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Congress Prepares to Abandon Consumer and Investor Energy Protections

Both the energy bill passed by the House on April 11, 2003 (HR 6) and the energy bill currently being debated in the Senate (S 14) will repeal the most important protection available to energy consumers and shareholders. The Public Utility Holding Company Act (PUHCA) was enacted during a time of widespread energy scandals three generations ago, and had the law not recently been filled with loopholes and had it been properly enforced, Enron and its ilk could never have hijacked consumers and shareholders.

PUHCA maintains transparency by limiting the geographic size and types of subsidiaries energy companies can operate. Because states are unable to effectively regulate *inter*state energy utilities (such as Southern Co), the federal government is needed to maintain transparency by limiting the size and scope of these utilities. PUHCA was passed in 1935 in response to widespread Enron-esque abuses in the 1920s, where utilities used sprawling geographic structures and complex webs of subsidiaries to inflate prices charged to consumers and hide debt from shareholders.

*Intra*state companies, such as Warren Buffett's MidAmerica (Iowa), and FPL (Florida) are effectively regulated by states, so PUHCA's protections are not necessary for them.

Corporate scandals of PUHCA companies (AEP, Reliant, Xcel) and scandals involving companies that should be regulated by PUHCA (CMS, Duke, Dynegy, Mirant) demonstrate the need for strengthening and retaining the act.

PUHCA has been weakened by:
A. Legislative Action: The **Energy Policy Act of 1992** removed an entire class of power plants from PUHCA, so that both intrastate and interstate utilities could own these Exempt Wholesale Generators wherever they are located. ***Result:*** PUHCA's geographic restrictions were undermined, the ability of states to protect retail rates was impaired, and ratepayers were harmed as PUHCA utilities were able to transfer assets and resources outside their core territory. These new exempt power plants led to a transfer of regulatory responsiblity away from states and on to FERC. FERC controlled roughly 10% of electric rates prior to 1992, but today FERC commands close to 80%—explaining why so many states felt they had to deregulate since they were slowly losing jurisdiction over their rate base. To make matters worse for consumers, FERC has been further deregulating wholesale rates by certifying that nearly all markets are "competative", even when (as in California) they clearly were (and are) not.

The Energy Policy Act also provided exemptions from PUHCA for owning foreign utilities. Clever lawyers found ways to turn these exemptions around and allow foreign holding companies to acquire U.S. electric

utilities, which had not been previously possible. ***Result:*** PUHCA utilities gambled ratepayer money by diverting consumers' resources into risky, developing markets.

B. SEC Regulatory Decisions: **No action letters** to Enron and other **power marketers**.
On Jan 5, 1994 SEC staff issued a no action letter on a request by Enron Power Marketing. SEC declined to follow FERC's definition of *facility*. Result: energy traders are free to command market power with no constraints on geography or subsidiary complexity.

In 1997, the SEC adopted **Rule 58**, allowing PUHCA companies to acquire or own fuel and engineering subsidiaries—the types of subsidiaries utilities have abused and that PUHCA was designed to stop.

C. Lax Enforcement of PUHCA's Interconnection Requirements - For years, the SEC has not enforced PUHCA properly, approving several mergers in clear violation of PUHCA. But in January 2002, the U.S. Court of Appeals for the D.C. Circuit asked the SEC to explain why it approved a merger that, in the court's opinion, does not satisfy PUHCA's interconnection agreements (Public Citizen was one of the initial parties in the case). Public Citizen is working with others to conduct similar reviews of SEC approved mergers involving Progress (merger between Florida Progress and Carolina Power & Light); Exelon (Pennsylvania-based PECO and Illinois-based Unicom); Xcel (Minnesota-based Northern States Power and Colorado's Public Service Co).

The Failure of Deregulation Means the SEC Should Adjust Its Prior Opinions on PUHCA
Much has changed since SEC staff recommended in a June 20, 1995 report to repeal PUHCA. The recommendation was made at a time when most economists, policymakers and industry participants were convinced that the coming wave of deregulation made the law irrelevant. Since 1995, of course, every state experiment with deregulation has failed, and the once strong consensus supporting deregulation has been shattered.

Access to Books and Records is not an Adequate Alternative to PUHCA
The SEC's solution in 1995, taken up by members of Congress ever since, has been to repeal PUHCA but provide state officials access to utilities' books and records. This PUHCA alternative fails to provide the accountability and transparency necessary for a functional energy market, as the burden of accountability will be shifted away from corporations and on to states. The resources of state regulatory commissions are overwhelmed in comparison to the finances at the disposal of energy companies intent on merging or consolidating their market share.

Solution: Retain and Strengthen PUHCA by Closing Loopholes and Enforcing the Law

Congress should ensure that the SEC:

- Revises the Commission's 1995 recommendation to conditionally repeal PUHCA to reflect significant changes in the marketplace, i.e. the failure of deregulation.
- Review exemptions granted to power marketers.
- Reevaluate Rule 58, which effectively repealed PUHCA's prohibitions on operating subsidiaries that present opportunities for abuse.
- Enforce PUHCA's interconnection requirements.
- If the SEC wishes to pass enforcement authority to FERC or another federal agency, the SEC should demand that such a transfer does no harm and that PUHCA's consumer and shareholder protections are not weakened in the process.