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The Public Utility Holding Company Act and the Protection of Energy Consumers: an Examination of the Corporate Records of the top Companies Pushing for PUHCA Repeal

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Executive Summary

House and Senate conferees are working toward a compromise on energy legislation passed earlier this year by both chambers and expect to begin deliberating the electricity portion of the legislation Thursday. While most of the public debate has focused on massive subsidies to energy companies included in the competing bills, a little-discussed aspect of the Senate version — repeal of the Public Utility Holding Company Act (PUHCA) — could have devastating consequences for consumers and investors by leading to further Enron-style meltdowns, consumer price gouging and market manipulation.

Despite the ongoing corporate crime wave, the blatant rigging of Western energy markets and the implosion of the energy-trading industry's house of cards, Congress is poised to abolish the one law that protects consumers from such rapacious energy companies. This disastrous course will lead to further industry consolidation, more deregulation and the creation of sprawling, non-transparent corporate structures that leave consumers and investors at the mercy of unaccountable, growth-hungry conglomerates.

An analysis of public documents shows that Enron Corp. and other energy companies that would benefit most from PUHCA repeal have been the leading proponents of such action and poured more than $100 million into lobbying Congress on this and other energy deregulation issues since 1999. This includes lobbying by individual companies and their various anti-regulation trade associations, such as the Edison Electric Institute and the Coalition to Repeal PUHCA Now!. Many of these same companies are under investigation for fraudulent trading practices that gouged billions from California consumers and ratepayers during the artificially created energy "crisis" of 2000 and 2001.

In addition to lobbying Congress, these companies have played a significant role in financing congressional campaigns. The companies and their associations have contributed more than $16 million since 1999 to federal candidates — of which 72 percent, or nearly $12 million, went to Republicans.

At the top of the list seeking repeal of PUHCA are: American Electric Power, Duke Energy, CMS Energy, Southern Company/Mirant and Xcel.

Abolishing PUHCA would largely remove government oversight of these companies. Since these companies claim that they should be trusted in the absence of PUHCA, Public Citizen has examined the companies' corporate responsibility records. These record are bleak and demonstrate that these energy companies have not been good corporate citizens. Nearly all of the federal government's allegations against these companies have been the result of secretive, non-transparent corporate structures that serve to obscure suspicious and possibly fraudulent transactions from consumers and shareholders. In fact, had PUHCA been properly enforced and not watered down by loopholes sought by Enron and other energy companies, it is highly likely that these corporations would have been forbidden from engaging in these practices.

Enron's collapse exposed the dangers of inadequate government oversight that is the central feature of electricity deregulation. The combination of deregulated state wholesale electricity markets, federal deregulation of commodity exchanges and the weakening of PUHCA by Congress and federal regulatory agencies removed accountability and transparency from the energy sector. California's recent energy crisis and the accounting fraud that led to Enron's bankruptcy likely would have been impossible under a regulated system.

PUHCA was enacted in 1935 in response to America's first Enron-style energy crisis in the 1920s. A handful of energy companies, employing business strategies strikingly similar to Enron's, built complex, far-flung empires by using energy profits to fuel the acquisition of new assets unrelated to their core energy business. Not only were consumers overcharged by these pyramiding corporations, but investors were robbed because the holding companies' assets were inflated by thousands of sham transactions. These holding companies finally collapsed, ringing in

Total PAC and Soft Money Campaign Contributions to Federal Candidates, 1999-2002 and Lobbying Expenditures 1999-2001 by Major Companies and Associations Advocating Repeal of PUHCA

	Campaign Contributions to Dems	Campaign Contributions to GOP	Total Campaign Contributions	% of Contributions to GOP	Total Spent Lobbying Congress, White House & Fed Agencies
AEP	$ 190,440	$ 357,410	$ 547,850	65%	$ 2,532,997
Alliance for Competitive Energy	-	-	-		1,580,000
Alliance for Power Privatization	-	-	-		25,000
Cinergy	173,336	455,017	628,353	72%	1,360,000
CMS Energy	275,459	412,106	687,565	60%	4,495,000
Coalition to Repeal PUHCA	-	-	-		881,000
Duke Energy	187,916	555,624	743,540	75%	4,370,000
Edison Electric Institute	398,133	706,253	1,104,386	64%	37,353,628
Electric Power Supply	21,137	28,614	49,751	58%	505,000
Enron	819,491	2,088,912	2,908,403	72%	8,070,000
Entergy	384,980	493,211	878,191	56%	7,601,257
Exelon	503,060	1,146,446	1,649,506	70%	5,970,200
FPL	128,432	1,079,314	1,207,746	89%	5,720,000
MidAmerican Energy	127,000	205,336	332,336	62%	840,000
Reliant	113,513	630,798	744,311	85%	4,000,000
Southern Co/Mirant	748,268	2,036,247	2,784,515	73%	13,305,000
TXU	336,032	1,302,449	1,638,481	79%	8,792,570
Xcel	92,350	291,432	383,782	76%	660,000
Totals	$4,499,548	$11,789,168	$16,288,716	72%	$ 108,061,652
Totals for AEP, CMS, Duke, Southern & Xcel	$1,494,434	$ 3,652,819	$ 5,147,252	71%	$ 25,362,997

SOURCE: Data from Center for Responsive Politics compiled by Public Citizen

the stock market crash of 1929 and the Great Depression.

PUHCA, which is enforced by the Securities and Exchange Commission (SEC), was designed to protect consumers by ensuring that electric, natural gas and water utilities re-invest ratepayer money into providing affordable and reliable service. The law requires that holding companies invest only in "integrated systems" — utilities that are "physically interconnected" — thereby maximizing economies of scale by operating a single, coordinated and transparent system. PUHCA has historically prohibited holding companies from investing ratepayers' money in assets that will not directly contribute to low bills and reliable service, such as out-of-region power plants or non-electricity industries such as water and telecommunications. Besides ensuring reliable service to ratepayers, this arrangement meant a steady stream of dividends for shareholders, as opposed to the robust growth in stock prices sought by many energy executives in the 1990s.

PUHCA, however, has lost much of its potency over the decades as a result of electricity deregulation, corporate lobbying and decisions by the SEC to simply ignore the law.

First, Congress undermined PUHCA by passing the 1992 Energy Policy Act, permitting holding companies to invest ratepayer money in foreign power projects and to divert resources away from American consumers. This allowed the proliferation of offshore subsidiaries and sham transactions through which companies were able conceal debt and overstate revenues. Second, energy traders such as Enron, AEP, Duke and CMS pushed a gaping hole in SEC jurisdiction when the commission, in response to petitions by energy traders throughout the mid-1990s, exempted power marketers from PUHCA. As a result, power marketers were allowed to trade electricity contracts free from government oversight in deregulated markets across the country. We now know that some of these companies engaged in sham trading schemes, often trading energy back and forth among themselves, to drive up energy costs and allow their accountants to book higher revenues. Finally, the SEC has refused to enforce PUHCA and has instead rubber-stamped mergers that are in direct violation of PUHCA's consumer protections.

These loopholes have already resulted in a significant increase in utility consolidation. In 1992, prior to the passage of the Energy Policy Act, the 10 largest electric utilities owned one-third of the nation's generating capacity. By 2000, the top 10 owned half of all capacity, while the top 20 owned 75 percent. PUHCA repeal will encourage more consolidation.

Although the energy industry claims that the law's ownership restrictions hinder adequate investment, the industry is only interested in purging PUHCA to satisfy its craving for Enron-style accounting freedom and convergence — the desire of energy corporations to extend their control beyond electricity into telecommunications, water and other essential consumer services.

The threats of increased industry consolidation, deregulation and sprawling, non-transparent corporate structures pose tremendous challenges to state and federal regulators to

adequately protect consumers. Therefore, retention of PUHCA is crucial to maintaining affordable and reliable energy market so that consumers can fairly purchase an essential commodity — energy.

American Electric Power

American Electric Power (AEP) has been the largest company pushing for the repeal of PUHCA. As recently as August 9, 2000, Mark Menezes, vice president for governmental affairs at AEP, was also a registered lobbyist for Coalition to Repeal PUHCA Now! AEP spent nearly $1.3 million lobbying Congress in 2001 on PUHCA and other issues. Public Citizen's analysis of AEP's corporate operations indicate the company has a lot to lose from the application of a strong, viable PUHCA.

On March 29, 2002, AEP boasted in its 10-k filing with the Securities and Exchange Commission that the 264% increase in after-tax profit (from $267 million in 2000 to $971 million in 2001) was largely "due to the growth of AEP's wholesale marketing and trading business." But just months after making this boast, AEP's energy trading business is being investigated by at least three separate federal agencies for engaging in Enron-esque trading fraud. AEP's trading practices were placed on notice by the Federal Energy Regulatory Commission (FERC) in late May. Weeks later, the Commodity Futures Trading Commission issued a subpoena to AEP regarding its trading practices. And the SEC announced its own formal investigation on August 30. News reports indicate that AEP could be investigated by the Justice Department amid allegations that an Internet trading platform, Intercontinental Exchange, of which AEP was an owner and largest volume user, exploited a collusive agreement among its participants to encourage fraudulent trading practices that drove up energy prices.

These fraudulent trading practices helped boost AEP's profitability in two ways. First, the "round-trip," or "wash," trading boosted AEP's revenues, deceiving investors into thinking the company was conducting a more robust business. But the most profitable and damaging result of this trading was that it enabled AEP, through its Intercontinental Exchange trading platforms, to manipulate energy prices by creating false benchmark prices that ended up artificially raising prices for everyone.

The numerous federal investigations into AEP's business practices raise questions about whether much of the company's recent profit growth has been fraudulent, since AEP's unregulated, wholesale energy trading business represents the bulk of the company's profit growth. Whereas unregulated electricity and natural gas trading represented just 55 percent of total revenues in 1999, by 2001 unregulated trading represented 81 percent. Revenues from unregulated trading jumped from $13.7 billion in 1999 to $50 billion in 2001 — a 263 percent increase.

Critics contend that AEP exploited high electricity prices — created, in part, by its own

trading schemes — to defraud consumers. In June 2002, Snohomish County in Washington state filed the first of what should be several complaints against AEP for price-gouging West Coast consumers. The complaint alleges that AEP, controlling a significant share of the regional market, forced Snohomish County to pay "unjust and unreasonable" rates for electricity. [1] The county had already canceled a similar Enron contract, and filed a similar complaint against Morgan Stanley, which was also trading energy contracts.

AEP's Tax Dodge

But that's not all. AEP has been a national leader in profiting off the death of its own employees. Beginning in 1990, the company began covering tens of thousands of its rank-and-file employees in a complex tax shelter, called the Corporate-Owned Life Insurance (COLI) program. AEP was eventually able to pad its profits by hundreds of millions of dollars by taking advantage of this tax dodge.

Prior to 1990, a corporation was allowed to purchase a life insurance policy only for those individuals important to the firm's survival. As a result, only top executives were legally allowed to be covered. But companies lobbied states to expand eligibility requirements and allow a corporation to cover all employees (three states, Florida, Oregon and Texas, are the exception).

AEP took advantage by purchasing insurance policies from Hartford Life on behalf of more than 20,000 of its employees.) Because interest payments on insurance policy loans were tax-deductible, AEP took out a loan from Hartford Life to secure the premium. In addition, AEP then invests the money from the loan — and the interest income from insurance policies was also tax-exempt. But that's not all: AEP was able to make a third deduction on its loan payments to Hartford Life!

It would be one thing if AEP was dodging taxes at three separate points in order to increase benefits for its employees. But as the insured workers die, AEP would receive a cash payout, typically larger than the payout awarded to the employee's family. As AEP spokesman Tom Ayres told the Wall Street Journal, "as the insured employees die, [AEP is] getting death benefits, which is cash income."[2] The lure of profiting four times off each employee prompted AEP to conduct "death sweeps" of Social Security records to more quickly cash in.

AEP ran into trouble, however, after Congress in 1996 outlawed the tax deductions that AEP and other companies were taking on the interest paid on the loans. As a result, the IRS sued AEP for making illegal tax deductions, and the agency won its case in February 2001 when U.S.

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[1] "Complaint is Filed Against Power Firm," *Seattle Post-Intelligencer*, June 19, 2002.

[2] Ellen E. Schultz and Theo Francis, "Valued Employees: Worker Dies, Firm Profits," *The Wall Street Journal*, April 19, 2002.

District Judge James Graham of the Southern District of Ohio ruled that $72 million in interest deductions claimed by AEP on its 1996 federal tax forms was illegal. This ruling cleared a path for the IRS to seek payments for illegal deductions in other years, which means AEP could be forced to refund as much as $317 million.[3]

AEP's Pollution

An analysis of U.S. Environmental Protection Agency air emissions data shows that AEP is one of the largest polluters in America, pumping out sulfur dioxide, which causes acid rain and can also impair breathing and aggravate existing respiratory diseases; carbon dioxide, the primary cause of global warming; nitrogen oxide, which contributes to acid rain, damages lung tissue, creates ground-level ozone and contributes to global warming; and mercury, a neurotoxin that is especially damaging to children and can cause developmental disorders in fetuses. Although this is not surprising given the fact that AEP is also America's largest producer of electricity, it is significant to note that AEP has some of the highest rates of emissions, meaning that the company emits a high level of pollutants for every megawatt of electricity it produces. For example, AEP has the 10th highest emission rate for nitrogen oxide and the 15th highest rate of emissions for sulfur dioxide.[4]

And AEP is trying to emit even more. The company is leading the lobbying and legal campaign to overturn Clinton-era emission standards so its coal-fired power plants can spew even more toxins and carbon dioxide into the air.

On behalf of the EPA, the Justice Department filed suit against power plants owned by AEP beginning in 1999, claiming that the utility was ignoring the New Source Review requirements. As part of the 1990 Clean Air Act, old coal power plants continued to be exempt from tougher emissions standards applied to newer plants, unless they upgraded their equipment. In that case, the EPA could determine that the upgrade constituted a "major modification" and therefore a New Source Review permit would be necessary. This permit would force the utility to reduce emissions.

Indeed, pollution from AEP's Gavin power plant has been so bad in Cheshire, Ohio, that AEP has offered to buy the entire city to move people away from the plant, so the company can continue operating it. AEP has proposed buying the entire town for $20 million, or the equivalent of giving property owners twice the market value for their homes. In exchange, citizens would be required to sign away their right to ever sue AEP for health problems related to the plant's emissions.

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[3] "Federal Judge Rules Against AEP in Tax Case," *Foster Electric Report*, February 28, 2001.

[4] "Benchmarking Air Emissions of the 100 Largest Electric Generation Owners in the US, 2000" www.ceres.org

AEP and PUHCA

On Jan. 18, 2002, the U.S. Court of Appeals for the District of Columbia ruled that the SEC failed to prove that the June 15, 2000, merger of AEP with Central & South West met the requirements of PUHCA and sent the case back to the SEC for further review. Specifically, the court told the SEC to revisit its conclusion that the merger met PUHCA requirements that utilities be "physically interconnected" and confined to a "single area or region."

Public Citizen maintains in its court challenge that the SEC's earlier decision to approve this merger between Ohio-based AEP and Texas-based CSW violated PUHCA's requirements that holding companies have interconnected systems. The SEC had ruled that because the two utilities are connected by a 250-mile transmission line in Missouri, owned by an unrelated company, that the merger satisfied PUHCA. The judge's decision illustrates that the court has finally noticed that the SEC has refused to enforce the law.

Duke Energy

With both a regulated and large unregulated business, Duke Energy has everything to gain from the repeal of PUHCA. That would explain why Duke spent nearly $2 million lobbying Congress in 2001.

Duke has profited handsomely off electricity deregulation. After-tax profits were $1.9 billion in 2001, nearly double what they were in 1997 before deregulation, and more than 25 percent higher than in 1999. Nearly all of this profit growth was driven by its activities in the newly unregulated wholesale markets. Revenue from the company's North American Wholesale Energy division grew 266 percent — from $11.8 billion in 1999 to $43.2 billion in 2001. Duke has become increasingly reliant on its unregulated energy business, with revenues from these activities representing three-quarters of all revenue in 2001, up from 54 percent in 1999.

But recent events indicate that most of this leap in profitability has been artificial. In May 2002, the SEC ordered Duke to release information on its trading practices, and in July the energy trader admitted that it had misled investors and federal officials about its trading operations. In July, the Commodity Futures Trading Commission issued a subpoena to Duke, and the company has been under investigation by FERC since May. In addition, Duke is under investigation by the Justice Department's Houston office as part of a grand jury investigation into allegedly fraudulent trading practices. The federal grand jury subpoenaed Duke in July.

Duke Energy has not only been aggressive in its accounting practices, it also has a national reputation for squeezing special tax breaks out of local communities. Duke Energy is so prolific at getting tax breaks that the state of North Carolina has a tax incentive named for the company. The William S. Lee Tax Act, named after a former chairman of Duke Energy and

enacted in 1996, represents much of Duke's philosophy: win tax breaks from local governments as aggressively as possible, a feat the company has accomplished to the tune of hundreds of millions in property tax breaks for its power plants from California to Arizona to Ohio to Florida to Kentucky.

Duke in California

The company is also adept at exploiting connections with government to sweeten deals for itself at taxpayers' expense. In January 2002, a public official in San Diego resigned when it was revealed that he had been a paid consultant for Duke at the same time he was administering a deal with the company on behalf of government. San Diego Unified Port District Commissioner David Malcolm had been appointed by San Diego-area government to help manage public lands under the Port District's jurisdiction.

In 1999, Duke agreed to lease a power plant from the Port District for $115 million, after the Port District had bought the power plant from a local utility as part of the state's electricity deregulation plan. But beginning in May 2000, Malcolm was hired by Duke as a $20,000 per month consultant while he still served as a Port District commissioner. Malcolm and Duke Energy failed to disclose this relationship, even though Malcolm had responsibility as a government official to serve the interests of the citizens in his district. A Duke spokesman underscored Malcolm's importance to the company's financial dealings when he told the Charlotte Observer that "obviously we [Duke Energy] don't want a person working for us to be working against us."[5]

Once Malcolm's dual role was exposed a year later, it became clear that the citizens of San Diego were not served well by Malcolm and Duke Energy. Taxpayers subsidized the Port District's purchase of the power plant, as the state provided $15 million to the Port District and the local utility was allowed to claim a $43 million tax deduction. But more important, Duke Energy was allowed to charge whatever prices it wanted for the electricity produced at the plant that taxpayers owned. Duke Energy showed its gratitude to the community by charging sky-high prices to consumers.[6] San Diego was the only district in California where consumers were not temporarily protected by retail rate caps under the state's electricity deregulation plan, so citizens had to fork over the full cost of Duke's overpriced power.

As a result of this fiasco, Malcolm was not only forced to resign his public post, but state and federal criminal probes were launched in early 2002. In addition, a civil lawsuit filed against Malcolm resulted in the residents of San Diego and the city's insurance provider having to pay

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[5]Charles Hurt, "Official Resigns Amid Questions," January 8, 2002.

[6]Craig Rose, "Port's South Bay Deal with Duke Draws Fire," *The San Diego Union-Tribune*, May 2, 2002.

$600,000 to settle the civil charges against Malcolm.[7] As part of the criminal probes, Duke Energy's role in buying influence to ensure the company could continue to charge high prices at the public's expense is being investigated.

Duke Energy's loose accounting is also evident with the company's efforts to escape some federal tax liability through its Texas Eastern Products Pipeline Company (TEPPCO) affiliate. In the 1980s, energy lobbyists persuaded Congress to lend a hand to the flagging energy sector by allowing companies to spin off publicly traded **partnerships.** These so-called Master Limited Partnerships (MLP) pay no taxes, since they are partnerships, not corporations. In theory, then, the partners (investors) in the partnership are supposed to pay the taxes. The partners, in turn, delegate day-to-day operations to an administrator (in this case, Duke) which runs TEPPCO and collects a fee from the partners. So Duke Energy wins in several ways. First, the company is not responsible for taxes or other liabilities associated with the hard assets in TEPPCO. But Duke still makes plenty of money off the plan, because the company is paid for servicing and running TEPPCO's facilities, and Duke collects a service fee from every investor.

Because Duke's tax shelter owns long-lived assets like pipelines, which allows for large depreciation, the limited partners deduct this large depreciation, which more than offsets any income for tax purposes. So, Duke earns a profit off of the assets it controls through the MLP and the fees it charges the partners, but the company pays taxes only for the revenues related managing the assets. And the partners who theoretically should be paying the tax pay nothing because the depreciation deductions cancel out their income for tax purposes. Duke has transferred hundreds of millions of dollars worth of assets to TEPPCO.

Of course, Duke's relationship with its accountant, Deloitte & Touche, could explain some of these incentives, since 78 percent of the $15 million in fees Duke paid the accounting firm in 2001 were for consulting services, as opposed to audits — a practice that creates a conflict of interest for auditors.

Dirty Air and Generous CEO Pay

In 2000, the Justice Department sued Duke Energy on behalf of the EPA for violations of the New Source Review (NSR) provisions of the Clean Air Act. Under the Clean Air Act, older power plants are "grandfathered" and don't have to comply with new, tougher air quality standards. But the NSR provision mandates that if a grandfathered plant makes major upgrades, then the plant will lose its exemption and be forced to comply with the tougher standards. The government argues that projects at 25 of Duke's coal-fired power plants classify as major upgrades, and therefore the improvements triggered the NSR. As a result of the upgrades, Duke Energy was able to expand capacity and produce more emissions.

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[7] Rene Beasley Jones, "Port Covers Legal Costs for Former Commissioner," *San Diego Business Journal*, Vol. 23, Issue 16, April 22, 2002.

In the end, although investors were getting hit on the chin from all of the federal investigations into Duke's business practices, the company's CEO, Richard Priory, benefitted greatly, earning nearly $15 million from 1999-2001.

CMS Energy

Michigan-based CMS Energy is not currently regulated by PUHCA. But the company joined the Coalition to Repeal PUHCA Now! and chose to spend $2 million lobbying Congress in 2001 alone on issues including PUHCA because CMS Energy believes PUHCA's consumer protections are a threat to the company's future expansion potential.

Although the profitability of CMS Energy suffered somewhat during the transition to electricity deregulation, the company nonetheless experienced a large boost in revenues tied to the company's unregulated businesses. Revenue from unregulated energy trading grew 265 percent — from $1.2 billion in 1999 to $4.3 billion in 2001. While unregulated trading in 1999 represented only 20 percent of total revenue, by 2001 it accounted for 45 percent.

The SEC, CFTC, FERC and the Justice Department have all been formally investigating CMS Energy since May 2002, making CMS Energy the most investigated energy trader next to Enron. Shortly after the investigative offensive, long-time CMS Energy Chairman and CEO William McCormick resigned. That was followed by the firing of the company's auditor, Arthur Andersen. At the time of the accounting firm's dismissal, Arthur Andersen noted that its approval of the company's books could no longer be relied upon, which should not come as a surprise since 71 percent of the $5.6 million CMS Energy paid Arthur Anderson was for non-audit consulting services.

CMS Energy, which lobbied hard on the House economic stimulus bill in the fall of 2001, stood to gain $136 million in tax cuts under the Bush proposal. The administration's initial proposal would have repealed the Alternative Minimum Tax, and CMS Energy and other companies would have been eligible for an immediate refund of any Alternative Minimum Tax paid since 1986.[8] The proposal was defeated only after the media noted that disgraced Enron would receive $254 million from the deal.

Although Chairman and CEO William McCormick Jr. was forced to resign amid the company's trading scandal, he walked away with a $4 million severance package. Tamela Pallas, the disgraced chief of the company's Houston-based CMS Marketing Services and Trading, received a $2 million walk-off bonus. Alan Wright, CMS's retiring CFO, received $1.65

[8] Citizens for Tax Justice Analysis, October 16, 2001 <www.ctj.org/html/amtdozen.htm>.

million.[9] McCormick's severance package was in addition to the $5.5 million he had earned from 1999-2001.

Although McCormick left with his financial future secure, the same cannot be said of the investors who lost hundreds of millions of dollars as a result of CMS Energy schemes. At least a dozen class-action lawsuits have been filed on behalf of shareholders against CMS, and the ongoing federal probes into the company's trading practices may end up jeopardizing the company's regulated business operations.

Southern Company/Mirant

Southern Co. is a classic holding company, with several state-based subsidiaries that are all connected with each other: Savannah Electric & Power (Georgia), Georgia Power, Alabama Power, Mississippi Power and Gulf Power (Florida). Southern's regulated businesses is a prime example of the historical success of PUHCA: a multi-state, interconnected utility that takes advantage of economies of scale to provide power to its consumers affordably and reliably. Unfortunately, Southern has been branching out more and more into its unregulated businesses, financing these excursions through its regulated rate base. This is most evident in the company's recent spinoff of Mirant. The unregulated activities of this subsidiary have exposed the vulnerabilities of complex corporate structure, sprawling investment portfolios and non-transparent operations.

Southern's profits have remained flat because the company's operations are largely regulated. After-tax profits in 2001 were just under $1.3 billion, practically unchanged since 1999. Unregulated sales outside Southern's service territory represented only 8 percent of total revenues.

By April 2001, Southern claimed it had created a brand-new company, Mirant, that would take on the company's unregulated functions. But in reality, Mirant is solidly under the wing of Southern. Marce Fuller, Mirant president and CEO, had been a Southern executive since 1994 before helping to lead the Mirant subsidiary. A.W. Dahlberg is chairman of the board of directors for Mirant. Prior to holding that title, Dahlberg was chairman of the board for Southern. The corporate controls remained in place. A lobbying disclosure form submitted to Congress on August 13, 2001, by J. Robert Minter, Mirant's vice president for government affairs, states, "during the first half of 2001, the registrant changed its name from Southern Energy, Inc to Mirant Corporation. This was a change in name only; the registrant remains the same company."

Profit growth for Mirant has been more robust than Southern, growing 58 percent — from $359 million in 2000 to $568 million in 2001.

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[9] "McCormick to get $4M severance from CMS," *Crain's Detroit Business*, Vol. 18, No. 33, August 19, 2002.

Southern Co./Mirant together helped force open cracks in the regulatory structure to take advantage of deregulation. The companies spent a combined $6.2 million lobbying Congress on a host of issues, including repeal of PUHCA.

Southern Co.'s Role in California Shortage

Southern purchased three California power plants (later transferred to Mirant) — Contra Costa, Pittsburg and Potrero—from PG&E for $800 million in April 1999, during the early days of California's deregulation. Public Citizen estimated that Southern was able to profit by $200 million in 2000 alone from selling overpriced power from these plants. State and federal agencies are investigating Southern for intentionally shutting down the Pittsburg plant in order to drive up prices charged by the other two, helping to initiate the energy crisis.[10] For example, on just one day in the summer of 2000, wholesale prices reached $750 per megawatt-hour, five times higher than on similar days a year earlier. State investigators concluded that unregulated power plant operators, including Mirant, had intentionally withheld electricity from the market.[11]

Southern boasted to its shareholders in a June 18, 2001, Form S-4 filing with the SEC that "our assets are strategically located near major load centers and, in some cases, are located in markets in which electricity prices are more likely to be higher due to transmission constraints and shortages of low cost generation."[12] Pursuing a deliberate strategy of commanding generation assets in high price areas with constrained transmission capacity, investigators believe, made it easy for Southern to manipulate prices and restrict the flow of electricity to California residents, leading to rolling blackouts.

The SEC announced in August that it was investigating Mirant's accounting practices. This follows up investigations announced by FERC into potentially fraudulent trading practices by Mirant. The company also faces investigations of manipulation by at least two states: The California PUC and the Texas PUC are investigating Mirant's role in manipulating each of those states' wholesale markets.

When Southern's manipulation of generation assets was combined with Mirant's alleged trading fraud, it added up to big profits for the Atlanta-based firms, and higher prices for West Coast consumers.

Xcel

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[10] Michael Pena and Lynda Gledhill, "Company hesitant to build power plant," *The San Francisco Chronicle*, June 2, 2001.

[11] Scott Thurm, Robert Gavin and Mitchel Benson, "Companies Shut Power Plants and Manipulated Auctions as Deregulation Stumbled," *The Wall Street Journal*, September 16, 2002.

[12] Page 8.

Xcel represents the new breed of regulated holding companies — stretching the limits of PUHCA while investing heavily in unregulated subsidiaries that are wreaking havoc with consumers in deregulated markets. The company was formed by the merger of Minneapolis-based Northern States Power and New Century Energies in the summer of 2000.

Xcel and its subsidiaries spent only $420,000 lobbying Congress in 2001, but the group is also a member of Coalition to Repeal PUHCA Now!.

Like AEP, Xcel relied on deregulated operations to fuel its growth in revenues and profits. After-tax earnings soared over by more than 50 percent — from $570 million in 1999 to nearly $800 million in 2001. This profit growth has been fueled by Xcel's unregulated trading and marketing activities. Revenue from energy trading and other non-regulated activities grew by more than 280 percent — rising from $1.7 billion in 1999 to $6.4 billion in 2001. These revenues represented a bigger growing share of the company's operations, with energy trading and other unregulated activities representing 42 percent of all revenues in 2001, up from 21 percent in 1999.

Xcel's major unregulated, separate subsidiary, NRG, has also been raking in profits. NRG net income increased 365 percent — from $57.2 million in 1999 to $265.2 million in 2001.

When Xcel purchased several power plants from San Diego Gas & Electric and Edison International, Craig Mataczynski, vice president of NRG said at the newly purchased El Segundo plant, "Consumers in California will begin to benefit from competitively priced electricity and more vibrant economy."[13]

But now Xcel is being investigated for allegations of manipulating prices at the El Segundo plant, which it purchased from Edison International in April 1998. The plant is operated by West Coast Power, a subsidiary of Xcel's NRG. An El Segundo employee told investigators that managers at times ordered him to shut down or reduce output at the facility. Such actions helped lead to price spikes and contributed to the state's rolling blackouts.

In a May 2000 report, the California Energy Commission cited several plants, including El Segundo, as the "major beneficiaries of high real-time prices."[14] And because NRG provides profit details for its West Coast Power subsidiary, Public Citizen was able to verify that the division's profits are 100 percent earned in California. By 1999 — the year after Xcel acquired El Segundo — after-tax profit was $29 million. In 2000, the year price spikes hit California, West Coast Power profits had soared 745 percent to $245 million. In 2001, profits soared again to

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[13]Robert J. Lopez and Rich Connell, "Energy Firms' Mixed Message is Focus of Inquiry," *The Los Angeles Times*, April 4, 2001.

[14]Christian Berthel and Scott Winokur, "Power Juggling Ramped up Price," *The San Francisco Chronicle*, May 20, 2001.

$326 million.

While the FERC has tentatively ordered West Coast Power to refund up to $45 million just for alleged overcharges in January and February of 2001, Xcel's NRG subsidiary complains that it is still owed hundreds of millions of dollars by the state, and so the company's net income is actually lower than it should be![15]

In addition, FERC has an ongoing investigation into the energy trading practices of Xcel and its subsidiary, NRG. The company announced in July 2002 that both the CFTC and SEC had launched formal investigations of the company's trading practices, and that the CFTC had issued a subpoena. As a result, Xcel is struggling to keep its once-flourishing NRG solvent as the unit's credit rating continues to take a beating.

Conclusion

The recent failures of energy deregulation demonstrate the need for strong regulation of critical commodities like electricity in order to protect consumers. PUHCA has helped ensure a measure of accountability by keeping the energy industry less concentrated and therefore easier to regulate. PUHCA has helped maintain transparent corporate structures for many utilities, so investors and regulators can better evaluate their operations.

But PUHCA's effectiveness has been eroded over the last two decades. Proponents of PUHCA repeal claim that the weakened law should be eliminated so that energy companies can more freely dictate needs for consumers. But Public Citizen's analysis of the corporate records of some the most ardent supporters of PUHCA repeal reveal that these industry participants have terrible records on corporate accountability. With this diminished credibility, now is not the time to give these same corporations even more control over our nation's energy markets.

If PUHCA is repealed, the electricity industry will experience an unprecedented wave of consolidations and mergers, making it even more difficult for regulators to monitor an already dysfunctional energy marketplace. That's why PUHCA should be strengthened, not repealed, in order to protect consumers.

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[15]NRG 10-Q filed with the SEC on May 15, 2001.