKRUPTCY OF ENRON ON THE FUNCTIONING OF ENERGY MARKETS

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY AND AIR QUALITY

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COMMERCE

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of at least \$10 million), among others. The second type is electronic multilateral trading among eligible commercial entities, such as eligible contract participants that can also demonstrate an ability to either make or take delivery of the underlying commodity (called "eligible commercial entities") or dealers that regularly provide hedging services to those entities.

Suggestions on Moving Forward:

As an oversight regulator, we will continue to look at how and why the markets within our statutory jurisdiction respond the way they do, whether well or poorly, to situations such as the failure of a significant participant. Separately, as a member of the President's Working Group on Financial Markets, the CFTC is working with the SEC, the Treasury Department, and the Federal Reserve Board to review for the President possible improvements in accounting, auditing, disclosure practices with respect to publiclyheld companies. And, within the Commission, we recently proposed a reorganization plan that will consolidate our market oversight functions into one division to help improve already excellent programs in market and financial surveillance.

The Enron situation has led some to call for further responses from Congress and regulators, even for re-regulation of markets that were provided legal certainty by the Commodity Futures Modernization Act. While I agree that it is prudent for a regulator to constantly review its policies and procedures to ensure that an appropriate level of oversight is exercised, I also believe that a situation of this magnitude deserves careful consideration before a regulator seeks to take action. I believe that regulators should make sure that the true problem has been identified before remedies are pursued.

I supported passage of the CFMA because I sincerely believed that a onesizefitsall approach to regulation was outdated, particularly in light of important advances in technology within the financial services industry. Rules tailored to the participant, the product, and the trading facility seemed to me to be a more appropriate approach than the prescriptive regulations of the past. To date, I have seen no evidence to the contrary in my agency's initial analysis of the Enron situation. The CFMA was enacted after a number of hearings conducted by our House and Senate oversight committees in the context of reauthorizing the Commission. Many issues relating to evolving markets received a full airing and important changes to the law were agreed upon as a result. I believe that any departure from the path of progress represented by this important piece of legislation should be approached with extreme caution.

We will continue to monitor the markets within our jurisdiction and to utilize all authorities given to us by the Congress to aggressively pursue violations of the Commodity Exchange Act. We stand ready to work with this Subcommittee, the Congress, other regulators, and market participants. Thank you for the invitation to appear before your Committee. I will be happy to answer any questions you may have.

Mr. BARTON. We thank you, Mr. Chairman, and appreciate your testimony.

We now want to hear from the Commissioner of the Securities and Exchange Commission, the Honorable Isaac Hunt, who has appeared before our subcommittee before.

Mr. HUNT. Yes, sir.

Mr. BARTON. Glad to have you back, and your statement is in the record, and you are recognized for 7 minutes, and to elaborate on the statement.

STATEMENT OF HON. ISAAC C. HUNT, JR.

Mr. HUNT. Chairman Barton, Ranking Member Boucher, and members of the subcommittee, I am Commissioner Hunt of the U.S. Securities and Exchange Commission. I am pleased to have this opportunity to testify before you on behalf of the SEC.

As you know, for almost 20 years the SEC has consistently supported repeal of those provisions of PUHCA that either duplicate laws administered by other regulators, or that are no longer necessary.

Since I last testified on PUHCA repeal before this committee in December, the magnitude of the Enron debacle and the harm that Enron's collapse has travesty inflicted on the company's investors and employees has become clearer.

Congress and various regulatory agencies, including the SEC, are appropriately investigating what happened at Enron, why it happened, and what should be done to prevent Enron-like debacles in the future.

As we continue to investigate and learn from the events surrounding Enron's collapse, we remain open-minded and of course would reconsider our views on conditional PUHCA repeal if warranted.

Currently, however, we are not aware of anything that would cause us to conclude that there is reason to abandon our long-standing support for conditional PUHCA repeal. The Commission continues to support repeal of PUHCA as long as the repeal is accomplished in a way that gives the FERC and State regulators sufficient authority to protect utility consumers.

Specifically, FERC and State regulators should be given additional authority to monitor, police, and regulate affiliate transactions. As long as electric and gas utilities continue to function as monopolies, there will be a need to protect against cross-subsidization.

The best means of guarding against this is likely to be audits of books and records, and Federal oversight of affiliate transactions. Any move to repeal PUHCA should include provisions providing FERC and State regulators the necessary tools to engage in this type of oversight.

In addition, Congress should consider giving FERC the authority to issue rules prohibiting or limiting those types of affiliate transactions that FERC concludes are inherently abusive.

The harm that Enron's collapse has tragically inflicted on the company's investors and employees are now clear. What may not be as clear is why Enron's power marketing activities did not subject it to PUHCA, and why Enron is an exempt public utility holding company.

In 1994, Enron Power Marketing, Inc., a subsidiary of Enron, received a no-action letter from the staff in the SEC's Division of Investment Management, in which the staff agreed not to recommend enforcement action against that subsidiary if it engaged in power marketing activities without it or Enron itself registering under the Act.

In its request for no-action relief, the subsidiary argued that the contracts, books, and records, and other materials underlying its power marketing activities were not, "facilities used for the generation, transmission, or distribution of electric energy or sale."

Accordingly, Enron argued that the power marketing subsidiary was therefore not "an electric utility company" for purposes of PUHCA, and therefore Enron was not a utility holding company for purposes of PUHCA.

The staff gave the subsidiary the requested no-action relief, and since that time, the staff has given analogous no-action relief to approximately 20 other companies.

Moreover, in 1997, the Commission, after public notice and comment, adopted Rule 58 that permits registered holding companies to engage in the brokering and marketing of energy commodities as permitted non-utility activities.

In July 1997, Enron acquired Portland General Electric and claimed an exemption to PUHCA registration under Rule 2 as intrastate public utility holding company. Enron was able to claim this exemption because both Enron and Portland General were incorporated in Oregon, and all of Portland General's operations were in Oregon.

Enron recently agreed to sell Portland General to Northwest Natural Gas, a transaction that is subject to Commission approval under PUHCA. Enron's claim to an intrastate exemption was and is consistent with the Commission's historical interpretation of the intrastate exemption.

For example, as early as 1937, the Commission granted an exemption to the Southeastern Indiana Corporation. That company, which was incorporated in Indiana, owned a single public utility subsidiary, which was also incorporated in, and operated exclusively in Indiana.

The company, however, also owned a number of nonutility subsidiaries incorporated in Indiana and Ohio that provides bus and telephone service in Indiana, Ohio, and Kentucky. In granting the company's request for an exemption, the Commission stated that, "such nonpublic utility activities of the applicant do not deprive it of its intrastate character insofar as public utility aspects of its business is concerned, and that so long as all of its public utility subsidiaries are organized under the laws of Indiana and confine their public utility business to that State, it will be entitled to the exemption provided by Section 3(a)(1)," the intrastate exemption.

Again, with respect to PUHCA, as we continue to investigate and learn from events surrounding Enron's collapse, we remain open-minded and would reconsider our views on repeal if warranted. Currently, however, it appears that the tragic collapse of Enron is not as a result of its classification or lack of classification as a public utility holding company.

Rather, a number of recent events, including Enron's collapse, suggests that for several years our system of disclosure regulation has needed repair. What happened to investors of Enron should be prevented from happening to investors in any other company.

All investors, including investors in public utility holding companies, are entitled to a regulatory system that produces disclosure that is meaningful and intelligible. Today, this morning, the SEC announced its intention to propose its first set of rule changes designed to enhance and improve our current disclosure system.

These proposals would, one, require companies to timely disclose transactions by their executive officers and directors in company securities, including transactions with the company.

Two, require enhanced disclosure of other companies critical accounting policies. Three, accelerate the timetables for companies to file their quarterly and annual reports with us.

Four, expand the list of significant events required to be disclosed on Form 8K, and accelerate the following deadlines for that form; and, five, require that public companies include their 8K re-

ports on their internet websites at the same time that those reports are filed with the SEC.

These proposals will be the first of a series of Commission initiatives to enhance our disclosure and financial reporting system. Other Commission initiatives to follow will include better disclosure of trend and evaluative data, clear and informative financial statements, and enhanced related party disclosures that would provide needed sunshine to affiliated transactions.

Likewise, in order to permit our systems of accounting from being abused, whether by public utility holding companies or other types of companies, we are working to establish a better system of private regulation of the accounting profession, and to make sure that they respond expeditiously and clearly to establish needed accounting standards.

The lessons learned from the Enron tragedy cannot be limited merely to public utility holding companies. In my opinion, these teachings must be used to protect all investors, not just those who have invested in public utility holding companies.

After all, investors who have lost their life savings will find little comfort in the fact that their losses came from an investment in a computer company, as opposed to a public utility holding company. Thank you for your time, and I would be happy to answer any questions that you may have.

[The prepared statement of Hon. Isaac C. Hunt, Jr. follows:]

PREPARED STATEMENT OF HON. ISAAC C. HUNT, JR., COMMISSIONER, U.S. SECURITIES AND EXCHANGE COMMISSION

Chairman Barton, Ranking Member Boucher, and Members of the Committee:

I. INTRODUCTION

I am pleased to have this opportunity to testify before you on behalf of the Securities and Exchange Commission ("SEC") regarding the SEC's continuing support for legislation to repeal much of the Public Utility Holding Company Act of 1935 ("PUHCA," "the 1935 Act" or "the Act").¹ As you know, for almost twenty years the SEC has consistently supported repeal of those provisions of PUHCA that either duplicate laws administered by other regulators or that are no longer necessary. The SEC has always stressed, however, that, in order to protect the customers of multistate, diversified utility holding companies, it is necessary to give the Federal Energy Regulatory Commission ("FERC") and state regulators authority over the books and records of holding companies and authority to regulate their ability to engage in affiliate transactions. Since I last testified before this Subcommittee on PUHCA repeal in December, the magnitude of the Enron debacle, and the harm that Enron's collapse has tragically inflicted on the company's investors and employees, have become clearer. Congress and various regulatory agencies, including the SEC, are appropriately investigating what happened at Enron, why it happened and what should be done to prevent Enron-like fiascos in the future. As we continue to investigate and learn from the events surrounding Enron's collapse, we remain open-minded and, of course, would reconsider our views on conditional PUHCA repeal if warranted. Currently, however, I am not aware of anything that would cause us to conclude that there is reason to abandon our longstanding support for conditional PUHCA repeal.

II. BACKGROUND

Before discussing the SEC's current views on PUHCA, it is useful to review the history of the SEC's longstanding support of repeal. PUHCA was enacted in 1935 in response to abuses that had occurred in the gas and electric industry during the

¹As I testified before this Subcommittee in December 2001, the SEC generally supports H.R. 3406, which is pending before this Subcommittee and which would repeal much of PUHCA. But see, footnote 7 *infra*.

first quarter of the last century.² The abuses included misuse of the holding company structure, inadequate disclosure of the financial position and earning power of holding companies, unsound accounting practices, excessive debt issuances, and abusive affiliate transactions.

The 1935 Act addressed these problems by giving the Commission authority over various practices of holding companies, including their issuance of securities and their ability to engage in affiliate transactions. The Act also placed restrictions on the geographic scope of holding company systems and limited registered holding companies to activities related to their gas or electric businesses. Because of its role in addressing issues involving securities and financings, the SEC was charged with administering the Act. In the years following the passage of the 1935 Act, the SEC worked to reorganize and simplify existing public utility holding companies in order to eliminate abuses.

In the early 1980s, however, the SEC concluded that many aspects of 1935 Act regulation had become redundant. Specifically, state regulation had expanded and strengthened since 1935, and the SEC had enhanced its regulation of all issuers of securities, including public utility holding companies. The SEC therefore concluded that the 1935 Act had accomplished its basic purpose and that many of its remaining provisions were either duplicative or were no longer necessary to prevent the recurrence of the abuses that had led to the Act's enactment. The Commission thus unanimously recommended that Congress repeal the Act.³

For a number of reasons—including continuing concern about the potential for abuse through the use of a multistate holding company structure, related concerns about consumer protection, and the lack of a consensus for change—repeal legislation was not enacted during the early 1980s. Because of continuing change in the industry, however, the SEC continued to look at ways to administer the statute more flexibly.

In response to accelerating changes in the utility industry during the early 1990s, in 1994, then-Chairman Arthur Levitt directed the SEC's Division of Investment Management to undertake a study, under the guidance of then-Commissioner Richard Y. Roberts, to examine the continued vitality of the 1935 Act. The study was undertaken as a result of the developments noted above and the SEC's continuing need to respond flexibly in the administration of the 1935 Act. The purpose of the study was to identify unnecessary and duplicative regulation, and at the same time to identify those features of the statute that remain appropriate in the regulation of the contemporary electric and gas industries.⁴

The SEC staff worked with representatives of the utility industry, consumer groups, trade associations, investment banks, rating agencies, economists, state, local and federal regulators, and other interested parties during the course of the study. In June 1995, a report of the findings made during the study ("Report") was issued. The staff's Report outlined the history of the 1935 Act, described the then-current state of the utility industry as well as the changes that were taking place in the industry, and again recommended repeal of the 1935 Act. The Report also outlined and recommended that the Commission adopt a number of administrative initiatives to streamline regulation under the Act.

Since the report was published, the utility industry in the United States has continued to undergo rapid change. Congress has facilitated many of these changes. For example, as a result of various amendments to the Act, any company, including registered and exempt holding companies, is now free to own exempt wholesale generators and foreign utilities and to engage in a wide range of telecommunications ac-

² See 1935 Act section 1(b), 15 U.S.C. § 79a(b).

³ See *Public Utility Holding Company Act Amendments: Hearings on S. 1869, S. 1870 and S. 1871 Before the Subcomm. On Securities of the Senate Comm. On Banking, Housing, and Urban Affairs*, 97th Cong., 2d Sess. 359-421 (statement of SEC).

⁴ The study focused primarily on registered holding company systems. There were, at the time of the study, 19 such systems. The 1935 Act was enacted to address problems arising from multistate operations, and reflects a general presumption that intrastate holding companies and certain other types of holding companies, which the 1935 Act exempts and which now number 119, are adequately regulated by local authorities. Despite their small number, registered holding companies account for a significant portion of the energy utility resources in this country. As of September 30, 2001, the 27 registered holding systems (which included 35 registered holding companies) owned 133 electric and gas utility subsidiaries, with operations in 44 states, and in excess of 2500 nonutility subsidiaries. In financial terms, as of September 31, 2001, the 27 registered holding company systems owned more than \$417 billion of investor-owned electric and gas utility assets and received in excess of \$173 billion in operating revenues. The 27 registered systems represent over 40% of the assets and revenues of the U.S. investor-owned electric utility industry and almost 50% of all electric utility customers in the United States.

tivities.⁵ In addition, the SEC has implemented many of the administrative initiatives that were recommended in the Report.⁶ In sum, during the past decade, while the SEC has continued to support repeal of the Act, we have also recognized that we need to administer it faithfully, while streamlining and adding flexibility to the regulatory structure where permitted by the Act.

III. REPEAL OF PUHCA

A. *The Commission's Continuing Support of Repeal*

As I have stated, the Commission continues to support repeal of PUHCA, as long as repeal is accomplished in a way that gives the FERC and state regulators sufficient authority to protect utility consumers.⁷ Not surprisingly, however, in light of recent events, there are those who are now asking whether Enron's collapse should cause those who support PUHCA repeal to reconsider.

As I stated at the beginning of my testimony, the harm that Enron's collapse has inflicted on the company's investors and employees is now readily apparent. The SEC, various other regulatory agencies and the Congress are now all investigating what happened at Enron, why it happened and what should be done to prevent Enron-like debacles in the future. These investigations are not only appropriate, but are necessary if the implications of Enron for a broad range of policy issues are to be fully understood. Currently, however, I am aware of nothing with regard to Enron that would change our opinion on PUHCA repeal.

Enron is currently an exempt holding company under PUHCA. When Enron acquired Portland General Electric in 1998, it claimed an exemption under PUHCA rule 2⁸ as an intrastate holding company.⁹ Enron was able to claim this exemption because it was incorporated in Oregon; Portland General, its only utility subsidiary, was incorporated in Oregon; and Portland General's utility operations were located in Oregon.¹⁰ For more than sixty years, the SEC has held that as long as the holding company and its utility subsidiaries are all incorporated in the same state and the utility operations are conducted primarily in that state, the holding company is entitled to an exemption. The SEC does not look to where the holding company's

⁵ Sections 32 and 33 of the Act, which were added to it by the Energy Policy Act of 1992, permit, subject to certain conditions, the ownership of exempt wholesale generators and foreign utility companies. The impact of section 32 on the electricity industry is discussed in more detail below. Section 34, which was added by the Telecommunications Act of 1996, permits holding companies to acquire and retain interests in companies engaged in a broad range of telecommunications activities.

⁶ The Report recommended rule amendments to broaden exemptions for routine financings by subsidiaries of registered holding companies (see Holding Co. Act Release No. 26312 (June 20, 1995), 60 FR 33640 (June 28, 1995)) and to provide a new exemption for the acquisition of interests in companies that engage in energy-related and gas-related activities (see Holding Co. Act Release No. 26667 (Feb. 14, 1997), 62 FR 7900 (Feb. 20, 1997) (adopting Rule 58)). In addition, the Report recommended, and the SEC has implemented, changes in the administration of the Act that would permit a "shelf" approach for approval of financing transactions. For example, during calendar year 2000, all eleven of the new registered holding companies received multi-year financing authorizations that included a wide range of debt and equity securities. The Report further recommended a more liberal interpretation of the Act's integration requirements which has been carried out in our merger orders. The Report also recommended an increased focus upon auditing regulated companies and assisting state and local regulators in obtaining access to books, records, and accounts. Six state public utility commissions participated in the last three audits of the books and records of registered holding companies.

⁷ We do, however, have a concern about coupling PUHCA repeal with provisions that would provide unique regulatory benefits to small groups of companies under other statutes that the Commission administers. Section 125 of H.R. 3406 raises this concern. Section 125 appears to address a unique set of circumstances that give rise to questions about the status of an issuer as an "investment company" under the Investment Company Act of 1940. The Investment Company Act already provides the Commission with significant flexibility to deal with status issues. We therefore see no reason for legislation to deal with such issues. More broadly, we are prepared to work with any utility holding companies currently relying on the exemption from the definition of "investment company" provided by section 3(c)(8) of the Investment Company Act if repeal of PUHCA leads to questions about their status under the Investment Company Act.

⁸ 17 C.F.R. § 250.2.

⁹ Enron recently agreed to sell Portland General to Northwest Natural Gas, a transaction that is subject to Commission approval under PUHCA.

¹⁰ The intrastate exemption which, in part, underlies rule 2 is PUHCA § 3(a)(1), 15 U.S.C. § 79c(a)(1). In administering the intrastate exemption, the SEC has traditionally looked to three factors: the state in which the holding company is incorporated, the state(s) in which its utility subsidiaries are incorporated, and the state(s) in which the public utility subsidiaries do business.

non-utility subsidiaries are incorporated or where the non-utility subsidiaries operate.¹¹

The manner in which the Commission has administered the intrastate exemption is consistent with its purpose. One of the overriding concerns of PUHCA is to give federal regulators jurisdiction over multistate public utility holding companies that no single state can effectively regulate. In particular, PUHCA is meant to ensure that if a state does not have jurisdiction over both the holding company and the utility that does business in its state—a situation that will occur if the holding company is incorporated in a state different than that in which the utility subsidiary is incorporated—a federal regulator with access to all the holding company’s books and records can step in to monitor and police affiliate transactions. In general, the Commission has concluded that, where the holding company and all of its utility subsidiaries are incorporated in the same state, this concern does not arise, and an exemption from PUHCA is warranted. Indeed, Oregon’s experience with Enron as an exempt company, at least anecdotally, confirms this—the Chairman of the Oregon Public Utility Commission recently testified that Oregon ratepayers were not harmed by Enron’s collapse and that “this utility [Portland General] is able to function just as well as it did before.”¹²

In 1994, Enron Power Marketing Inc. (“EPMI”), a subsidiary of Enron, received a no-action letter from staff in the SEC’s Division of Investment Management in which the staff agreed not to recommend enforcement action against EPMI if it engaged in power marketing activities without it or Enron registering under the Act. In its request for no-action relief, EPMI argued that the contracts, books and records and other materials underlying its power marketing activities were not “facilities used for the generation, transmission, or distribution of electric energy for sale,”¹³ that the power market subsidiary was therefore not an “electric utility company” for purposes of PUHCA, and that Enron was thus not a utility holding company for purposes of the Act. EPMI’s request stated that, at the time, other companies were already engaged in similar power marketing activities. The staff, without necessarily concurring in EPMI’s legal analysis, gave EPMI the requested no-action relief. Since 1994, the staff has given analogous no-action relief to approximately twenty companies.¹⁴

As Chairman Pitt recently testified before a House Subcommittee, the speed and tragic consequences of Enron’s collapse demonstrate the need for a variety of reforms in our administration of the securities laws that the Chairman and others at the SEC have been discussing in recent months. All investors, including investors in public utility holding companies, are entitled to a regulatory system that produces disclosure that is meaningful and intelligible. To address flaws in the current system, we continue to consider ways to ensure that investors receive more current disclosure, better disclosure of “trend” and “evaluative” data, and clear and informative financial statements. Likewise, to prevent our system of accounting from being abused, whether by public utility holding companies or other types of companies, we are working to establish a better system of private regulation of the accounting profession and to make sure that the FASB responds expeditiously and clearly to establish needed accounting standards.

In sum, Enron is a tragedy for our entire system of disclosure regulation. What happened to investors of Enron should be prevented from happening to investors in any company. However, the tragic collapse of Enron is not a result of its classification or lack of classification as a public utility holding company.

B. Affiliate Transactions and Cross-Subsidization

Thus, we continue to believe that repeal of PUHCA will not sacrifice any needed investor protections. As we have testified in the past, however, we continue to believe that, in order to provide needed protection to utility consumers, the FERC and state regulators should be given additional authority to monitor, police, and regulate affiliate transactions.

¹¹ See, e.g., *In the Matter of Southeastern Indiana Corp.*, 2 S.E.C. 156 (1937) (“[S]uch non-public utility . . . activities of the applicant do not deprive it of its intrastate character so far as the public utility aspect of its business is concerned. . .”).

¹² See Tom Detzel, “Senators Mull Enron, PGE Link,” *The Oregonian* (Feb. 7, 2002) (quoting Roy Hemmingway, Chairman, Oregon Public Utility Commission).

¹³ See PUHCA § 2(a)(3), 15 U.S.C. § 79b(a)(3) (definition of “electric utility company”).

¹⁴ The Commission has also given exempt and registered holding companies the authority necessary to engage in power marketing as a nonutility activity. For example, rule 58, 17 CFR § 250.58, which was adopted in early 1997, permits registered holding companies to engage in “[t]he brokering and marketing of energy commodities, including but not limited to electricity, natural or manufactured gas and other combustible fuels” as a permitted nonutility activity.

Specifically, although deregulation is changing the way utilities operate in some states, electric and gas utilities have historically functioned as monopolies whose rates are regulated by state authorities. Some regulators subject these rates to greater scrutiny than others. There is a continuing risk that a monopoly, if left unguarded, could charge higher rates and use the additional funds to subsidize affiliated businesses in order to boost its competitive position in other markets. Because repeal of PUHCA would eliminate existing restrictions on both the size of utility holding companies and their ability to engage in non-utility activities, this risk may be magnified if holding company systems become bigger and more complex. Thus, so long as electric and gas utilities continue to function as monopolies, the need to protect against this type of cross-subsidization will remain. The best means of guarding against cross-subsidization is likely to be audits of books and records and federal oversight of affiliate transactions. Any move to repeal PUHCA should include provisions giving the FERC and state regulators the necessary tools to engage in this type of oversight.

As we testified late last year with respect to H.R. 3406, the bill represents a form of this type of conditional repeal. In particular, H.R. 3406 would provide the FERC with the right to examine books and records of holding companies and their affiliates that are necessary to identify costs incurred by associate utility companies, in order to protect ratepayers. H.R. 3406 would also provide an interested state commission with access to such books and records (subject to protection for confidential information), if they are necessary to identify costs incurred by utility companies subject to the state commission's jurisdiction and are needed for effective discharge of the state commission's responsibilities in connection with a pending proceeding. H.R. 3406 thus gives the FERC and state regulators the ability to review affiliate transactions after-the-fact and to exclude unjustified costs arising from affiliate transactions from a utility's rate base. While this is a significant power, and one we believe that state and federal rate regulators should possess, we also believe that Congress should consider giving the FERC the authority to use its rulemaking authority to prohibit or limit on a prospective basis those types of affiliate transactions that it concludes are so abusive that they should not be allowed.

C. Market Power Issues

Repeal of PUHCA would remove barriers that now exist to consolidation within the utility industry as well as barriers that prevent diversified, non-utility companies from acquiring utilities. Removal of these restrictions may raise competitive issues related to the "market power" of utilities. PUHCA was intended to address, among other things, the concentration of control of ownership of the public-utility industry. In particular, section 10(b)(1) of the Act requires the SEC to disapprove a utility acquisition if it will tend toward concentrated control of public-utility companies in a manner detrimental to the public interest or the interest of investors or consumers.¹⁵ Traditionally, the SEC's analysis of utility acquisitions under section 10(b)(1) includes consideration of federal antitrust policies.¹⁶ More specifically, the anticompetitive ramifications of an acquisition have traditionally been considered in light of the fact that public utilities are regulated monopolies subject to the ratemaking authority of federal and state administrative bodies.¹⁷

However, the SEC is not the only agency that reviews the potential anticompetitive effects of utility acquisitions. In many instances, proposed utility acquisitions are subject to FERC and state approval. Like the SEC, the FERC must consider antitrust implications of matters before it.¹⁸ In addition, the potential anticompetitive effects of utility acquisitions are independently reviewed by the Department of Justice or the Federal Trade Commission.

In recent years, the SEC has looked to all these regulators for their expertise in assessing operational and competitive issues, particularly in situations in which the

¹⁵The SEC must also consider whether the purchase price is reasonable; whether the purchase will unduly complicate the capitalization of the resulting system; and whether the transaction will serve the public interest by tending toward the economic and efficient development of an integrated public-utility system.

¹⁶*Municipal Electric Association v. SEC*, 413 F.2d 1052, 1056-07 (D.C. Cir. 1969) (section 10(b)(1) analysis "must take significant content" from "the federal anti-trust policies"), cited in *City of Holyoke v. SEC*, 972 F.2d 358, 363; *Environmental Action, Inc. v. SEC*, 895 F.2d 1255, 1260 (9th Cir. 1990) ("Federal antitrust policies are to inform the SEC's interpretation of section 10(b)(1)").

¹⁷*Entergy Corp., Holding Co.* Act Release No. 25952 (Dec. 17, 1993), citing *Northeast Utilities, Holding Co.* Act Release No. 25221, request for reconsideration denied, Holding Co. Act Release No. 26037 (Apr. 28, 1994), remanded sub nom. *Cajun Electric Power Cooperative, Inc. v. SEC*, 1994 WL 704047 (D.C. Cir. Nov. 16, 1994).

¹⁸See *Gulf States Utilities Co. v. FPC*, 411 U.S. 747 (1973).

combined entity resulting from a merger would have control of key transmission facilities and of surplus power. Thus, although the SEC does independently assess the transaction under the standards of PUHCA, we have generally relied upon the FERC's greater expertise regarding issues related to utility competition. The Court of Appeals for the District of Columbia Circuit has stated that "when the SEC and another regulatory agency both have jurisdiction over a particular transaction, the SEC may 'watchfully defer' to the proceedings held before—and the result reached by—that other agency."¹⁹

Therefore, repeal of PUHCA is unlikely to affect how market power issues are reviewed at the federal level. Other federal agencies already have significant authority in this area. While PUHCA provides an additional layer of regulatory approval for certain utility mergers, the Commission's reliance, where appropriate, on other regulators for the key market power determination makes its review of market power issues largely redundant. Nonetheless, because repeal of PUHCA may increase consolidation in the utility industry, Congress could conclude that additional clarification of the FERC's authority in this area is necessary to give the FERC sufficient authority to ensure that what consolidation does occur in the utility industry does not harm consumers.

D. Other Consumer Protection Issues

I know that Congress and others are considering other types of consumer protections in the utility area. For example, there has been discussion of whether the FERC needs additional ratemaking authority in the wholesale electricity markets. Likewise, there has been discussion of whether the FERC or the Commodity Futures Trading Commission should be given additional authority to oversee trading in energy-related derivatives to prevent market manipulation. While I recognize that it is important for Congress to consider issues of these types, the SEC does not have statutory authority to regulate utility rates under PUHCA. Likewise, PUHCA does not give the SEC authority to attempt to prevent manipulation in the energy trading markets. The SEC therefore lacks the expertise to express a view on whether reforms are needed in these areas.

E. PUHCA Repeal and National Energy Policy

Repealing the Act is not, however, a magic solution to the current problems facing the U.S. utility industry. PUHCA repeal can be viewed as part of the needed response to the current energy problems facing the country—notably, the Administration's recent report on energy policy includes a recommendation that PUHCA be repealed.²⁰ But repeal of the Act will not have any direct effect on the supply of electricity in the United States. The Act does not, for example, currently place significant restrictions on the construction of new generation facilities. As part of the Energy Policy Act, Congress amended the Act in 1992 to remove most restrictions on the ability of registered and exempt holding companies (as well as companies not otherwise subject to PUHCA) to build, acquire and own generating facilities anywhere in the United States. These types of facilities—exempt wholesale generators or "EWGs"—are not considered to be electric utility companies under PUHCA, and, in fact, are exempt from all provisions of PUHCA. The only limitation that remains under PUHCA is one imposed by Congress on registered holding companies' investments in EWGs—namely, that a registered company may not finance its EWG investments in a way that may "have a substantial adverse impact on the financial integrity of the registered holding company system."²¹ In short, the Energy Policy

¹⁹ *Madison Gas and Electric Company v. SEC*, 168 F.3d 1337, (D.C. Cir. 1999); *City of Holyoke v. SEC*, *supra* note 10, citing *Wisconsin's Environmental Decade, Inc. v. SEC*, 882 F.2d 523 (D.C. Cir. 1989).

²⁰ See National Energy Policy: Report of the National Energy Policy Development Group at 5-12 (May 2001) (recommending the reform of "outdated federal electricity laws, such as the Public Utility Holding Company Act").

²¹ While no Commission approval is required for the acquisition of an EWG as a result of the Energy Policy Act, Commission approval is required, for example, before a registered holding company can issue securities to finance the acquisition of, or guarantee securities issued by, an EWG. Under the Energy Policy Act, Congress directed the SEC to adopt rules with respect to registered holding companies' EWG investments. Pursuant to these requirements, in 1993 the SEC adopted rules 53 and 54 to protect consumers and investors from any substantial adverse effect associated with investments in EWGs. Rule 53, which created a partial safe harbor for EWG financings, describes circumstances in which the issue or sale of a security for purposes of financing the acquisition of an EWG, or the guarantee of a security of an EWG, will be deemed not to have a substantial adverse impact on the financial integrity of the system. For transactions outside the Rule 53 safe harbor, a registered holding company must obtain SEC approval of the amount it wishes to invest in EWGs. The standards that the SEC uses in assessing applications of this type are laid out in Rule 53(c).

Act removed restrictions on the ability of registered and exempt holding companies to build, acquire and own generating facilities anywhere in the United States. As a result, a number of registered holding companies now have large subsidiaries that own generating facilities nationwide. Numerous other companies not subject to the Act have also entered the generation business.²²

Instead, repeal of the Act would eliminate regulatory restrictions that prohibit utility holding companies from owning utilities in different parts of the country and that prevent nonutility businesses from acquiring regulated utilities. In particular, repeal of the restrictions on geographic scope and other businesses would remove the impediments created by the Act to capital flowing into the industry from sources outside the existing utility industry. Repeal would thus likely have the greatest impact on both the continuing consolidation of the utility business as well as the entry of new companies into the utility business.

Repeal of the Act would also eliminate any impediments that exist to other regulators' attempts to modernize regulation of the utility industry. For example, during the past year, questions have arisen about how the Act will impact the ability of the FERC to implement its plans to restructure the control of transmission facilities in the United States.²³ Specifically, in order to "ensure that electricity consumers pay the lowest price possible for reliable service," the FERC recently implemented new regulations designed to create "independent regionally operated transmission grids" that are meant to "enhance the benefits of competitive electricity markets."²⁴ As a result of FERC's new regulations, many utilities will cede operating control—and in some cases, actual ownership—of their transmission facilities to newly-created entities. The status of these entities, as well as the status of utility systems or other companies that invest in them, raise a number of issues under the Act. Most prominently, it has been asserted that the limits the Act places on the other businesses in which a utility holding company can engage will create obstacles for nonutility companies that may wish to invest in or operate these new transmission entities. While the SEC believes it has the necessary authority under the Act to deal with the issues created by the FERC's restructuring without impeding that restructuring, repeal of the Act would nonetheless effectively resolve these issues.

This example, however, raises the broader issue of the relationship between the FERC's and the SEC's regulation of the utility industry. The FERC is clearly the agency that Congress intended to take the lead role in regulating the utility industry. The SEC, in contrast, is primarily devoted to regulating the securities markets. Although we always attempt to work together with the FERC to ensure that, to the extent possible, our regulation of utility holding companies under PUHCA does not impede their ability to regulate the utility industry, sometimes conflict is inevitable. Given this, if Congress chooses not to repeal PUHCA, we believe that responsibility for the Act, whether in its current form or in a modified form, should be transferred from the SEC to the FERC. Given the nature of the FERC's responsibilities and its expertise in regulating the utility industry, it is simply in a better position to balance the goals of PUHCA and the other statutes it administers, and thereby regulate the utility industry in a more consistent and effective manner.

The SEC takes seriously its duties to administer faithfully the letter and spirit of the 1935 Act and is committed to promoting the fairness, liquidity, and efficiency of the United States securities markets. By supporting conditional repeal of the 1935 Act, the SEC hopes to reduce unnecessary regulatory burdens on America's energy industry while providing adequate protections for energy consumers.

Mr. BARTON. Thank you, Commissioner Hunt.

We would now like to hear from Mary Hutzler, who has testified before, and who is the Acting Director of the Energy Information Administration, to give us your view on the facts and the figures about what happened when Enron's bankruptcy became more prevalent.

And I would point out for the record that each testifier has gotten a little bit longer than the previous one, and so hopefully you can disassociate yourself from that trend.

²² See, e.g., National Energy Policy: Report of the National Energy Policy Development Group at 5-11 (May 2001) (noting that "[m]ost new electricity generation is being built not by regulated utilities, but by independent power producers").

²³ See FERC Order 2000, "Regional Transmission Organizations," 65 FR 810 (Jan. 6, 2000) (codified at 18 C.F.R. § 35.34).

²⁴ Order 2000, 65 FR at 811.

curves. Mark-to-market accounting is not just used by the energy industry. It is used by a broad range of industries, and it is very complicated.

But I think it also has tremendous value. The second thing would be link it to transparency.

Mr. BARTON. Okay. Mr. Markey, we are about to end the hearing. I have asked two questions, and Mr. Sawyer has asked a question. Would you like to ask one or two questions and let this panel go?

Mr. MARKEY. Mr. Chairman, we are fortuitously scheduled to be here until 3:30 a.m., and we—

Mr. BARTON. Your definition of fortuitous and my definition of fortuitous are different.

Mr. MARKEY. Well, these are really important people in terms of discussing this energy marketplace, and I don't have anything to do. I mean, if they don't have anything to do, I don't have anything to do. I can stay here. I mean, if you don't mind.

Mr. BARTON. We are going to recess the hearing and we will reconvene at 6 p.m.

[Brief recess.]

Mr. BARTON. The subcommittee will reconvene. Congressman Markey should be on his way back. He promised me that he would, and he keeps his promises, and so I will ask some questions until he gets back, and then we will recognize him for questions. I would like to ask—oh, Mr. McCullough is not here. Did he have a plane to catch? Oh, he is on his cell phone.

I just saw Mr. Markey just come in and so I will wait until he gets here and then we will recognize him. The Chair would recognize Mr. Markey for 5 minutes for questions. Well, let me put it this way. How much time do you think you are really going to use, and I will recognize you for that amount of time?

Mr. MARKEY. If I had 10 minutes, I think that would do it.

Mr. BARTON. Okay. The Chair would recognize Mr. Markey for 15 minutes for questions.

Mr. MARKEY. It won't take that long. It won't take that long. Mr. Green, did you ever see those Ed McMahon adds that say congratulations, you may have already won millions of dollars from the Publishers Clearinghouse Sweepstakes. Well, congratulations, Mr. Green, you may already soon be an unregistered mutual fund.

Are you aware that Enron sought and obtained an exemption from the Investment Company Act of 1940, the law that protects mutual fund investors?

Mr. GREEN. I am not.

Mr. MARKEY. You're not? Well, Enron apparently obtained an exemption from that Act from the Securities Exchange Commission staff back in 1997. Were you aware of that?

Mr. GREEN. I was not.

Mr. MARKEY. Now, were you also aware that there is a provision in Mr. Barton's electricity restructuring bill, Section 125, that would allow every exempt and registered holding company to transform itself into an unregulated mutual fund without any of the protections that the Investment Company Act provides with respect to self-healing, leveraging, independent boards, and excessive fees?

Mr. GREEN. I am not aware of that.

Mr. MARKEY. Did you know that the SEC has warned Mr. Dingell and me in a letter we just received today that if this particular provision were passed, quote, hundreds of unregulated investment companies would result, and that, quote, that it would be virtually impossible to determine an exact number of potential unregulated investment companies created by Section 125?

Mr. GREEN. Well, these are areas that I really don't have an interest in.

Mr. MARKEY. Are you aware that the Investment Company Institute, which represents mutual fund industry, is strongly opposed to this provision, and in a letter that they sent me today, they have requested that Section 125 should be deleted from H.R. 3406 in its entirety?

Your company, Mr. Green, could already be an unregistered mutual fund, in other words; a benefit that perhaps you are not aware of, but something that with the right MBA who gets hired this summer could put you into a position of diversification than the person that you are today?

Mr. GREEN. Well, that's not our business. We stick to our core businesses, and don't diversify in that sense.

Mr. MARKEY. And that's good.

Mr. BARTON. Would the gentleman yield on this line?

Mr. MARKEY. I would be glad to.

Mr. BARTON. That particular provision in the bill was put in for a company or companies in the midwest, and it has nothing to do with Mr. Green's company, and we have already told at the staff level that due to the concerns of Mr. Dingell and yourself, that we will be very willing to clarify the specific language in it, and if it is controversial, we will take it out in its entirety. So I don't see a reason to berate Mr. Green on this.

Mr. MARKEY. I am not berating him.

Mr. BARTON. It has got nothing to do with that particular paragraph.

Mr. MARKEY. I know that. Well, let me ask Mr. Owens. What is the EEI position on that provision?

Mr. OWENS. We have no position.

Mr. MARKEY. No position?

Mr. OWENS. No. We are not concerned about that.

Mr. MARKEY. Okay. I guess the point that I am trying to make here is that Mr. Green and his company may not be interested in taking advantage of that, but we know that Mr. Lay and Mr. Schilling would have taken advantage of it, and did take advantage of it.

So if it is a broad exemption that is universal, then while Mr. Green may decide not to do it, it would not be because he was restricted from doing it. It would just be a choice to stay home and to do the things that he does well.

But it wouldn't mean that others wouldn't be able to get out into the field without the safeguards, the protections that are in the 1940 Act. Mr. Plank, in your opinion—let's do this. Tell me, Mr. Plank, what is the one thing you want us to remember from this hearing? Give me the one big truth you want us to have?

Mr. PLANK. Commodity price volatility and natural gas is excessive to the point where our responsibility as producers to Ameri-