



Money Harvest

Utility Holding Companies Are Threshing Ratepayers

by Charlie Higley

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Public Citizen's Critical Mass Energy Project

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Money Harvest

Utility Holding Companies Are Threshing Ratepayers

Executive Summary

This report describes what holding companies are, how they work, and their advantages and disadvantages from the perspective of consumers, workers, and shareholders. Written as a series of questions and answers, *Money Harvest* explains why holding companies that own utilities present special problems for ratepayers, workers, competitors, even bond and share holders. The report concludes that ratepayers (and others) would be better off if holding companies did not own electric utilities. The report includes recommendations for state and federal legislation that would eliminate many of the evils created by utility holding companies.

Supplementing this report is a **case study** on the utility holding companies of Texas. The case study uses data from 1989 to 1998 to show that the ratepayers of five Texas electric utilities are subsidizing the expansion of the three utility holding companies that own them.

What is a holding company?

A holding company is a corporation that owns the stock of another company. Holding companies are created when one company acquires another company by purchasing most or all of the voting stock of the target company.

The chief purpose of a holding company is to increase profits for the company's management and shareholders by acquiring other (hopefully) profitable businesses.

Even though each subsidiary retains its own board of directors, its own management, and its distinct corporate identity, the parent holding company can select the board of directors of each subsidiary. Thus, the parent holding company can control the management and budgets of its subsidiaries.

Today holding companies are very prevalent in the world's economy. As of 1993, world-wide there were 35,000 holding companies with 170,000 subsidiaries. The top-ten companies in the 1999 Fortune 500 are all holding companies.

What are utility holding companies and what are their disadvantages?

By federal law, a corporation is considered a *utility* holding company if it owns 10 percent or more of the stock of an electric or gas utility. Today there are 150 electric utility holding companies, which own nearly 80 percent of the assets used to produce, transmit, and distribute the nation's electricity. These 150 utility holding companies also own over 4,200 non-utility subsidiaries. In 1979, there were only 58 utility holding companies with 175 non-utility subsidiaries.

Despite their prevalence, utility holding companies create problems for consumers, competitors, workers, and shareholders by bringing together regulated and non-regulated companies into one corporate family. Regulated companies, such as electric utilities, are regulated because they

have a local monopoly to provide electricity service. Thus, electricity rates and terms of service have to be examined by state and federal regulators, or else utility owners would charge whatever rates they pleased, or would provide service to only the most profitable customers.

In contrast, non-regulated companies sell a product the price of which is not regulated. For example, appliance dealers sell, install, and repair appliances, the prices of which are determined by the market forces of supply and demand. Since there are many appliance dealers, consumers are free to shop to find the best deals, and there is no need to regulate the price of appliances or the price to install and service them.

Any time regulated and non-regulated companies are brought together in a holding company system, cross-subsidies will likely flow from the regulated subsidiary to the non-regulated subsidiary. Cross-subsidies occur when the regulated utility subsidiary pays excessive prices for services provided by the holding company or by other non-regulated affiliates. For example, if the utility purchases engineering, construction, or administrative services from the parent holding company, the holding company may attempt to charge the utility excessive fees in the hopes that the utility will be able to pass these excessive fees to its ratepayers. Since ratepayers have to buy electricity from the utility, they end up paying higher rates to cover the excessive fees required by the parent holding company.

How do cross-subsidies harm ratepayers, competitors, and shareholders?

Cross-subsidies harm ratepayers because they end up paying higher rates for purchasing regulated services, with some of their rates being used to subsidize other services provided by non-regulated affiliates that the ratepayer may not even use. Since ratepayers have to buy the regulated product, ratepayers are often forced to pay higher rates for these subsidies.

Competitors suffer because the non-regulated holding company affiliates are receiving subsidies from ratepayers, allowing the affiliates to unfairly reduce prices to either take customers away from their competitors or to drive them out of business. For example, many small businesses that provide air conditioning, heating, electrical, plumbing, appliance sales, and appliance repair services are facing unfair competition from utility affiliates propped up with cross-subsidies that ultimately come from the ratepayer. When a small business owner pays his or her monthly power bill, they are likely providing subsidies to holding company affiliates that are trying to put them out of business.

Shareholders and bondholders of the utility holding company are potentially harmed because cross-subsidies impose burdens on various parts of the holding company system, making securities more risky and less valuable. Holding company mergers and acquisitions also threaten shareholders—most mergers reduce shareholder value, even though company managers often receive lucrative bonuses, and Wall Street investment bankers rake in commissions and fees.

Shareholders and bondholders of firms that compete with utility affiliates suffer because their securities are made less valuable through unfair competition by subsidized affiliates of utility holding companies.

Since the ratepayer has no choice but to buy the regulated service, ratepayers are easily *milked* by the numerous ways holding companies and their utilities can *cook the books*, increasing revenues, profits, and dividends, all at the expense of the captive ratepayer. The only thing standing in the way of the utility holding company is the regulator. However, regulatory commissions do not have the staff or resources to effectively control utility holding companies. In fact, regulation of utility holding companies has always been expensive, obtrusive, and ultimately ineffective.

What can be done to reduce the problems created by utility holding companies?

Given the fact that regulators cannot effectively control cross-subsidies between regulated and non-regulated businesses when both are owned by a holding company, Congress and the states should follow the recommendation made by the President Franklin D. Roosevelt 64 years ago—to prohibit holding companies from owning both regulated and non-regulated subsidiaries.

Congress and the states should require holding companies to divest their regulated subsidiaries into stand-alone companies that have no affiliates or subsidiaries. This would focus regulation only on regulated services. No longer would there be the need to police affiliate transactions for cross-subsidies and self-dealing between regulated and non-regulated affiliates. It would eliminate fishing expeditions by regulators into the activities of non-regulated companies. It would reduce significantly the cost and intrusiveness of regulation.

What are the results from the case study on the utility holding companies of Texas?

The case study (included in this report) shows that the ratepayers of five Texas electric utilities are subsidizing the expansion of the three holding companies that own them. Electric bills for the customers of the five electric utilities have been increasing, while the assets, revenues, and retained earnings of the utility holding companies have also increased.

The three utility holding companies and the five electric utilities are:

- **Central and South West Corporation (CSW)**, the utility holding company that owns *Central Power & Light Company (CPL)*, *West Texas Utilities Company (WTU)*, and over 120 additional subsidiaries.
- **Reliant Energy, Inc.** (also known as Houston Industries, Inc.), which until 1997 was the parent holding company of *Houston Lighting and Power Company (HLP)*, and which also owns other subsidiaries.
- **Texas Utilities Company (TU)**, the utility holding company that owns *Southwestern Electric Service Company (SES)*, *Texas Utilities Electric Company (TU Electric)*, and about 280 additional subsidiaries.

Ratepayers of the five electric utilities would be better off if their electric utilities were not owned by utility holding companies. The following evidence supports this conclusion.

- From 1989 through 1998, the assets, revenues, and retained earnings of all three utility holding companies increased (the only exception was a decrease in the retained earnings of Texas Utilities Company).
- To subsidize the expansion of their empires, the three utility holding companies relied in part on \$9.6 billion, which was collected from the ratepayers (as part of their electric bills) by the five electric utilities, which then gave it to the three holding companies in the form of dividends during the period 1989 through 1997.
- All three utility holding companies have used ratepayer money to acquire foreign utilities and companies.
- As they were providing profits to the three utility holding companies, the ratepayers of all five electric utilities were paying higher annual electric bills (in terms of revenue per customer) at the end of 1997 than they were in 1989.
- Meanwhile, as the three utility holding companies expanded their empires, 12,024 utility workers lost their jobs between 1989 and 1997.
- To make matters worse, the Texas Legislature may force ratepayers to hand over an estimated \$4.6 billion to the subsidiaries of the three utility holding companies in the form of a stranded cost bailout for bad investments in power plants.

Money Harvest

Utility Holding Companies Are Threshing Ratepayers

Introduction

This report describes what holding companies are, how they work, and their advantages and disadvantages from the perspective of consumers, workers, and shareholders. Written as a series of questions and answers, *Money Harvest* explains why holding companies that own utilities present special problems for ratepayers, workers, competitors, and shareholders.

This report concludes that *everyone* would be better off if holding companies did not own electric utilities.

Supplementing this report is a **case study** on the utility holding companies of Texas. The case study uses data from 1989 to 1998 to show that the ratepayers of five Texas electric utilities are subsidizing the expansion of the three utility holding companies that own them.

What is a holding company?

A holding company is a corporation that owns the stock of another company. Holding companies are created when one company **acquires** another company by purchasing most or all of the voting stock of the target company.

In their groundbreaking study, James Bonbright and Gardiner Means write, “the holding company is the most effective device that has ever been invented for combining under a single control and management the properties of two or more hitherto independent corporations.”¹

Will Rogers said that a holding company “is a thing where you hand an accomplice the goods while a policeman searches you.”²

President Franklin D. Roosevelt described holding companies as “a corporate invention which can give a few corporate insiders unwarranted and intolerable powers over other people’s money.”³

If the holding company owns all of the **voting stock** (common stock and special types of preferred stock) of another company, the company becomes a **wholly-owned subsidiary**. Subsidiaries within a holding company system are also known as **affiliates** or **operating companies**. Subsidiaries within a holding company system retain their legal identities as distinct corporations, with each subsidiary retaining its own board of directors, its own management, and the ability to buy and sell stock and debt securities.

Even though each subsidiary retains its own board of directors, its own management, and its distinct corporate identity, the parent holding company can select the board of directors of each subsidiary, since the parent owns a **controlling interest** (a controlling interest means owning enough voting stock to influence appointments to the board of directors). Through the control of each subsidiary’s board of directors, the parent holding company can control the management and the budget of each subsidiary. Therefore, the board of directors of the parent holding

company is in control of the management and budget of its subsidiaries, although this control is somewhat decentralized since each subsidiary retains its own corporate identity.

In contrast, some corporations do not use a holding company structure. Instead, when such a corporation buys another business, the target company is said to **merge** with (be absorbed by) the purchasing company, and the target company ceases to exist as a separate legal entity, losing its board of directors and the ability to issue securities.⁴ Companies that are merged into another company are often referred to as **unincorporated divisions** within the surviving company. The term *merger* is often used to describe holding company acquisitions as well as formal mergers.

Holding companies often acquire other companies by trading the holding company's stock for the target company's stock. **Stock swaps** and **stock-for-stock transactions** are common phrases used to describe the acquisition by a holding company of another company, although stock swaps can also be used in mergers. More information on how holding companies acquire other corporations is presented in a later section.

How many holding companies are there?

Today, holding companies are very prevalent throughout the world. Professor Phillip Blumberg of the University of Connecticut cites a 1983 survey by the United Nations that shows that there were 10,000 multinational holding companies with 98,000 subsidiaries.⁵ A follow-up 1993 survey concludes that the number of multinational holding companies had increased to 35,000 with 170,000 subsidiaries.⁶

A quick look at the top ten companies in the 1999 Fortune 500 reveals that all are holding companies: General Motors, Ford, Wal-Mart, Exxon, General Electric, IBM, Citigroup, Philip Morris, Boeing, and AT&T.⁷ Many corporations headquartered in other countries are also holding companies.

Why are holding companies created?

Holding companies are created to increase profits for management and shareholders by acquiring other (hopefully) profitable businesses.

By creating a system of affiliated companies, the holding company structure can increase profits by reducing the costs associated with engineering, construction, administration, marketing, legal affairs, strategic planning, budgeting, and other corporate services. A holding company may be better able to weather changes in the business cycle by owning companies engaged in different lines of business.

However, management efficiencies of the holding company system can disappear if the number of subsidiaries becomes too large. A holding company system can actually lose money if it strays into lines of business outside of its core area of expertise. By acquiring other businesses, holding companies reduce or eliminate competitors, which can lead to higher prices for consumers and increased political power for holding company management. The advantages and disadvantages of holding companies are more fully explained in later sections.

When were holding companies first created?

Holding companies were first formed in 1832, when the Baltimore & Ohio Railway Company was authorized to acquire the stock of another railroad. Other early holding companies include the Western Union Telegraph Company (circa 1860), and the American Bell Telephone Company, predecessor of the American Telephone & Telegraph Company (circa 1880).⁸

Early holding companies were allowed to come into existence by special legislative charters enacted by the states in which these companies were incorporated. Without specific authorization from state legislatures, common law prohibited one corporation from owning the stock of another corporation.⁹

However, in 1888 New Jersey added provisions to its corporation law that allowed corporations to own the stock of other companies.¹⁰ Other states quickly followed New Jersey's lead, and the holding company soon became commonplace.

Are there different types of holding companies?

In the broadest terms, there are three types of holding companies. A **pure holding company** exists solely to hold the voting securities of its subsidiaries. There are two sources of income for a pure holding company: the stream of dividends coming from the ownership of the common stock of its subsidiaries; and any gains realized by investing in stocks and bonds.

Another type of holding company generates income by selling products or services as well as receiving income from dividends and investments. Such a holding company is known as a **general or operating holding company**.

A third type, known as the **pyramid holding company**, is distinguished by owning only a portion of the voting stock of its subsidiaries. A pyramid holding company still owns a controlling interest in its subsidiaries, allowing it to control their destinies, but with far less invested capital, since the holding company does not own all of the voting stock.

Utility holding companies, which are holding companies that own electric or gas utilities, exist today as pure, operating, and pyramid holding companies. Later sections provide more information about utility holding companies.

The abuses of consumers and shareholders at the hands of pyramid holding companies of the Roaring Twenties led to their disfavor. In a report to Congress in 1935, President Franklin D. Roosevelt's administration provided a vivid description of the abuses of pyramid holding companies:

By the pyramiding of holdings through numerous intermediate holding companies and by the issue, at each level of the structure, of different classes of stock with unequal voting rights, it has frequently been possible for relatively small but powerful groups with a disproportionately small investment of their own to control and to manage solely in their own interest tremendous capital investments of other people's money.

....

For all this concentration so dangerous to his democracy, the American consumer pays the bill. With a large and often unsound capitalization to support, many holding companies have not been able to be satisfied with reasonable dividends on the securities of their operating companies. They have compelled the consumer to bear the burden of various fees, commissions, and other charges which they levy against their subsidiaries.¹¹

Given all of the mergers and acquisitions currently underway, not only in the electric and gas industries, but also in oil, telecommunications, book publishing, financial services, the Internet, grain & livestock, etc., the concerns expressed by President Roosevelt 64 years ago are appropriate today. Indeed, the pyramid holding company appears to be making a comeback.

For example, Texas Utilities Company, a utility holding company, owns about 280 subsidiaries and 29 affiliates in many countries. Below is a portion of TU's holdings—indentation means that a company is a subsidiary:

```
Texas Utilities Company
  TU United Kingdom Holdings, Inc.
    TU International Holdings Ltd.
      TXU Eastern Holdings Limited
        TU Finance (No. 2) Limited
          TU Acquisitions Limited
            The Energy Group Limited
              Eastern Group plc
                Eastern Generation Limited
                  Anglian Power Generators Limited
```

As the pyramid shows, 9 layers (each a holding company) separate Texas Utilities Company from its Anglian Power subsidiary, a structure comparable to the pyramids of other giant holding companies of the 1920s and 30s. Many other U.S. utility holding companies have foreign holdings with similar layers of pyramiding (see the accompanying case study on the utility holding companies of Texas for more information).

How are corporations financed?

Many corporations are financed by a combination of common stock, preferred stock, and various types of debt, such as corporate bonds. For the typical American industrial corporation, common stock represents about 70 percent of total capitalization, and debt makes up the remaining 30 percent (preferred stock, which in some ways acts more like debt, often contributes anywhere from 0 to 5 percent of total capitalization).

Because of their steady stream of revenues, regulated utilities have a more leveraged capital structure (that is, more debt), with common stock and debt each contributing about 50 percent of total capitalization.

One reason companies sell common stock is to raise money with which to buy plant and equipment. The issuance of common stock also assures lenders that the company is a going concern, and that it will be able to make timely payments on its loans and bonds. With equity

capital (common stock) in place, banks and others will loan money to the corporation so that it can buy additional equipment or hire employees to produce a product, the sale of which creates revenues that are used to make the monthly payments on the loans (as well as to pay for salaries, wages, materials, taxes, and other expenses of doing business) and, if anything is left over, to pay dividends to the owners of the common stock.

Why do companies need to take out loans? Why not just finance the entire corporation with common stock? Loans and bonds are a cheaper source of capital than selling common stock. Since loans and bonds (debt) are a cheaper source of money, it is to the company's advantage to use as much debt as possible because it reduces the cost of doing business.

However, because a company has to make payments on its loans every month, it has to have assets that it can sell in an emergency to raise money to make the payments on the loans. The assets, such as factories and equipment, are often paid for with the proceeds of selling common stock. Thus, all companies have to strike a balance between the use of high-cost common stock and low-cost, but unforgiving, debt.

How do holding companies work?

Douglas Hawes of the law firm LeBoeuf Lamb Leiby & MacRae writes, "One of the special marks of a holding company is that it creates, or appears to create, a new value where one did not exist before."¹² How does a holding company create "new value"?

First, consider a stand-alone utility company with no subsidiaries or affiliates. The company's common stock is held by its shareholders, and the common stock represents about 50 percent of the company's total capitalization. In addition, the company has issued bonds that make up the remaining 50 percent of capital, with the debt (bonds) providing leverage for the equity capital (common stock).

As Hawes explains, since the common stock of the company is held by shareholders, the management of the company cannot use the common stock as an asset to back up additional investments.

However, if the company reorganizes and creates a holding company, the holding company now owns typically all of the common stock of the original company (which has become a subsidiary), and shareholders now own the common stock of the holding company.

The management of the holding company can now use the subsidiary's common stock as an asset to back up investments in other companies. The creation of a holding company provides management with an asset that it did not have access to previously, namely the subsidiary's common stock. Even though no new money was created in the process, the formation of the holding company created for its managers a new asset, thus the special magic of the holding company.¹³

With this new asset (the subsidiary's common stock) in hand, the management of the holding company can take out new loans with which to acquire (buy the common stock of) other businesses. However, by taking on new loans to acquire other companies, the holding company

has **double leveraged** the equity capital of its original subsidiary. The assets and revenues of the original subsidiary now have to support and back up the new loans taken on by the holding company that are being used to acquire other companies.

Thus, the subsidiary's creditors and bond holders are now no longer first in line to get paid back; the people who made loans to the holding company have to be paid back as well. This means the riskiness of the subsidiary's debt has increased, which means the value of the debt has decreased, a point of obvious concern to the holders of these securities.¹⁴ Further, since the subsidiary's debt has become riskier, the subsidiary will have to pay higher interest rates if it wants to issue new debt or take out new loans, potentially increasing the cost of business and thus the prices charged for its products. With potentially fewer customers buying the higher-priced products, the revenues and the profits of the subsidiary could go down, thus potentially threatening the solvency of the entire holding company system (however, if the subsidiary is a monopoly utility that provides an essential service, such as electricity, customers usually have no choice but to purchase the higher-priced electricity. This particular type of consumer abuse is unique to *utility* holding companies, which are more fully explained in a later section).

Therefore, just the creation of a holding company can increase the riskiness and the cost of doing business of the subsidiary. However, this increased risk can be balanced or perhaps even reduced *if the holding company acquires profitable companies*.

As long as the holding company acquires profitable companies, usually everyone is happy. The people who lent money to both the holding company and its subsidiaries get their bond and loan payments on time, potentially making the debt more valuable.

The market value of the common stock of the holding company could increase. This makes shareholders better off through capital gains and potentially increased dividends.

An increase in the value of the holding company common stock can make it easier for the holding company to raise money by selling additional common stock. With additional cash on hand, the holding company can purchase additional common stock from its subsidiaries, making it less expensive for a subsidiary to raise the appropriate amount of equity capital. Less expensive capital means that a subsidiary's cost of doing business has decreased, which could lead to less expensive products and services.

An increase in the market value of holding company common stock also makes it easier to acquire other companies through stock swaps.

The holding company and its subsidiaries may be able to take out new loans or sell bonds at lower interest rates, thus reducing the cost of doing business, which in turn can mean more revenues and profits, with the cycle repeating itself.

However, should the holding company acquire a business that turns out to be a poor performer, then the entire holding company system is potentially threatened. The poor performing subsidiary may need to be propped up with money from other subsidiaries so that the debt holders of the poor subsidiary can be paid on time. Or, the holding company may need to take

out new loans to prop up the poor subsidiary. Any of these actions can hurt the value of the holding company stock and the value of the debt taken on by any of the various pieces of the holding company system. Faced with higher costs of doing business, the revenues and profits of the subsidiaries could be reduced, since fewer customers may be willing to purchase products that are becoming more expensive, with the now vicious cycle repeating itself.

In summary, when times are good, a holding company can increase the profitability and reduce the costs of doing business for all of its subsidiaries, bringing benefits to shareholders, bondholders, and customers alike. However, when times go bad (for example, a poorly performing subsidiary, or a downturn in the economy), the additional leverage created by the formation of the holding company can threaten the profitability and increase the costs of doing business for all of its parts, inflicting losses on shareholders and bondholders while customers shun the higher cost products in favor of cheaper alternatives (again, an option not available to customers of *utility* holding companies—see a later section).

How do holding companies acquire other businesses?

Holding companies often take out loans to purchase other companies, especially smaller companies. The loans allow the holding company to purchase the target company's voting stock.

In addition to taking out loans, holding companies can buy other companies by using its retained earnings, which are the profits that are left over after taxes and dividends have been paid. A holding company's retained earnings come from five sources: (1) the sale of additional stock or debt securities; (2) the common stock dividends that subsidiaries pay to the holding company; (3) revenues from the sale of products and services by the holding company itself; (4) allowances for depreciation of assets; and (5) any gains realized from investing in stocks or bonds.¹⁵

Finally, a holding company can acquire other companies by using its own common stock that it may have on hand for just such a purpose. A holding company can acquire another company by **swapping** its stock for that of the target company's.¹⁶ In order to comply with state laws and the federal tax code, the stock swap often occurs through the use of a **reverse triangular reorganization**.¹⁷ Alan Gasiorek provides a description of the reverse triangular reorganization:

The acquiring parent uses a [**phantom**] subsidiary to affect the transaction. The [acquiring corporation] contributes its voting stock ...usually to a newly created [phantom] subsidiary. That subsidiary merges into the target corporation in accordance with state merger statutes. The [phantom] subsidiary is extinguished, its assets [the voting stock] absorbed by the target corporation. The target then distributes the [voting stock] received in the merger to its shareholders in return for the shares they hold in the target. These target shares are subsequently distributed to the acquiring parent.¹⁸

In summary, holding companies can acquire other companies by (1) taking out loans; (2) using retained earnings, or (3) swapping stock with the target company. A holding company can use all three methods depending on the size of the acquisition, the amount of money and stock the holding company has on hand, and applicable state law and federal law.

What are utility holding companies?

Investor-owned electric utilities have been using the holding company structure since at least 1882, when the predecessor of the United Gas Improvement Company was formed. Other early utility holding companies include the predecessor of the General Electric Company (1890), the North American Company (1890), and the American Light and Traction Company (1900).¹⁹

As defined in the Public Utility Holding Company Act of 1935, a corporation is considered a **utility holding company** if it owns 10 percent or more of the stock of an electric or gas utility (see a later section for more information about PUHCA).

Background on Electric Utilities: Number, Ownership, and Why They Are Regulated

Currently there are about 3,200 distinct electric utilities, of which there are three basic ownership structures: **investor-owned utilities** (which number about 240), which own 78 percent of the assets used to provide electricity; **publicly-owned utilities** (including **municipal utilities** (2,014) and **federal utilities** (10)), which own about 14 percent of electric power assets; and **cooperative utilities** (931), which own about 8 percent of electric power assets.²⁰

Most utilities, whether investor-owned, public, or co-op, have a legal monopoly to be the only supplier of electricity to customers that live in the utility's service territory (many states have begun deregulating electricity service—see a later section for more information). As a customer, you have to buy electricity from your local electric utility. Until 1970 or so, most industry observers believed it was cheaper for one company to produce, transmit, and distribute electricity than if there were several companies, due to the existence of natural monopolies.

A **natural monopoly** exists when sufficient economies of scope and scale exist that make it less expensive for one company to provide a product or service than for many. An **economy of scale** exists when the cost of producing a product decreases as more of the product is made. For example, up until roughly 1970, it was cheaper to produce electricity with a large power plant than with many small ones (since 1970, new technologies have been developed that have reduced the scale economies of electricity production—now it is cheaper to produce power with many smaller plants than with one large one). An **economy of scope** exists when one firm can perform all the steps needed to produce and sell a product more cheaply than if several firms were to do the same. For example, for most of this century it has been cheaper for one firm to generate, transmit, distribute, and sell electricity than for several firms to provide each service separately.²¹

In exchange for their state-granted monopolies, investor-owned utilities are allowed an opportunity (but not a legal guarantee) to recover in rates the costs of doing business (for example, the costs of the power plants, fuel, buildings, wages, depreciation, interest payments, taxes, etc.) plus an opportunity (but not a legal guarantee) to earn a profit on invested capital. Municipal and cooperative utilities also recover their costs of providing electricity through rates, but they are non-profit organizations, so they do not harvest profits from their customers.

Since electric utilities are monopolies, state and federal agencies have had to **regulate** electricity rates and terms of service, otherwise utility owners would charge whatever rates they pleased, or

would provide service to only the most profitable customers. In contrast, **non-regulated** companies produce goods and services the prices of which are determined by the presence of many competing companies pursuing the dollars held by consumers free to choose the best deal.

The electric power system relies on three types of ownership and regulation: (1) ownership by investor-owned utilities whose rates and terms of service are regulated by state and federal agencies; (2) ownership by the public through subdivisions of state government or federal agencies, with rates and terms of service self-regulated by the state and federal agencies that own the system; and (3) ownership by consumer-owned cooperatives, which are also self-regulated by the consumer/members that own the co-op.

What is a registered utility holding company?

A **registered utility holding company** is a holding company that generally owns two or more electric utilities, with each utility typically serving customers within one state. Because of the multi-state nature of these holding companies, state regulators are unable to regulate them, thus the need for federal regulation. In other words, “registered utility holding company” means a **federally regulated** utility holding company.

In 1935, President Roosevelt signed into law the Public Utility Holding Company Act that allows the Securities and Exchange Commission to regulate the corporate and financial structure of utility holding companies to facilitate federal and state regulation in the public interest (see a later section for more information on PUHCA).

As of June 1, 1998 there were 16 electric registered utility holding companies and 3 gas registered holding companies.²²

In contrast, as of November 1, 1997 there were 131 “exempt” investor-owned utility holding companies, which are holding companies that have qualified for exemption from many provisions of PUHCA. Utility holding companies can receive exempt status if: (1) the company's business is conducted primarily within the borders of a single state, or (2) the holding company is a public utility operating within the state in which it is organized or within contiguous states. Since exempt holding companies do business chiefly within one or neighboring states, state utility commissions are supposedly able to regulate them. Nevertheless, all utility holding companies (exempt or registered) must comply with sections 9, 10, and 11 of PUHCA (see a later section for more information on PUHCA sections 9, 10, and 11).

Unitil Corporation, which became a registered holding company in 1992, was the first company to obtain registered status since 1967, reflecting the stable nature of the industry up to 1992. After Unitil, five companies have become electric registered holding companies, four of them since June 1, 1996: Alliant Energy, Inc., Ameren Corp., Cinergy Corp. (1994), Conectiv, Inc., and New Century Energies.

The sharp increase in the number of companies receiving registered holding company status reflects the sharp increase in utility mergers that have occurred since PUHCA was amended by the Energy Policy Act of 1992 (see a later section for more information).

As registered holding companies, these firms must comply with all provisions of the Public Utility Holding Company Act of 1935.

The 16 electric registered holding companies and their subsidiary electric utilities are:

- Allegheny Power System, Inc. (Monongahela Power Co., Ohio Valley Electric Corp., The Potomac Edison Co., West Penn Power Co.)
- Alliant Energy, Inc. (IES Utilities Co., Interstate Power Co., South Beloit Water, Gas & Electric Co., Wisconsin Power & Light Co., Wisconsin River Power Co.)
- Ameren Corporation (Union Electric Co., Central Illinois Public Service Co.)
- American Electric Power Company (AEP Generating Co., Appalachian Power Co., Columbus Southern Power, Indiana Michigan Power Co., Kentucky Power Co., Kingsport Power Co., Ohio Power Co., Wheeling Power Co.)
- Central and South West Corporation (Central Power & Light Co., Public Service Company of Oklahoma, Southwestern Electric Power Co., West Texas Utilities Co.)
- Cinergy Corporation (The Cincinnati Gas & Electric Co., PSI Energy, Inc.)
- Conectiv (correct spelling) (Delmarva Power & Light Co., Atlantic City Electric Co., Chesapeake Utilities Corp.)
- Eastern Utilities Associates (Blackstone Valley Electric Co., Eastern Edison Co., Newport Electric Corp., EUA Ocean State Corp.)
- Entergy Corporation (Entergy Arkansas (formerly Arkansas Power & Light Co.), Entergy Louisiana (formerly Louisiana Power & Light Co.), Entergy Mississippi (formerly Mississippi Power & Light Co.), Entergy New Orleans (formerly New Orleans Public Service, Inc.), Entergy Operations, Entergy Power, Entergy Gulf States Utilities)
- GPU Corp. (Jersey Central Power & Light Co., Metropolitan Edison Co., Pennsylvania Electric Co., GPU Nuclear Corp.)
- New Century Energies (Cheyenne Light, Fuel and Power Co., Public Service of Colorado, Southwestern Public Service Co.)
- New England Electric System (Granite State Electric Co., Massachusetts Electric Co., The Narragansett Electric Co., New England Electric Transmission Corp., New England Power Co.)
- Northeast Utilities (The Connecticut Light & Power Co., Holyoke Water Power Co., North Atlantic Energy Corp., North Atlantic Energy Services Corp., Northeast Nuclear Energy Co., Public Service Company of New Hampshire, Western Massachusetts Electric Co.)
- PECO Energy Company (Susquehanna Power Co.)
- The Southern Company (Alabama Power Co., Georgia Power Co., Gulf Power Co., Mississippi Power Co., Savannah Electric & Power Co., Southern Nuclear Operating Co.)
- Unitil Corp. (Concord Electric Co., Exeter & Hampton Electric Co., Fitchburg Gas & Electric Light Co., Unitil Power Corp.)

The 3 gas registered holding companies and their subsidiary gas utilities are:

- The Columbia Energy Group (Columbia Gas of Kentucky, Columbia Gas of Maryland, Columbia Gas of Ohio, Columbia Gas of Pennsylvania, Commonwealth Gas of Virginia)
- Consolidated Natural Gas Company (The East Ohio Gas Co., The Peoples Natural Gas Co., Virginia Natural Gas, Hope Gas)
- National Fuel Gas Company (National Fuel Gas Distribution Co.)

How many utility holding companies are there?

Today there are 150 investor-owned electric utility holding companies with about 240 utility subsidiaries and 4,200 non-utility, non-regulated subsidiaries.²³ Most investor-owned utilities are subsidiaries of utility holding companies. In some cases, the utility itself is a holding company.

In 1979, there were 58 utility holding companies with about 120 utility subsidiaries and 175 non-utility subsidiaries.²⁴ Why has there been such a large increase in the number of utility holding companies (and non-utility subsidiaries) during the past twenty years?

The answer is three-fold. First, after building too many power plants during the 1970s, many utilities wound down their very expensive construction programs. Since they were no longer spending billions on new power plants, the financial position of many utilities improved during the 1980s, leaving them with extra money on hand. With the intent of increasing profits, utilities began forming holding companies by using the extra money to acquire other (hopefully profitable) companies.²⁵

Second, with the deregulation of the electric power industry a subject for open debate since at least the mid-1970s, many utilities began forming holding companies in preparation for a new wave of mergers and acquisitions that would accompany deregulation.²⁶

Third, holding company promoters believe there are many benefits, in the form of centralized control and reduced costs, that can be achieved by creating a well-managed holding company system.

Although there are potential benefits from the use of the holding company structure, there are also many disadvantages, *especially if the holding company owns both regulated and non-regulated subsidiaries*. Further, many benefits from holding companies accrue to management and (occasionally) shareholders, while consumers and workers may see higher prices and layoffs. The benefits and disadvantages of holding companies, and the special disadvantages of *utility* holding companies, are the subject of the next three sections.

What are the advantages of holding companies?

In addition to the potential to increase profits by acquiring other profitable companies, and the reduced investment risk of owning a diversified set of companies, holding companies offer other potential advantages.

As was mentioned earlier, the formation of a holding company creates a new asset (the common stock of its subsidiary) which can be used by the management of the holding company to acquire

other businesses. This is the special magic of the holding company that is not available in other corporate structures.

Also mentioned earlier, a successful holding company may be able to reduce the cost of equity capital. It may also be able to take advantage of lower-cost debt. Less-expensive equity and debt means the cost of doing business can be reduced, allowing subsidiaries of the holding company to offer lower prices for its products and services, thus increasing sales.

By owning the voting stock of its subsidiaries, the board of directors of the parent holding company has direct control over the boards and management of its subsidiaries. This gives the parent holding company control over budget priorities and the allocation of financial resources for the holding company system. Thus, the parent holding company has the legal authority to control the direction of the entire system in the hope of maximizing profits and efficiency.

All of the subsidiaries can potentially benefit by sharing engineering, construction, administrative, purchasing, accounting, financial, legal, public relations, insurance, pension, and marketing services. Instead of having each company fend for itself, the holding company system can arrange for the provision of all of these services for all of its subsidiaries, with all of the potential cost savings available from the efficient use of shared resources. Cost savings not only make a company more profitable, but reduced costs can also be passed on to consumers in the form of lower prices.²⁷

Companies organized in a holding company structure can reduce their tax exposure. If done correctly, the federal tax code considers acquisitions by holding companies as tax-free reorganizations.²⁸ Thus, the tax code appears to encourage acquisitions by holding companies by ultimately reducing the taxes paid by the previously separate companies.

If the holding company owns 80 percent or more of the voting stock of the acquired company, as well as 80 percent or more of the value of all outstanding stock (voting or nonvoting), the holding company can use **consolidated accounting** of the income, expenses, assets, and liabilities of all subsidiaries so owned. Consolidated accounting allows the holding company to reduce taxes by offsetting gains in one subsidiary with losses in another. Reduced taxes can increase the profits of the holding company system.²⁹

Because holding company systems often diversify into different lines of business, they can better weather changes in the business cycle.

Just as the holding company structure makes it easy to acquire other companies, it also makes it easy to sell subsidiaries, because they keep their own legal identities, their own management, and their own board of directors.

Finally, a *utility* holding company may have skills and resources that cannot be fully deployed because of constraints imposed by regulation, such as fixed service territories, restrictions on the types of services and products it can sell, and other limitations. By acquiring other companies, a utility holding company may be able to more fully utilize its abilities and assets.

What are the disadvantages of holding companies?

Since holding companies are formed from mergers and acquisitions, employees are often laid off in their wake. Firing workers is one of the easiest ways for management to reduce business costs and increase short-term profits. The loss of thousands of jobs is perhaps the most troubling aspect of holding company acquisitions.

Next, as a holding company acquires a company in the same line of business, the acquisition eliminates a potential competitor. Although holding companies may justify the acquisition on the grounds of economies of scope and scale, they may be trying to reduce or eliminate competition by buying their competitors. This strategy may allow the holding company (and its subsidiaries) to raise the price of goods and services above the level that would have resulted if more competitors were present. In other words, the holding company could increase prices and profits because too few competitors are present. Obviously, an unnecessary increase in prices harms consumers.

Andersen Consulting has found that less than half of 43 recent utility mergers have made shareholders better off.³⁰ Mercer Management Consultants found similar results: only 12 of 33 utility acquisitions resulted in increased revenues and profit growth, whereas the remaining 21 acquisitions actually saw a decrease in revenues and profits.³¹

The poor performance of many utility mergers mirrors the poor performance of mergers in general. Looking at thousands of mergers within many types of industries, Andersen Consulting found that shareholders were made worse off in 57 percent of the mergers, and only 25 percent of the surviving companies had above average financial performance.³²

Beyond Wall Street standards, claims of better customer service and lower consumer prices are almost impossible to verify since little data is available by which to benchmark such claims, especially when the applicants are regulated utilities.

As holding companies become larger and larger, their economic and political clout also increases. Recent merger announcements, such as the proposed Exxon acquisition of Mobil (both of which are holding companies), would create a company with annual revenues of over \$180 billion, larger than General Motors. If Exxon-Mobil were a nation it would have the 18th largest economy in the world, larger than Denmark, Finland, Austria, and Greece. Put another way, a combined Exxon-Mobil would have operations in 150 countries; in over a 125 of these countries Exxon-Mobil's revenues would be larger than the country's gross domestic product, making it difficult for governments to regulate Exxon-Mobil's activities. Combined, Exxon and Mobil gave over \$700,000 to Congressional candidates in the last election—together ranking in the top five of the largest corporate political action committees (for more information on Exxon-Mobil, see our website at www.citizen.org/cmep/).

Large holding companies usually get the red carpet treatment when they knock on a lawmaker's door. Unless they are wealthy, individual voters rarely get similar access to politicians. Currently, many corporations are providing politicians with enormous campaign contributions in exchange for the introduction of legislation that would eliminate laws and regulations that

protect consumers, workers, and the environment (for more information on campaign finance reform and regulatory rollback, see our website at www.citizen.org/congress/).

On a global scale, holding companies and corporations are trying to eliminate social safety nets, environmental laws, labor unions, and restrictions on capital to make it easier for them to rake in profits (for more information on global trade issues, see our website at www.citizen.org/pctrade/tradehome.html).

Large holding companies can also dominate regulatory procedures that, in theory, were designed to protect public health and safety. For example, pharmaceutical companies have considerable influence over the Food and Drug Administration, forcing it to declare food additives and drugs safe before they have been adequately tested (for more information on health care issues, see our website at www.citizen.org/hrg/).

Other disadvantages of holding companies have been summarized by Constantinos Markides,³³ many of which are outlined below.

Although benefits can be realized by bringing together various companies under one roof, perhaps the greatest risk of a holding company system is that it can diversify away from its core business and enter lines of commerce in which it may not have adequate expertise.

A growing holding company system is faced with the need to recruit, train, and hire new management as additional subsidiaries are acquired. Also, the management of the subsidiaries may shirk their responsibilities in the belief that the parent will do the hard work.

The holding company system incurs extra corporate costs because each subsidiary maintains its own board of directors, management, and the ability to issue securities.

Holding company management can become more and more removed from the day-to-day activities of its subsidiaries as additional companies are brought into the fold. Thus, holding company management may make decisions that do not help a particular subsidiary.

If a holding company system becomes too big, the sharing of engineering, construction, administrative, purchasing, accounting, financial, legal, public relations, insurance, pension, and marketing services can actually become less efficient and more expensive, potentially dragging down the whole system.

A holding company system can also fall prey to the desires of management and investment bankers to make the system bigger for the sake of bigness (big assets for big egos). Mergers and acquisitions provide hefty commissions for stock underwriters, investment bankers, accountants, and lawyers. The Andersen Consulting study of thousands of mergers mentioned previously, which shows that most mergers harm shareholders, confirms that shareholders are often mistreated by greedy management and investment bankers.

The value of the holding company system can also fall prey to “stock watering,” in which the value of the stock of the holding company becomes inflated beyond the real value of the assets that underlie it. Markides (who cites Jacoby) explains the phenomenon:

A ‘growth’ company whose stock is selling at a high multiple [that is, price-to-earnings ratio, or P/E] acquires a low P/E company. As a result the earnings per share (EPS) of the acquiring company increases (by simple arithmetic). The market applies the high multiplier on the new [higher] EPS, and so the price of the [acquiring] firm goes up. As Jacoby argues: “This makes further acquisitions through exchange of stock attractive. They are the basis of a further expansion in reported earnings per share and further inflation of the price of the stock.... [This] can continue until the public recognizes that there is no growth in the operating earnings of the acquired companies. The price of the [holding company’s] stock then plummets to a point where the P/E ratio is normal.” ... [The] effect on the firm could be harmful: It creates incentives for the firm to continue its diversification (through acquisitions), even beyond the optimal level.³⁴

Because of these risks, it has been argued that holding companies offer little attraction to investors, who can diversify their risk by investing in different companies rather than investing in a holding company.

What are the particular disadvantages of utility holding companies?

Utility management in particular may not be very good at running other companies. Indeed, the \$200 billion bailout of poorly-managed investor-owned utilities, currently underway throughout the nation, proves that the management teams of many utilities were not capable of efficiently running their own companies.³⁵ Through the use of utility holding companies, the management teams of many utilities are now spreading their apparent lack of skill into many other lines of business, to the potential detriment of shareholders, bondholders, and consumers alike.

Second, many utility holding companies are expanding their reach by acquiring other utilities. Moody’s Investment Services is bearish about the prospects of utility acquisitions:

Near-term merger-related savings are limited to cuts in non-fuel operation and maintenance [26%], and interest expenses [12%], which represent only 38% of total generating costs. Moody’s believes that a significant portion of such savings could be achieved outside of the context of a business combination. Merger-related savings over and above what could otherwise be achieved often must be used to offset transaction expenses, which are not insignificant.³⁶

Since plant investment [11%] has already been made and many fuel expenses [47%] are incurred pursuant to long-term contracts, there is not much that utilities can do to reduce costs quickly in these two areas, which together represent 58% of generation costs. Therefore, it appears that companies can impact costs most immediately by reducing non-fuel operating and maintenance and interest expenses, which together account for 38% of their generating costs.³⁷

In addition to the two problems just noted, all of the disadvantages mentioned in the previous section apply to utility holding companies. In addition, **utility holding companies present a special problem because they often bring together regulated and non-regulated companies into one corporate family.**

Not only do utility holding companies own subsidiaries that require regulation, such as electric utilities, many also own subsidiaries that provide non-utility (or non-regulated) services, such as real estate services, appliance sales and repair, financial services, agricultural companies, certain types of telecommunications, even coal mines, and many others.

Any time regulated and non-regulated companies are brought together in a holding company system, there is the potential for **cross-subsidies** to flow from the regulated subsidiary to the non-regulated subsidiary, to the detriment of consumers, competitors, and shareholders.

Any time regulated and non-regulated services are sold by affiliates in the same holding company system, regulators must review the transactions of money and services between affiliates to prohibit cross-subsidies between the regulated and non-regulated services.

As was mentioned earlier, state and federal agencies have had to **regulate** electricity rates and terms of service, otherwise utility owners would charge whatever rates they pleased, or would provide service to only the most profitable customers. In contrast, **non-regulated** companies sell a product the price of which is not regulated. For example, appliance dealers sell, install, and repair appliances, the prices of which are determined by the market forces of supply and demand. Since there are many appliance dealers, consumers are free to shop to find the best deals, and there is no need to regulate the price of appliances or the price to install and service them.

Cross-subsidies occur when the regulated utility subsidiary pays excessive prices for services provided by the holding company or by other non-regulated affiliates. For example, if the utility purchases engineering, construction, or administrative services from the parent holding company, the holding company may attempt to charge the utility excessive fees in the hopes that the utility will be able to pass these excessive fees to its ratepayers. Since the ratepayers have to buy electricity from the utility, they will have to pay higher rates to cover the excessive fees required by the parent holding company. It is up to regulators to ensure that this type of ratepayer abuse does not happen.

Another type of cross-subsidy occurs when the regulated utility subsidiary provides staff, office space, or equipment to non-regulated affiliates at subsidized prices or no price at all. For example, a non-regulated affiliate may rent office space from the utility. The cost of the building used by the utility is paid for by the ratepayer. If the utility allows the non-regulated affiliate to use the office space for free or at reduced rent, then ratepayers are providing a subsidy to the non-regulated affiliate.³⁸ Again, it is up to regulators to make sure this abuse does not occur.

Analysts have given names to specific types of cross-subsidies. One type is called **self-dealing**, in which, for example, a utility manipulates the operation of the transmission system so that an affiliate that owns power plants can make excessive profits by dominating the market for electricity.

A specific type of self-dealing is known in anti-trust law as **tying**, in which the sale of a regulated product is *tied* to the sale of a non-regulated product.³⁹ For example, a utility could charge a higher price for electricity (the regulated product) unless the customer agrees to also purchase an air conditioner maintenance contract (the non-regulated product) from an affiliate of the utility. As another example, the utility could *refuse* to provide a customer with electricity service unless the customer purchases an appliance maintenance contract from the utility's unregulated affiliate.

Another type of cross-subsidy is **improper transfer pricing**, in which one affiliate charges high prices for services provided to a regulated affiliate. Or, the regulated affiliate provides services at low prices to the non-regulated affiliate.

A third type of cross-subsidy is **improper cost allocation**, in which the regulated affiliate covers the costs for employees, buildings, equipment, name & logo, customer lists, and other assets that are also used by the non-regulated affiliate for free or low prices.

How do cross-subsidies harm ratepayers, competitors, and shareholders?

Cross-subsidies harm ratepayers because they end up paying higher rates for purchasing regulated services, with some of their rates being used to subsidize other services provided by non-regulated affiliates that the ratepayer may not even use. Since ratepayers have to buy the regulated product, ratepayers are often forced to pay higher rates to cover these subsidies.

President Franklin Roosevelt was particularly critical of utility holding companies and their cross-subsidies: "In its destruction of local control and its substitution of absentee management, [the utility holding company] has built up in the public-utility field what has justly been called a system of **private socialism** which is inimical to the welfare of a free people."⁴⁰

President Roosevelt equated private socialism with cross-subsidies because ratepayers end up paying for cross-subsidies through higher rates. The higher rates are a similar to a tax that is collected by a private, investor-owned corporation, hence the term "private socialism."

Forcing ratepayers to pay for cross-subsidies is the principal problem of a holding company that owns regulated and non-regulated companies. This is why the nickname **combine** is so appropriate for a utility holding company. "Combine" comes from "combination," since holding companies are a combination of businesses. However, "combine" is also the nickname of farm machinery that harvests and threshes grain—**utility holding companies are similar to combines because they harvest and thresh money from ratepayers.**

Competitors suffer because the non-regulated affiliates are receiving subsidies from ratepayers, allowing the affiliates to unfairly reduce prices to either take customers away from their competitors or to drive them out of business. For example, many small business contractors that provide air conditioning, heating, electrical, plumbing, appliance sales, and appliance repair services are facing unfair competition from utility affiliates propped up with cross-subsidies that ultimately come from the ratepayer. When a small business owner pays his or her monthly power

bill, they are likely providing subsidies to holding company affiliates that are trying to put them out of business.⁴¹

Shareholders and bondholders of the utility holding company are potentially harmed because cross-subsidies impose burdens on various parts of the holding company system, making securities more risky and less valuable.

Shareholders and bondholders of firms that compete with utility affiliates suffer because their securities are made less valuable through unfair competition by subsidized affiliates of utility holding companies.

How do subsidies flow from the ratepayer to the utility holding company?

As was mentioned earlier, a utility holding company's retained earnings comes from five sources: (1) the sale of additional securities; (2) the common stock dividends that subsidiaries pay to the holding company; (3) revenues from the sale of products and services by the holding company itself; (4) allowances for depreciation of assets; and (5) any gains realized from investing in stocks or bonds.

Ratepayers can end up paying subsidies to the utility holding company by any combination of 2 through 4. Remember, ratepayers have to buy the regulated service because there are no alternatives.

The rates for regulated services provided by investor-owned utilities are determined by state (and sometimes federal) regulators. The regulator determines a utility's **revenue requirement**, which is the amount of money paid by ratepayers to pay back the utility for providing electric service. The revenue requirement is determined by adding up the **operating costs** of providing electricity (**engineering, construction, administrative, purchasing, accounting, financial, legal, public relations, insurance, pension, and marketing services**; fuel costs, wages, salaries, maintenance, **interest charges, capital charges, depreciation allowances**, and taxes) as well as adding on the **profit** demanded by those who provided equity capital to the utility, which is paid as **dividends** to stock holders. **Rates** are determined by dividing the revenue requirement by the number of customers.⁴²

Most regulatory commissions establish a utility's revenue requirement (and therefore the rates) for the next few years into the future. In order to generate the largest revenues possible, utility management tries to show on paper that its operating costs and need for profits are higher than what may actually occur. Then the utility charges ratepayers the approved rates and collects its revenues and profits. After a few years the regulators may conduct a **rate case** to review part or all of the process of determining rates to make sure the utility is not taking too much money from the ratepayers.

Nevertheless, if the utility was successful in arguing for higher rates than were actually needed, then the utility will have unfairly collected too much money from the ratepayers. Also, if the utility cuts its costs (usually by laying off workers), then the utility again will have collected too much money from the ratepayers.

By charging higher rates, the holding company that owns the utility can end up with extra ratepayer money. First, the holding company itself may provide the utility with the engineering, construction, administrative, purchasing, accounting, financial, legal, public relations, insurance, pension, and marketing services that make up part of the utility's operating costs. The holding company may try to charge high fees for providing these services, in the hopes that regulators will allow (or not even notice) the utility to charge ratepayers for these high fees. Similarly, the holding company may attempt to charge high interest and capital charges to the utility, with the utility passing on these high charges to the ratepayer. **Therefore, utility holding companies may receive subsidies from ratepayers for charging high fees and charges for services provided to the utility.**

Instead of the holding company, often another subsidiary provides the utility with corporate services. Either way, ratepayer money ultimately flows to the holding company system.

Depreciation allowances (which are given to the utility for the wear and tear (or the "using up") of power plants and equipment) may also be inflated or accelerated, allowing the utility to charge higher rates to ratepayers. Also, the utility may try to ask for too much profit. **Both actions can unfairly increase the revenues and profits of the utility, its parent holding company, and other affiliates in the holding company system.**

Since the ratepayer has no choice but to buy the regulated service, ratepayers are easily **milked** by the numerous ways holding companies and their utilities can **cook the books**, increasing revenues, profits, and dividends, all at the expense of the captive ratepayer.

The only thing standing in the way of the abusive practices of the utility holding company is the regulator.

Do stranded cost bailouts help build utility holding company empires?

Across the country, electric utilities are receiving a **ratepayer-funded bailout** of their bad investments in power plants (so-called **stranded costs**, which are power plants, power contracts, and other assets that need subsidies to keep operating). In particular, electric utilities that invested in nuclear power plants may receive a ratepayer-funded bailout of at least \$100 billion.⁴³

Instead of receiving billions of ratepayer dollars for their obsolete, dangerous, and polluting nuclear reactors, electric utilities should be required to write-down the value of these overpriced assets, as other companies do when they make bad investments. However, the utility lobby has been able to convince many legislators and regulators in nearly two dozen states (and at the federal level) to pass bad laws and bad regulations that are forcing ratepayers to hand over billions of dollars, with some of this money ultimately flowing to utility holding companies.

As mentioned in the previous section, subsidies from ratepayers to holding companies can flow in the form of common stock dividends that subsidiaries pay to the holding company; revenues from the sale of products and services by the holding company itself; and allowances for depreciation of assets. When an electric utility receives a stranded cost bailout, ratepayer money can flow to the holding company that owns the utility through all three routes.

Stranded cost bailouts give utilities billions of dollars, which they can use however they please. As an analogy, if you had to make payments on a car, and someone hands you twenty thousand dollars, you could pay off the car, or take a vacation, or even buy another car. When utilities receive a stranded cost bailout, they may be able to pay higher dividends to the holding company. Or, the utility may be able to purchase additional services from the holding company or an affiliate. Or, the utility can increase depreciation charges for the obsolete power plants, or increase amortization payments for expensive power contracts, or pay off expensive loans. All of these mechanisms increase the flow of money from the ratepayer to the holding company.

Therefore, stranded cost bailouts unfairly give more ratepayer money to utility holding companies, which have been using the extra cash to expand their empires by purchasing other companies, while rates remain high (see the accompanying case study on the utility holding companies of Texas).

Can regulation of utility holding companies reduce cross-subsidies?

Because utility holding companies have always played a dominant role in the electric power industry, the attempt to eliminate cross-subsidies by regulating **affiliate transactions** has been one of the regulators' principle jobs.⁴⁴ The policing of affiliate transactions requires that regulators have access to the books and records of all the companies in a holding company system, so that regulators can inspect or audit the transactions between regulated and non-regulated subsidiaries.

However, regulation of affiliate transactions has always been expensive, obtrusive, and ultimately ineffective.

There are three approaches in regulating affiliate transactions to reduce cross-subsidies. The first approach is to prohibit the mixing of regulated and non-regulated businesses in the same holding company system, thus *eliminating* transactions between regulated and non-regulated affiliates. This approach is known as a **structural remedy** to the problem of affiliate transactions because it prohibits the use of a corporate structure, namely the holding company, which allows the ownership of regulated and non-regulated companies, the very root of cross-subsidies. Structural remedies are favored by the Federal Trade Commission, the Department of Justice, and others (including Public Citizen).⁴⁵

The second and third approaches are known as **behavioral remedies**, which means that regulators try to control the behavior of utility holding companies to reduce cross-subsidies. One approach is to require that the holding company notifies the regulator in advance, or even seeks regulatory approval, before it engages in certain affiliate transactions or acquisitions. The other approach has a regulator deciding whether the transaction was appropriate after the transaction took place.

For both approaches, "the key to effective regulatory control [of affiliate transactions] is the same: access to detailed information about both the specific transaction in question and the general business, operations, costs, and profitability of the affiliate."⁴⁶

For either behavioral approach, regulators need to determine whether the affiliate transaction was priced appropriately.⁴⁷ Or, regulators need to determine whether the rate of return enjoyed by the affiliate is reasonable when compared to the returns enjoyed by the utility and to non-affiliated competitors.⁴⁸ Both determinations require that regulators make extensive reviews of the costs of providing the service in question, what the service would have cost if provided by a non-affiliate, or a thorough examination of the return enjoyed by other non-affiliated suppliers of the service.

All of this data gathering and examination concerning the appropriateness of affiliate transactions is way beyond the capability of state and federal regulatory commissions, since most have far fewer staff and resources than needed to police thousands of affiliate transactions.⁴⁹

Further, holding companies often dispute the findings of a regulator concerning the appropriateness of the affiliate transaction, often taking the matter to court, where the lawyers of the holding company almost always make their case with more legal resources (paid for by the ratepayer) and more information than the regulators.⁵⁰

Competitors harmed by cross-subsidies have a similar uphill battle in stopping abusive affiliate transactions.⁵¹ Competitors, usually much smaller than utility holding companies, have far fewer resources with which to pursue justice. Competitors have restricted access to information about the affiliate transactions in question. Even if competitors had perfect access to information, holding companies often appeal any ruling made against them, delaying any compensation or remedy to the aggrieved small business. Finally, the competitor may have gone out of business long before any court or regulatory agency could come to the rescue. In short, given that there are thousands of affiliate transactions within any given holding company system, regulators can do little more than scan the books of the affiliates of the holding company to determine if abuses are occurring, a situation far from adequate.⁵²

All of this regulatory scrutiny, including an intrusive requirement to inspect the books and records of non-regulated affiliates, plus all of the legal costs associated with enforcing transaction rules, represents a huge cost that ratepayers and private businesses have to pay just to allow holding companies to own both regulated and non-regulated businesses. Indeed, even the non-regulated affiliates suffer by having regulators probe their books and records, in what the companies like to call “fishing expeditions.”⁵³

Another cost to both society and to private capital is the number of companies that have been put out of business when trying to compete against holding company affiliates receiving cross-subsidies from regulated affiliates.⁵⁴

Therefore, regulation of affiliate transactions has always been expensive, obtrusive, and ultimately ineffective.

What problems were caused by the holding companies of the Roaring Twenties?

After the first World War, the U.S. economy entered the Roaring Twenties, a period of unprecedented economic boom. Electricity use exploded, and holding companies began merging and consolidating into empires that stretched across state and national borders. Although some

operating efficiencies resulted from these mergers, many were done to increase profits and to escape state regulation; state regulatory commissions were and remain powerless from controlling the operations of holding companies or subsidiaries organized in other states. Prior to 1935 there was no federal regulation of utility holding companies, so for most purposes they were unregulated monopolies.

During the Roaring Twenties, utility holding companies not only bought other utilities, they also diversified into non-utility businesses, such as foreign utilities, real estate firms, cotton mills, paper mills, ice companies, and others.

The Roosevelt administration noted that “in 1929 and 1930 twenty large holding-company systems controlled 98.5 percent of the transmission of electric energy across State lines.”⁵⁵ As Hawes describes, “In 1932, about 49 percent of the investor-owned electric utility industry was controlled by three super holding companies: the Electric Bond and Share Group, the Insull empire, and the United Corporation Another 35 percent of investor-owned electric utilities were controlled by the next twelve largest systems.”⁵⁶ Said another way, Professor Joel Seligman of the University of Arizona notes that these three holding companies produced 45 percent of the electricity generated in the U.S.⁵⁷

The Electric Bond and Share Group owned utilities scattered throughout the U.S. including Washington Water Power Co., Utah Power & Light Co., Montana Power Co., Texas Power & Light Co., Arkansas Power & Light Co., Minnesota Power & Light Co., Ohio Power Co., Pennsylvania Power & Light Co., and Florida Power & Light Co (these were the names of the utilities circa 1935, many of these names are still in use today). It also owned numerous non-utility subsidiaries.

The Insull empire (named after Samuel Insull, the father of the state-regulated investor-owned utility and a leading promoter of utility holding companies) also owned utilities scattered throughout the U.S., including Central Power & Light Co. (Corpus Christi, Texas), West Texas Utilities Co., Public Service Co. of Oklahoma, Wisconsin Power & Light Co., Central Illinois Public Service Co., Commonwealth Light & Power Co. (Chicago), Kentucky Utilities Co., Pennsylvania Central Power & Light Co., Virginia Public Service Co., Jersey Central Power & Light Co., and Maine Central Power Co. It too owned many non-utility subsidiaries.

Like its brethren, the United Corporation too was a far-flung empire, consisting of utilities such as Cincinnati Gas & Electric Co., Ohio Edison Co., Niagara Hudson Power Corp., Philadelphia Electric Co., Public Service Electric & Gas of New Jersey, Connecticut Light & Power Co., Alabama Power Co., and Georgia Power Co. Like other holding companies of the day, it owned many non-utility subsidiaries.

The wave of diversification and consolidation quickly got out of hand, largely because state commissions were unable to regulate utilities or holding companies organized in other states. With completely ineffective regulation, utility holding companies were forcing ratepayers to pay for excessive charges and cross-subsidies between regulated and non-regulated affiliates, while shareholders were being sold watered stock.

As the electric power industry grew, utility engineers and economists realized that by connecting power plants together with transmission lines, utilities could share power plants, thus reducing the cost of producing power and increasing system reliability. However, the large holding companies owned utilities scattered throughout the U.S., making it mostly impossible for economic interconnection. Indeed, the motivation for buying utilities was for profit, not for achieving the economies of scale that can lead to lower prices and increased reliability. Again, the Roosevelt administration:

The growth of the holding-company systems has frequently been primarily directed by promoters' dreams of far-flung power and bankers' schemes for security profits, and has often been attained with the great waste and disregard of public benefit which might be expected from such motives. Whole strings of companies with no particular relation to, and often essentially unconnected with, units in an existing system have been absorbed from time to time. The prices paid for additional units not only have been based upon inflated values but frequently have been run up out of reason by the rivalry of contending systems. Because this growth has been actuated primarily by a desire for size and the power inherent in size, the controlling groups have in many instances done no more than pay lip service to the principle of building up a system as an integrated and economic whole, which might bring actual benefits to its component parts from related operations and unified management. Instead, they have too frequently given us massive, overcapitalized organizations of ever increasing complexity and steadily diminishing coordination and efficiency.⁵⁸

With the stock market crash of October 1929, many of these overleveraged holding companies came tumbling down. According to Seligman:

But the far-flung geographic dispersion of the utility holding companies and their immense size far exceeded economies of scale. And the stock market crash and ensuing depression rebutted the utilities' claims of efficiency. Although, between 1929 and 1936, utility operating companies' revenues dropped only about 15 percent from their highest historical levels, fifty-three utility holding companies with \$1.7 billion worth of securities outstanding [about \$12 billion in today's dollars] went into receivership or bankruptcy. Twenty-three other utility holding companies with about \$535 million [\$4 billion] of outstanding securities defaulted on interest payments and voluntarily offered readjustment plans. During the same seven-year period, fifty-three operating companies with \$600 million [\$4.3 billion] of outstanding securities either were forced into bankruptcy or receivership or voluntarily sought a readjustment plan.⁵⁹

Although states began passing laws in the 1930s to curb holding company abuses, out-of-state holding companies, and out-of-state subsidiaries, were and remain today beyond the jurisdiction of state commissions, thus the need for federal regulation.

Why did Congress enact the Public Utility Holding Company Act of 1935?

In response to the abuses of ratepayers and shareholders at the hands of utility holding companies, President Franklin Roosevelt signed into law the Public Utility Holding Company Act of 1935 (PUHCA, pronounced POO-kah).⁶⁰

The goal of PUHCA is to allow effective federal and state regulation of multi-state utility holding companies. PUHCA gives the Securities and Exchange Commission (SEC) authority to regulate utility holding companies and their subsidiaries. Along with PUHCA, amendments to the Federal Power Act were also enacted, giving the Federal Power Commission (now known as the Federal Energy Regulatory Commission) the authority to regulate the transmission of electricity in interstate commerce, and the sale of electricity at wholesale in interstate commerce. PUHCA and the Federal Power Act work in tandem to provide for the regulation of multi-state utility holding companies that are otherwise beyond the reach of state regulation.

Drawing from the Act itself, Hawes provides an excellent summary of why PUHCA was enacted:

Congress found that investors and consumers are or may be adversely affected when:

1. Investors cannot obtain adequate information to appraise the financial position or earning power of the issuers because of the absence of uniform standard accounts.
2. Securities are issued without the consent of states.
3. Securities are issued on the basis of fictitious or unsound asset values bearing no fair relationship to the amount invested or earning power of the properties, and on the basis of paper profits from intercompany transactions or in anticipation of excessive revenues from utility subsidiaries.
4. Securities that require the utility to support an overcapitalized structure and tend to prevent voluntary rate reductions are issued.
5. Utility subsidiaries are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions where arm's length bargaining is absent and free competition is restrained.
6. Service, management, construction and other contracts involve the allocation of charges among utility subsidiaries in different states so as to make effective state regulation difficult.
7. Control of utility subsidiaries affects the accounting practices, rates, dividends, and other policies of such companies so as to complicate and obstruct state regulation.
8. Control of utility subsidiaries is exerted through disproportionate investment.
9. The growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties.
10. There is a lack of economy of effective public regulation.
11. There is a lack of economies in the raising of capital.⁶¹

What are the most important provisions of PUHCA?

PUHCA defines that a corporation is considered a **utility holding company** if it owns 10 percent or more of the voting securities of an electric or gas utility (Section 2(a)(7)). It also defines that a corporation that owns 5 percent or more of the voting securities of another company is an **affiliate** of a that company (Section 2(a)(11)(A)). It also captures shareholders who have a **controlling influence**, or the ability of a minority shareholder to effectively control the corporation (Section 2(a)(7)(B)). Both the inclusion of numerical benchmarks and the concept of controlling influence were firsts for American law.⁶²

The most important provision is Section 11, Simplification of Holding Company Systems. This section forces utility holding companies into “a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system.” This provision is further buttressed by the definition from Subsection 2(a)(29): “integrated public-utility system means, ...a system consisting of one or more units of generating plants and/or transmission lines and/or distribution facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation.”

This part of Section 11 allows holding companies to own other utilities only if the utilities are adjacent to each other, and they can be connected to each other, and they can be operated as a single system. As was mentioned earlier, utilities that share each others’ power plants can reduce costs to the consumer as well as increase the reliability of the system. The logic of PUHCA, which is still relevant today, is that if utilities cannot be connected to each other into a single system, few savings will result to the consumer, and therefore a holding company has to sell off or cannot acquire the non-integrating utility. Also, forcing holding companies into integrated systems makes it easier for state and federal regulators to prevent ratepayer abuse.⁶³

Another important part of Section 11 is known as the **death sentence clause**,⁶⁴ which is “to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders....” The structural effect of this clause is to prohibit holding companies from owning subsidiaries that also own holding companies. The practical effect prohibits the pyramiding of holding companies, and it also attempts to prohibit minority “controlling interests,” which can greatly complicate the ownership of a utility. This clause makes it easier for state and federal regulators to prevent shareholder abuse.

Other important provisions are Section 9, which requires holding companies to receive advance approval from the Securities and Exchange Commission before acquiring other utilities or businesses; and Section 10, which imposes conditions on any acquisition by a holding company. In particular, Section 10 prohibits acquisitions by utility holding companies that would violate the integration and simplification provisions of Section 11 that were explained above. Even

today, Sections 9, 10, and 11 work together to keep utility holding companies from recreating the pyramided, far-flung empires that were so detrimental to the interests of consumers and shareholders.⁶⁵

Section 3 defines how utility holding companies can receive exemption from most of PUHCA's provisions. Utility holding companies can receive **exempt** status if: (1) the holding company and each of its subsidiary utilities are incorporated in a single state, and that they do business primarily within the borders of that state, or (2) the holding company itself is a public utility operating within the state in which it is incorporated or within contiguous states. Since exempt holding companies do business chiefly within one or neighboring states, state utility commissions are supposedly able to regulate them. As of November 1, 1997 there were 131 "exempt" investor-owned utility holding companies.

In contrast to exempt holding companies, there are **registered** holding companies, which must comply with all of the provisions of PUHCA. Registered holding companies are also known as **multi-state**, or **federally regulated** holding companies, of which there are currently 19 (see a previous section for a list of registered holding companies).

Simply put, exempt holding companies operate in a single state (more or less) and are primarily regulated by state commissions and FERC, whereas registered holding companies own utilities in several states and are regulated by state commissions, FERC, and the SEC.

Importantly, all utility holding companies (exempt or registered) must comply with Sections 9, 10, and 11 (discussed above).⁶⁶

Finally, PUHCA prevents non-utilities from owning utilities. For example, if General Motors acquired a U.S. based electric utility, GM would fall under PUHCA. Since GM's car manufacturing has nothing to do with producing electricity, GM would have to sell all of its non-utility assets, something GM is not likely to do (GM can own a power plant, but not a utility).

What happened after PUHCA was enacted?

PUHCA effectively abolished all pyramid holding companies that were more than twice removed from their operating subsidiaries, making it easier for state and federal regulators to control utility activities. It also forced holding companies into owning adjacent utilities that can be operated as single electrical systems, allowing for lower cost electricity and greater reliability through integrated and coordinated operation.

As summarized by Professors Phillip Blumberg and Kurt Strasser of the University of Connecticut:

When the restructuring requirements of [PUHCA] became effective in 1938, there were 214 utility holding companies owning 922 gas or electric operating companies and 1,054 non-utility companies. Under the [Security and Exchange] Commission's effective enforcement of the Act, holding companies divested 839 operating utility subsidiaries worth \$1.3 billion [about \$9 billion in today's

dollars]. By 1955, only 25 registered utility holding companies with 171 electric and gas subsidiaries and 137 non-utility subsidiaries remained.⁶⁷

Beyond the reduction in the numbers of utility holding companies, the Act was a boon to shareholders, who were greatly battered due to the watered stock and the pyramid nature of the pre-PUHCA holding companies. A study by the Securities and Exchange Commission found that the common stocks of the largest utility holding companies had outperformed the Dow Jones Utilities Average during the period 1938 to 1951. These gains came as the result of the corporate simplification requirements of Section 11, as well as other provisions of PUHCA that protect shareholders from abuse at the hands of utility management.⁶⁸

Shareholders were not the only ones to see benefits from the enactment of PUHCA. Ratepayers benefited as well, with average monthly bills for ratepayers dropping 10 to 14 percent (depending on the amount of power used) between 1938 and 1951. These gains to ratepayers were realized by the integration requirements of Section 11.⁶⁹

Does PUHCA regulate cross-subsidies?

To combat cross-subsidies, holding companies subject to PUHCA face restrictions in owning non-utility businesses. Section 11 requires that any subsidiary owned by a **registered** holding company must provide a service that is “reasonably incidental, or economically necessary or appropriate to the operations of such integrated ... utility system.”⁷⁰ This provision of PUHCA attempts to reduce cross-subsidies between regulated and non-regulated affiliates by limiting the type and number of non-utility affiliates owned by a holding company.

Exempt holding companies are not directly bound by the diversification limitations of Section 11, although a clause in Section 3 allows the SEC to revoke exempt status “unless and except insofar as it finds the exemption detrimental to the public interest, or the interest of investors or consumers.”⁷¹ According to Hawes, the SEC has revoked exempt status perhaps a half dozen times, most recently in 1981.⁷²

After the enactment of PUHCA, many states also passed laws beefing up their ability to regulate exempt holding companies, their affiliate transactions, and their corporate structures. As of 1993, twenty-two states had enacted laws or regulations concerning holding companies.⁷³ Unfortunately, most state regulations allow exempt holding companies to diversify into many lines of business.

In the debate preceding the enactment of PUHCA, the Roosevelt administration recommended a structural remedy, specifically that utility holding companies should be prohibited from owning regulated and non-regulated subsidiaries:

[Public utility] holding companies should be restricted as soon as practicable to the business of operating and owning the securities of public utility properties; they should not be permitted to engage in non-utility or speculative ventures.⁷⁴

At the time, all aspects of the electric utility, which produced, transmitted, distributed, and sold electricity at retail, were considered regulated services. Thus, Roosevelt’s recommendation

would have prohibited ownership by utility holding companies of any business that did not produce, transmit, distribute, or sell electricity.

However, the holding company lobby was able to defeat Roosevelt's approach, and instead PUHCA was weakened to allow holding companies to own both regulated and non-regulated businesses.⁷⁵ Utility holding companies have taken advantage of this weakening of PUHCA, thus today there are 150 utility holding companies with over 4,200 non-utility subsidiaries.

Even though weakened, PUHCA itself still contains the warning: "The national public interest ... may be adversely affected...when subsidiary public-utility companies ... enter into transactions in which **evils** result from an absence of arm's length bargaining or from restraint of free and independent competition; ..."⁷⁶

Is PUHCA still relevant today?

If PUHCA were repealed, no federal or state law would stop utility holding companies from rebuilding their ruinous empires. As was mentioned previously, Sections 9, 10, and 11 of PUHCA work together to keep *all* utility holding companies from recreating the pyramided, far-flung empires that were so detrimental to the interests of consumers and shareholders.

The repeal of PUHCA would likely increase the flow of cross-subsidies from a holding company's regulated utilities to its unregulated subsidiaries. Utility ratepayers would end up paying higher rates as they subsidize other businesses, especially foreign ventures, without receiving any benefits. Utility holding companies would have even more advantages when compared to businesses that do not receive guaranteed profits from captive customers.

Repealing PUHCA would result in a larger wave of utility mergers than is taking place today. Mergers reduce the number of potential competitors and can increase the market power of surviving utilities, which could render competition meaningless. Many mergers would occur without regard to the operating efficiencies that can only be achieved by integrated and coordinated operation.

Nevertheless, the ability of PUHCA to protect consumers and shareholders is being undermined by amendments, rulemakings, and by weak enforcement by the Securities and Exchange Commission.

Even with PUHCA on the books, utility holding companies have been forming in increasing numbers. In 1979, there were 58 utility holding companies with about 120 utility subsidiaries and 175 non-utility subsidiaries. Today there are 150 utility holding companies with about 240 utility subsidiaries and 4,200 non-utility subsidiaries. As was explained in a previous section, the reasons for the increase in the number of holding companies are: (1) the financial position of many utilities improved during the 1980s, providing them with the cash needed to acquire other companies; (2) many utilities anticipated the wave of mergers and acquisitions that would accompany deregulation; and (3) most corporate managers believe that holding companies lead to greater profits (at least for managers—as has been mentioned, mergers and acquisitions generally make shareholders and workers worse off).

Amendments to PUHCA enacted in 1978 and 1992 now allow utility holding companies to own power plants (specifically, “qualifying facilities” and “exempt wholesale generators”) anywhere in the U.S., regardless of the integration requirements of Section 11. Additional amendments enacted in 1992 allow utility holding companies to own foreign utility holding companies and utilities; American holding companies now own utility holding companies in South America, Europe, Asia, and Australia.⁷⁷

Since other countries do not have provisions against the formation of pyramid holding companies and their attendant complicated corporate structures, many of the foreign utility holding companies now owned (or partly owned) by U.S. holding companies have layers and layers of holding companies and minority controlling interests. For example, Texas Utilities Company, an exempt utility holding company, owns about 280 subsidiaries and 29 affiliates in many countries. Below is a portion of TU’s holdings—indentation means that a company is a subsidiary:

```
Texas Utilities Company
  TU United Kingdom Holdings, Inc.
    TU International Holdings Ltd.
      TXU Eastern Holdings Limited
        TU Finance (No. 2) Limited
          TU Acquisitions Limited
            The Energy Group Limited
              Eastern Group plc
                Eastern Generation Limited
                  Anglian Power Generators Limited
```

As the pyramid shows, 9 layers (each a holding company) separate Texas Utilities Company from its Anglian Power subsidiary, a structure comparable to the pyramids of Electric Bond & Share Co. and other giant holding companies of the 1920s and 30s. Ironically, TU, whose domestic utilities were previously owned by Electric Bond & Share (Ebasco), again owns at least four foreign companies that used to be part of Ebasco: Ebasco Cayman Islands Limited, Ebasco Services Singapore, Ebasco Energy of Switzerland, and Ebasco Services of Canada.⁷⁸ Many other U.S. holding companies have foreign holdings with similar layers of pyramiding (see the accompanying case study on the utility holding companies of Texas for more information). The return of the American pyramid holding company is directly attributable to the 1992 PUHCA amendment that allows for the ownership of foreign utilities.

In 1997, the Securities and Exchange Commission promulgated Rule 58, in which the SEC defined “energy-related” companies, so that multi-state holding companies are now allowed to diversify into many lines of businesses, such as energy management; refueling stations for electric vehicles; the sale, installation and servicing of gas and electric appliances; brokering or marketing of gas, electricity, or oil; and several other areas.

Several recent mergers approved by the Securities and Exchange Commission appear to violate the integration requirements of Section 11. The formation of New Century Energies, a registered holding company created by the acquisition of Southwest Public Service Co. (Amarillo, Texas) by Public Service of Colorado (Denver), was approved even though the two utilities are not connected together, and thus they cannot be operated as “a single integrated public-utility

system.” Instead, the SEC accepted a promise by New Century that it would build a transmission line connecting the two utilities. However, New Century recently announced that it may never build the line.⁷⁹

Alliant Energy, Inc., the result of mergers between Wisconsin Power & Light Co. (Madison), Interstate Power Corp. (Dubuque, Iowa), and IES Industries (Cedar Rapids, Iowa), also appears to violate the integration requirement of Section 11, yet the SEC again accepted the promise of the utilities to build transmission lines to connect the systems together.⁸⁰

Two proposed mergers also violate PUHCA’s integration requirement. American Electric Power Company (Columbus, Ohio) is attempting to acquire Central and South West Corp. (Dallas). The two systems are not connected to each other, and thus they cannot be operated as a single system. The merger partners are attempting to get around the integration requirement through the use of a short-term contract for using a transmission line that joins the two systems (which is owned by another utility). Public Citizen has joined with other intervenors to stop this merger, which appears to blatantly violate PUHCA.⁸¹

The other proposed merger that would appear to violate the law is between New Century Energies (Denver) and Northern States Power Co. (Minneapolis). These two systems are not connected together, thus this proposed merger appears to violate the integration requirement.

One of the main goals of PUHCA was to reorganize the electric power industry in ways that would save consumers money, primarily by requiring holding companies to own adjoining utilities that could be operated as a single system. Previous sections of this report show that PUHCA was successful in doing just that. Nevertheless, recently approved and proposed mergers violate the integration principle, jeopardizing the public interest by the same means used 70 years ago. If the SEC continues to ignore PUHCA by approving mergers that can never provide benefits to consumers, then the American consumer will have to pay for the mistakes of the past.

Without strong provisions to take its place, the repeal of PUHCA would just make a bad situation worse. A later section provides recommendations on ways PUHCA can be made stronger.

Is deregulation affecting utility holding companies?

As of May 22, 1999, 21 states have enacted laws or regulations that have or will remove price and service regulation for some aspects of electricity service—Arkansas, Arizona, California, Connecticut, Delaware, Illinois, Maine, Maryland, Massachusetts, Michigan, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania, Rhode Island, Vermont, and Virginia. Ohio and Texas may soon pass deregulation legislation as well.

In theory, investor-owned electric utilities in these states will no longer have retail monopolies for the provision of electricity service—customers are supposed to be able to choose among competing electricity suppliers.

In practice, the only customers able to take advantage of the new laws and regulations are large industrial customers, who have the buying power and expertise to find the cheapest power available. Most residential electricity customers in these states still have to buy electricity from their reorganized local utility (which is almost always part of a utility holding company system), either because “transition periods” are forcing consumers to bail out (subsidize) their utilities for uneconomic power plants, or large industrial customers get to buy cheap power before residential customers, or because the laws or regulations are so poorly written that incumbent utilities are dominating retail markets, in effect becoming unregulated monopolies.

Nevertheless, deregulation is having an impact on utility holding companies. State and federal laws and regulations are urging utilities to separate their regulated services from their unregulated services into separate subsidiaries. The production of power is becoming deregulated, so utilities are moving their power plants into power generation subsidiaries. Wholesale and retail sales of electricity are becoming deregulated, so utilities are moving these services into marketing subsidiaries.

On the other hand, most industry observers expect that the *delivery* of electricity from power plants to homes and businesses will remain a regulated service. Therefore, utilities are beginning to move their transmission and distribution assets (the poles and wires) into separate subsidiaries. State and federal regulators will likely continue regulating the price for transmitting and distributing electricity, because transmission and distribution services are natural monopolies (see a previous section for a description of natural monopoly). In other words, it will still be cheaper for one company to own the poles and wires than for several companies, thus the need for continued regulation of transmission and distribution.

Even though some aspects of the electric power industry are becoming unregulated, others will remain regulated. Unless the recommendations of this report are followed, utility holding companies will still own regulated and non-regulated subsidiaries. Therefore, all of the concerns related to the mixing of regulated and non-regulated services in one holding company system remain valid. Indeed, since many utility holding companies are engaged in a frenzy of mergers and acquisitions involving regulated and non-regulated companies, cross-subsidies and other forms of holding company abuse will likely get worse as deregulation progresses.

What can be done to reduce the problems caused by utility holding companies?

Given the fact that regulators cannot effectively control cross-subsidies between regulated and non-regulated businesses when both are owned by a holding company, Congress and the states should follow the recommendation made by the Roosevelt administration 64 years ago—to prohibit holding companies from owning both regulated and non-regulated subsidiaries.

Congress and the states should require holding companies to **divest** their regulated subsidiaries into stand-alone companies that have no affiliates or subsidiaries. This would focus regulation only on regulated services. No longer would there be the need to police affiliate transactions for cross-subsidies and self-dealing between regulated and non-regulated affiliates. It would eliminate fishing expeditions by regulators into the activities of non-regulated companies. It would reduce significantly the cost and intrusiveness of regulation.

Divestiture is explained in a following section. Additional provisions for dealing with utility holding companies can be found in the “Recommendations” section.

What is divestiture?

If a utility sells a power plant, or if a holding company sells a subsidiary, the sale is known as a **divestiture**.

According to Gasiorek, divestitures “may take one of three forms: a **spin-off**, a **split-off**, or a **split-up**.”⁸²

In a *spin-off*, the ownership of one (or more) of the subsidiaries is transferred from the holding company to the shareholders of the holding company. In other words, the shareholders of the holding company now directly own the voting stock of one or more subsidiaries, which becomes a stand-alone company. A spin-off is very simple—the holding company simply gives the voting stock of a subsidiary to the shareholders of the holding company. If done correctly, a spin-off is a tax-free reorganization under section 355 of the federal tax code.⁸³

A *split-off* is very similar to a spin-off, except that the shareholders of the holding company must hand over holding company stock in exchange for the stock of the subsidiary.

“In a *split-up*, the distributing company liquidates and distributes shares in two or more of its businesses to its shareholder body. ... As such, the economic substance of a split-up may resemble either a spin-off or a split-off.”⁸⁴

Although there are subtle differences between the various types of divestiture, the important fact is that corporations do them all the time, and if they are done correctly, they are tax-free reorganizations. Since subsidiaries of holding companies retain their own boards, management, and ability to issue securities, divestiture simply moves the subsidiary out from under the umbrella of the holding company system.

In addition to entire subsidiaries, specific assets, such as power plants, can be placed into a holding company subsidiary then spun-off to shareholders.⁸⁵

Can divestiture solve market power problems?

As explained by Binz & Frankena, “market power is the ability of a firm, alone or in concert with other firms, to profitably maintain the prices of a product above competitive levels ...”⁸⁶

Market power comes in two types, vertical and horizontal. **Vertical** market power exists when a company uses its ownership of various parts of the production process to influence or control the price of the product when sold at retail. For example, electric utilities typically own facilities (or even separate subsidiaries) that generate, transmit, distribute, and sell electricity. The cost of each stage of production (generation, transmission, distribution, and retailing) can ultimately influence the cost of producing the final product. For example, if the cost of transmitting electricity becomes more expensive, the cost of electricity delivered to a person’s home would likely increase as well.

Consider a utility holding company that has four subsidiaries: one that owns all of the power plants, one that owns all of the high-voltage transmission lines, one that owns all of the low-voltage distribution lines, and one that buys electricity at wholesale and sells it to customers at retail (this is the model that utility holding companies are moving toward in states that have deregulated retail sales of electricity).

The subsidiary that owns the transmission lines has a **natural monopoly**⁸⁷ because it is cheaper for one company to own one set of transmission lines than for many companies to own duplicate sets of transmission lines. However, all companies that own power plants need to use the transmission lines in order to get their electricity to market. In order to dominate a power market, the subsidiary of the utility holding company that owns the transmission lines could favor its power plant affiliate by charging it lower prices for using the transmission system, while charging higher prices to non-affiliated competitors. This type of vertical market power (a classic example of a cross-subsidy) has plagued the wholesale electricity market for decades.

Horizontal market power exists, for example, if one company owns all of the power plants serving a city. By owning all the power plants, the company essentially has a monopoly, so it can dictate the price of electricity.

Divestiture can solve problems created by vertical or horizontal market power. By divesting their regulated subsidiaries into stand-alone companies that have no affiliates or subsidiaries, utility holding companies would no longer be able to favor their subsidiaries that own power plants with special access to the transmission lines and electricity markets, eliminating vertical market power problems. By divesting an appropriate number of power plants, a utility holding company would no longer have a monopoly on the generation of electricity, eliminating horizontal market power problems.

Divestiture by utility holding companies would focus regulation only on regulated services. No longer would there be the need to police affiliate transactions for cross-subsidies and self-dealing between regulated and non-regulated affiliates. It would eliminate fishing expeditions by regulators into the activities of non-regulated companies. It would reduce significantly the cost and intrusiveness of regulation.

Conclusions

The very nature of a holding company that owns an electric utility makes it the enemy of ratepayers, competitors, shareholders, and workers.

Not only do *utility* holding companies own subsidiaries that require regulation, such as investor-owned utilities, many also own subsidiaries that provide non-utility (or non-regulated) services, such as real estate services, appliance sales and repair, financial services, agricultural companies, certain types of telecommunications, even coal mines, and many others. Any time regulated and non-regulated companies are brought together in a holding company system, there is the potential for *cross-subsidies* to flow from the regulated subsidiary to the non-regulated subsidiary, to the detriment of consumers, competitors, and shareholders.

Cross-subsidies occur when the regulated utility subsidiary pays excessive prices for services provided by the holding company or by other non-regulated affiliates. For example, if the utility purchases engineering, construction, or administrative services from the parent holding company, the holding company may attempt to charge the utility excessive fees in the hopes that the utility will be able to pass these excessive fees to its ratepayers. Since the ratepayers have to buy electricity from the utility, they end up paying higher rates to cover the excessive fees required by the parent holding company.

Competitors suffer because the non-regulated holding company affiliates are receiving subsidies from ratepayers, allowing the affiliates to unfairly reduce prices to either take customers away from their competitors or to drive them out of business. When a small business owner pays his or her monthly power bill, they are likely providing subsidies to holding company affiliates that are trying to put them out of business.

Shareholders and bondholders of the utility holding company are potentially harmed because cross-subsidies impose burdens on various parts of the holding company system, making their securities more risky and less valuable. Shareholders and bondholders of firms that compete with utility affiliates suffer because their securities are made less valuable through unfair competition by subsidized affiliates of utility holding companies.

Workers are harmed because many are laid off when holding companies merge or acquire other companies.

Given that there are literally thousands of transactions between regulated and non-regulated affiliates in a holding company system, utility regulators have a nearly impossible task in trying to protect ratepayers, competitors and security holders from the ravages of cross-subsidies.

Recommendations

Congress and the states should prohibit the ownership of electric utilities by holding companies. This would reduce rates for electricity customers by eliminating the flow of ratepayer money to the utility holding companies, which have been using this flow of money to acquire or subsidize other companies, instead of reducing rates and improving the service of their utility subsidiaries. It would stop the use of ratepayer money to fuel the expansion of holding company empires, which almost always results in the laying off of thousands of workers. It would stop the use of ratepayer money from subsidizing the destruction of other business that do not receive subsidies from ratepayers. It would discourage the use of additional debt that can reduce the value of stocks and bonds of security holders.

If a state decides to deregulate its electric power industry, then the legislation should include provisions that prohibit holding companies from owning local distribution systems and high-voltage transmissions systems, which will remain regulated utilities even after deregulation.

If a state deregulates its electric power industry *and* allows utility holding companies to own both regulated and non-regulated companies (for example, a regulated company would own the high-voltage transmission system, while a non-regulated company would own the power plants), **then the legislation should include the following provisions**, all of which are designed to ensure that benefits flow to the captive ratepayers of the regulated subsidiary:⁸⁸

- Legislation should require the state utility commission to approve the payment of dividends by a regulated company to a holding company to ensure that the regulated company's management, and not the holding company, is making the dividend decision, that the dividend payment is consistent with the pay-out ratio normally used by regulated companies engaged in comparable businesses, that the regulated company's credit will not be impaired, and that safe, reasonable, and adequate service by the regulated company will continue to be provided.
- Legislation should prohibit any regulated company from issuing any bonds, notes, liens, guarantees, or other evidence of indebtedness that pledge the credit or assets of the regulated company to support diversified affiliates.
- Legislation should prohibit service on both a regulated company's board of directors and the board of the holding company or of any affiliate.
- Legislation should prohibit any employee of a regulated company to also be employed by, or to receive any type of compensation from any other company.
- Legislation should require that half of the net income of any company affiliated, associated, or otherwise related with the regulated company be returned to the ratepayers of the regulated company.
- Legislation should prohibit any company affiliated or associated with any regulated

company to provide any products or services, or to own any company that provides products or services, that compete with or otherwise reduce the sales of the products or services of such regulated company.

- Legislation should prohibit any regulated company to use, or to resemble in anyway, the name, logo, service mark, trademark, or trade name of any company, or any associated company thereof.
- Legislation should prohibit any regulated company:
 - from discriminating against any other person or company in the provision of goods, services, facilities, and information, or in the establishment of standards;
 - from not providing all goods, services, facilities, or information, including marketing leads, to all other persons on reasonable and non-discriminatory terms and conditions.
 - from providing, transferring, or permitting the use of, or access to, tangible or intangible assets of the regulated company.
- Legislation should impose a limitation on the total level of investment by holding companies into non-regulated ventures.
- Legislation should require that the state regulatory commission has access to the books and records of any company affiliated with a regulated company.
- Legislation should direct the state regulatory commission to establish an office responsible for auditing transactions for any company affiliated with a regulated company.
- Legislation should direct the state regulatory commission to establish an annual proceeding to review all transactions for any company affiliated with a regulated company.
- Legislation should direct the state regulatory commission to establish standards for all transactions, including the purchase of goods, services, and real property, for any company affiliated with a regulated company. The standards should require that financial accounting records, as well as supporting documents and data from the regulated company and its affiliates, conform to a system that ensures a reasonable audit trail.
- Legislation should direct the state regulatory commission to require that any regulated company, or any associated holding company, must carry the burden of proving the fairness and reasonableness of all diversification transactions with respect to the ratepayers and shareholders of the regulated company. Any transactions not proven to be legitimate should be disallowed.
- Legislation should direct the state regulatory commission to penalize a regulated company or its affiliates for any cross-subsidies that are found to be willful or the result of negligence, and to ban further transactions to protect the ratepayers and shareholders of the regulated company.

- Legislation should direct the state regulatory commission to establish a system whereby all regulatory costs incurred by both regulated companies and by the state regulatory commission related to diversification are borne by shareholders and not ratepayers.

- Legislation should require regulated companies to include in their annual report to shareholders the following information:
 - notification of existing and proposed diversification;
 - amount of dividend and resources of the regulated company to each affiliate;
 - percentage of diversified (i.e., non-regulated) activities to overall business;
 - personnel of the regulated company involved in diversification activities;
 - actions taken to protect against diversification risks;
 - state regulatory commission findings and penalties concerning cross-subsidies; and
 - other diversification information as determined by the state regulatory commission.

Case Study

The Utility Holding Companies of Texas

This case study looks at data from the past ten years to show that the ratepayers of five Texas electric utilities are subsidizing the expansion of the three holding companies that own them. Electric bills for the customers of the five electric utilities have been increasing, while the assets, revenues, and retained earnings of the utility holding companies have also increased.

This case study shows that ratepayers would be better off if holding companies did not own electric utilities.

The three utility holding companies⁸⁹ and the five electric utilities studied for this report are:

- **Central and South West Corporation (CSW)**, the utility holding company that owns *Central Power & Light Company (CPL)*, *West Texas Utilities Company (WTU)*, and over 120 additional subsidiaries.
- **Reliant Energy, Inc.** (also known as Houston Industries, Inc.), which until 1997 was the parent holding company of *Houston Lighting and Power Company (HLP)*, which also owns other subsidiaries.
- **Texas Utilities Company (TU)**, the utility holding company that owns *Southwestern Electric Service Company (SES)*, *Texas Utilities Electric Company (TU Electric)*, and about 280 additional subsidiaries.

The data used in this study cover a ten-year period 1989 through 1998, although some data were only available for shorter periods. For the five electric utilities, the data include electricity rates, electricity sales per customer, electricity revenue per customer (also referred to as electricity bills), employees, and dividends paid to the parent holding company (the data are from the Energy Information Administration's *Electric Sales and Revenue* and *Financial Statistics of Major U.S. Investor-Owned Electric Utilities*). For the three holding companies, the data include assets, revenues, and retained earnings (the data are from 10-K forms filed with the Securities and Exchange Commission, which were compared to financial data found in Moody's *Public Utility Manual*).

Since 1989, the ratepayers of these five Texas electric utilities have paid \$9.6 billion to the three holding companies that own these utilities. The holding companies have used these billions to purchase other companies, many located outside Texas and the United States. Although these acquisitions have increased the assets, revenues, and profits of the holding companies, Texas ratepayers have had to pay higher electric bills, while thousands of Texas utility workers have lost their jobs. In addition, each utility holding company may receive additional billions from ratepayers if they convince Texas lawmakers to give them a multi-billion dollar bailout for their bad investments in expensive power plants. This "stranded cost" bailout will keep electricity bills high as billions flow to the three utility holding companies, which will likely use these subsidies to expand their multinational empires.

Results

The following sub-sections show how each utility holding company has increased its assets, revenues, and profits while ratepayers of their electric utility subsidiaries have paid higher electric bills and utility workers have lost thousands of jobs.

Central and South West Corporation

Central and South West Corporation (CSW) is a utility holding company that owns Central Power & Light Company (CPL) and West Texas Utilities Company (WTU), along with many other domestic and foreign companies, as shown in Appendix Central and South West. (This study does not include the effects of the proposed merger between CSW and American Electric Power Company, which would form a utility holding company with combined assets of \$33 billion.)

As shown in Table 1, since 1989 CSW has expanded its assets from \$8.4 billion to \$14 billion, an increase of 65 percent, its revenues from \$2.5 billion to \$5.5 billion, an increase of 115 percent, and its retained earnings from \$1.5 billion to \$1.8 billion, an increase of 24 percent.

| Central and South West Corporation | 1989 | 1998 | Change |
|---|----------------|----------------|--------|
| Assets | \$8.34 billion | \$13.7 billion | 65% |
| Revenues | \$2.55 billion | \$5.48 billion | 115% |
| Retained Earnings | \$1.47 billion | \$1.82 billion | 24% |
| Central Power & Light Company | | | |
| Dividends Paid to CSW from 1989 through 1997..... | | \$1.38 billion | |
| Stranded Costs | | \$1.8 billion | |
| | 1989 | 1997 | Change |
| Electric Rates (cents per kWh) | 5.4 | 6.5 | 21% |
| Electric Sales (MWh per customer) | 26.5 | 32.0 | 21% |
| Electric Bills (\$ per customer) | \$1,432 | \$2,087 | 46% |
| Employees | 2,377 | 1,668 | -30% |
| West Texas Utilities Company | | | |
| Dividends Paid to CSW from 1989 through 1997..... | | \$270 million | |
| Stranded Costs | | -\$200 million | |
| | 1989 | 1997 | Change |
| Electric Rates (cents per kWh) | 6.6 | 6.0 | -10% |
| Electric Sales (MWh per customer) | 22.9 | 25.9 | 13% |
| Electric Bills (\$ per customer) | \$1,513 | \$1,543 | 2% |
| Employees | 1,294 | 907 | -30% |

MWh = megawatt-hour; kWh = kilowatt-hour

Sources: Holding company data are from 10-K forms filed with the Securities and Exchange Commission. Electric utility data are from Energy Information Administration's *Electric Sales and Revenue and Financial Statistics of Major U.S. Investor-Owned Electric Utilities*. Stranded cost data are from the Public Utility Commission of Texas.

To pay for its expanding empire, CSW has relied in part on the \$1.7 billion taken from ratepayers in the form of dividends paid by its subsidiaries CPL and WTU.

Meanwhile, electricity rates for customers of CPL have increased from 5.4 to 6.5 cents per kWh, an increase of 21 percent; electricity sales per customer have increased from 27 to 32 MWh, an increase of 21 percent, and electricity revenue per customer has increased from \$1,432 to \$2,087, an increase of 46 percent.

For customers of WTU, electricity rates have decreased from 6.6 to 6.0 cents per kWh, a decrease of 10 percent (the only utility in this study with a decrease in rates). Nevertheless, electricity sales per customer have increased from 23 to 26 MWh, an increase of 13 percent, and electricity revenue per customer has increased from \$1,513 to \$1,543, an increase of 2 percent.

If their electric utility had not been owned by CSW, ratepayers of CPL could have saved \$245 per year or 12 percent on their electric bills; and ratepayers of WTU could have saved \$162 per year or 11 percent (these figures were derived by dividing total dividends paid by the number of customers in 1997 and by the number of years during which the dividends were paid).

Thus, while CSW expands its multinational empire, ratepayers of its subsidiary utilities CPL and WTU are paying higher electricity bills, with billions of ratepayer dollars flowing to CSW to subsidize its expansion.

Ratepayers are not the only people to suffer at the hands of CSW and its subsidiary utilities. CPL has reduced its workforce from 2,377 to 1,668 (30 percent), and WTU has reduced its workforce from 1,294 to 907 (30 percent). As a rule, thousands of workers usually lose their jobs as holding companies expand their empires, and CSW is no exception. Therefore, ratepayers of CPL and WTU are being harmed (in the form of higher bills) by having their utilities owned by a utility holding company, namely Central and South West Corporation.

The harm to ratepayers and workers is likely to increase if CPL is successful in its demands for a \$1.8 billion bailout for its stranded costs,⁹⁰ because some of this bailout will flow to its parent holding company CSW, which could then use the extra money to acquire additional companies (because WTU's electric assets are thought to be undermarketed by \$200 million, CSW's total bailout is estimated at \$1.6 billion).⁹¹ If current trends continue, electricity bills will continue going up and more workers will be fired as ratepayer subsidies continue flowing to CSW.

During the past decade, CSW has been using ratepayer money (along with other income) to acquire businesses in the United Kingdom, Mexico and Brazil. According to CSW:

CSW International was formally established 1994 and is based in Dallas, Texas. CSWI develops, acquires, constructs, owns and operates power production and transmission/distribution facilities in England, Latin America, and worldwide. The current focus in Latin America is in Mexico and Brazil.

CSWI's other principle offices are in Crawley, West Sussex, England, and Mexico City, Mexico. Crawley is the home office of SEEBOARD. Because of its Dallas, Texas location and its long-time business relationships in Mexico, CSWI began its international efforts in the Mexican market. Monterrey, Mexico is the principal

office location of Enertek, the joint venture established to build a cogeneration facility in Altamira, Mexico.

CSWI formed Enertek with the Mexican petrochemical group Alpek of Monterrey to build, own and operate a 107-MW class, gas-fired cogeneration project at Alpek's petrochemical complex in Altamira, Tamaulipas. CSWI and Alpek hold equal shares in the project, which is currently under construction.

The project, CSWI's first in Mexico, will function primarily as an industrial power project by supplying electricity and thermal heat to two existing Alpek units operating at Altamira, Petrocel and Idelpro, and a new Temex plant now under construction. Most of the cogeneration project's electric production will be used by the industrial facilities at the site, while some excess capacity may be available and wheeled to other participating industrials in the area. Petrocel and Temex will also take the steam output of the project. It is scheduled for commercial operation in 1998.

In Brazil, CSWI has an equity investment in Empresa De Electricidade Vale Paranapanema S/A (Vale). Vale is a private Brazilian electric distribution company with five additional electric distribution systems in the Brazilian states of Sao Paulo, Parana, and Tocantins serving approximately 600,000 customers. This investment places CSWI in an advantageous position for considering further investments in Brazil and elsewhere in Latin America.

CSWI was also part of a consortium that was awarded a government contract to perform a feasibility study for the 1,100 megawatt Lajeado hydrogenerating plant. The proposed site is on the Tocantins River near Palmas, the capital city of the Brazilian state of Tocantins. This contract marked the first time a group other than a government agency is conducting a feasibility study for a new hydro plant in Brazil.⁹²

Since other countries do not have provisions against the formation of pyramid holding companies and their attendant complicated corporate structures, many of the foreign utility holding companies now owned by CSW have layers and layers of holding companies and minority controlling interests. For example, CSW owns about 125 subsidiaries in many countries. Below is a portion of CSW's holdings—indentation means that a company is a subsidiary:

Central and South West Corporation
CSW INTERNATIONAL, INC.
CSW International Two, Inc.
CSW Investments
SEEBOARD Group plc
SEEBOARD plc
Electricity (UK) Limited

As the pyramid shows, 6 layers (each a holding company) separate Central and South West from its Electricity (UK) Limited subsidiary, a structure comparable to the pyramids of the Insull

Empire, which previously owned most of the domestic utilities now owned by CSW (see Appendix Central and South West Corporation for more information).

Reliant Energy, Inc. (also known as Houston Industries, Inc.)

Reliant Energy (Reliant) is a utility holding company that owns Houston Lighting & Power Company (HLP) as an unincorporated division. Prior to 1997, Reliant’s predecessor Houston Industries owned HLP as a wholly-owned subsidiary.⁹³ Reliant also owns other subsidiaries, as shown in Appendix Reliant Energy. (This study does not include the effects of the recent announcement by Reliant to acquire a 40 percent interest in Energieproduktiebedrijf UNA, a Dutch power generation company.)

As shown in Table 2, since 1991 Reliant has expanded its assets from \$11 billion to \$19 billion, an increase of 74 percent, its revenues from \$3.7 billion to \$11 billion, an increase of 210 percent, and its retained earnings from \$1.2 billion to \$1.4 billion, an increase of 20 percent.

| Reliant Energy, Inc. | 1991 | 1998 | Change |
|---|----------------|----------------|--------|
| Assets | \$11.0 billion | \$19.1 billion | 74% |
| Revenues | \$3.71 billion | \$11.5 billion | 210% |
| Retained Earnings | \$1.20 billion | \$1.45 billion | 20% |
| Houston Lighting & Power Company | | | |
| Dividends Paid to Reliant from 1989 through 1996..... | | \$2.72 billion | |
| Stranded Costs | | \$1.5 billion | |
| | 1989 | 1997 | Change |
| Electric Rates (cents per kWh) | 5.6 | 6.2 | 10% |
| Electric Sales (MWh per customer) | 41.9 | 41.8 | 0% |
| Electric Bills (\$ per customer) | \$2,360 | \$2,572 | 9% |
| Employees | 11,008 | 6,131 | -44% |

MWh = megawatt-hour; kWh = kilowatt-hour

Sources: Holding company data are from 10-K forms filed with the Securities and Exchange Commission. Electric utility data are from Energy Information Administration’s *Electric Sales and Revenue and Financial Statistics of Major U.S. Investor-Owned Electric Utilities*. Stranded cost data are from the Public Utility Commission of Texas.

To pay for its expanding empire, Reliant has relied in part on \$2.7 billion taken from ratepayers in the form of dividends paid by its subsidiary HLP.

Meanwhile, electricity rates for customers of HLP have increased from 5.6 to 6.2 cents per kWh, an increase of 10 percent; electricity sales per customer remained nearly the same at 42 MWh;⁹⁴ and electricity revenue per customer has increased from \$2,360 to \$2,572, an increase of 9 percent.

If their electric utility had not been owned by Reliant, ratepayers of HLP could have saved \$218 per year or 8 percent on their electric bills (these figures were derived by dividing total dividends paid by the number of customers in 1997 and by the number of years during which the dividends were paid).

Thus, while Reliant expands its multinational empire, ratepayers of its former subsidiary HLP have been paying higher electricity bills, with billions of ratepayer dollars flowing to Reliant to subsidize its expansion.

Ratepayers are not the only people to suffer at the hands of Reliant. HLP has reduced its workforce from 11,008 to 6,131, a decrease of 44 percent. As a rule, thousands of workers usually lose their jobs as holding companies expand their empires, and Reliant is no exception.

Therefore, ratepayers of HLP are being harmed (in the form of higher bills) by having their utility as part of a utility holding company, namely Reliant Energy.

The harm to ratepayers and workers is likely to increase if HLP is successful in its demands for a \$1.5 billion bailout for its stranded costs,⁹⁵ because some of this could be used by Reliant to acquire additional companies. If current trends continue, electricity bills will continue going up and more workers will be fired as ratepayer subsidies continue flowing to Reliant.

During the past decade, Reliant Energy has been using ratepayer money (along with other income) to acquire businesses throughout the world. According to Reliant:

Reliant Energy International, the company's international subsidiary, has ownership interests in electric utilities that serve 9.5 million customers in Argentina, Brazil, Colombia and El Salvador and is developing natural gas distribution systems in Colombia and Mexico. The company also has industrial power generation projects in operation in Argentina and India.⁹⁶

Texas Utilities Company

Texas Utilities Company (TU) is a utility holding company that owns Southwestern Electric Service Company (SES) and Texas Utilities Electric Company (TU Electric), along with many other domestic and foreign companies, as shown in Appendix Texas Utilities Company.⁹⁷

As shown in Table 3, since 1989 TU has expanded its assets from \$17 billion to \$40 billion, an increase of 129 percent, its revenues from \$4.3 billion to \$15 billion, an increase of 241 percent, although its retained earnings have decreased from \$2.9 billion to \$1.4 billion, a decrease of 50 percent.

To pay for its expanding empire, TU has relied in part on the \$5.2 billion taken from ratepayers in the form of dividends paid by its subsidiaries SES and TU Electric.

Meanwhile, electricity rates for customers of SES have increased from 6.4 to 7.3 cents per kWh, an increase of 14 percent; electricity sales per customer have increased from 21 to 25 MWh, an increase of 14 percent; and electricity revenue per customer has increased from \$1,368 to \$1,786, an increase of 31 percent.

For customers of TU Electric, electricity rates have increased from 5.3 to 6.2 cents per kWh, an increase of 17 percent; electricity sales per customer have increased from 36 to 38 MWh, an

increase of 6 percent; and electricity revenue per customer has increased from \$1,911 to \$2,355, an increase of 23 percent.

| Table 3. Texas Utilities Company and Subsidiaries. | | | |
|---|-----------------------|----------------|--------|
| Texas Utilities Company | 1989 | 1998 | Change |
| Assets | \$17.2 billion | \$39.5 billion | 129% |
| Revenues | \$4.32 billion | \$14.7 billion | 241% |
| Retained Earnings | \$2.88 billion | \$1.45 billion | -50% |
| Southwestern Electric Service Company | | | |
| Dividends Paid to TU from 1993 through 1996..... | \$12.0 million | | |
| Stranded Costs | no estimate available | | |
| | 1989 | 1997 | Change |
| Electric Rates (cents per kWh) | 6.4 | 7.3 | 14% |
| Electric Sales (MWh per customer) | 21.4 | 24.5 | 14% |
| Electric Bills (\$ per customer) | \$1,368 | \$1,786 | 31% |
| Employees | 158 | 118 | -25% |
| Texas Utilities Electric Company | | | |
| Dividends Paid to TU from 1989 through 1997..... | \$5.19 billion | | |
| Stranded Costs | \$1.5 billion | | |
| | 1989 | 1997 | Change |
| Electric Rates (cents per kWh) | 5.3 | 6.2 | 17% |
| Electric Sales (MWh per customer) | 35.8 | 37.9 | 6% |
| Electric Bills (\$ per customer) | \$1,911 | \$2,355 | 23% |
| Employees | 12,064 | 6,053 | -50% |
| MWh = megawatt-hour; kWh = kilowatt-hour | | | |
| Sources: Holding company data are from 10-K forms filed with the Securities and Exchange Commission. Electric utility data are from Energy Information Administration's <i>Electric Sales and Revenue</i> and <i>Financial Statistics of Major U.S. Investor-Owned Electric Utilities</i> . Stranded cost data are from the Public Utility Commission of Texas. | | | |

If their electric utility had not been owned by TU, ratepayers of SES could have saved \$73 per year or 4 percent on their electric bills, and ratepayers of TU Electric could have saved \$239 per year or 10 percent on their electric bills (these figures were derived by dividing total dividends paid by the number of customers in 1997 and by the number of years during which the dividends were paid).

Thus, while TU expands its multinational empire, ratepayers of its subsidiary utilities SES and TU Electric are paying higher electricity bills, with billions of ratepayer dollars flowing to TU to subsidize its expansion.

Ratepayers are not the only people to suffer at the hands of TU and its subsidiary utilities. SES has reduced its workforce from 158 to 118 (25 percent), and TU Electric has reduced its workforce from 12,064 to 6,053 (50 percent). As a rule, thousands of workers usually lose their jobs as holding companies expand their empires, and TU is no exception.

Therefore, ratepayers of SES and TU Electric are being harmed (in the form of higher bills) by having their utilities owned by a utility holding company, namely Texas Utilities Company.

The harm to ratepayers and workers is likely to increase if TU Electric is successful in its demands for a \$1.5 billion bailout for its stranded costs,⁹⁸ because some of this bailout will flow to its parent holding company TU, which could then use the extra money to acquire additional companies.⁹⁹ If current trends continue, electricity bills will continue going up and more workers will be fired as ratepayer subsidies continue flowing to TU.

During the past decade, TU has been using ratepayer money (along with other income) to acquire businesses throughout the world. According to TU:

In 1995, TU acquired Eastern Energy Limited, an electric distribution company with one-and-a-quarter million customers in southeastern Australia. TU Australia was formed to hold the common stock of Eastern Energy. Eastern Energy serves half the state of Victoria, including suburban Melbourne, the second largest city in Australia. The area served includes about 35 major cities. The purchase of Eastern Energy allows Texas Utilities to serve a rapidly developing service area in a deregulated energy market.

In 1998, Texas Utilities acquired The Eastern Group. The Eastern Group owns Eastern Electric, the largest supplier and distributor of electricity in the United Kingdom. Eastern has 3.1 million retail electric customers and 500,000 natural gas customers. The company's service territory covers over 20,300 sq. km in the east of England and parts of North London. The company also owns Eastern Generation, the fourth largest generator of electricity in Great Britain. Eastern Generation owns, operates or has an interest in eight power stations, representing approximately 10% of the United Kingdom's total registered generating capacity.¹⁰⁰

Texas Utilities Company:

- Serves 3.1 million retail electric customers and 500,000 natural gas customers in the United Kingdom.
- Owns the largest supplier and distributor and fourth largest generator of electricity in Great Britain, with more than 10 percent of the country's total generating capacity.
- Engages in the trading of electricity and natural gas throughout the U.K. and the rest of Europe and has energy holdings in Sweden, Norway, Finland, and Spain.
- Also owns an equity interest in North Sea gas fields.
- Distributes electricity to 1.25 million people in the state of Victoria, Australia, including suburban Melbourne Operates a gas distribution system in Monterrey, Mexico.
- Will provide natural gas service to a portion of Mexico City with as many as 2.2 million customers in the franchised area.
- Has additional energy projects underway in China, Chile, Hawaii, and in Europe.¹⁰¹

Since other countries do not have provisions against the formation of pyramid holding companies and their attendant complicated corporate structures, many of the foreign utility holding companies now owned by TU have layers and layers of holding companies and minority controlling interests. For example, TU owns about 280 subsidiaries and 29 affiliates in many countries. Below is a portion of TU's holdings—indentation means that a company is a subsidiary:

Texas Utilities Company
 TU United Kingdom Holdings, Inc.
 TU International Holdings Ltd.
 TXU Eastern Holdings Limited
 TU Finance (No. 2) Limited
 TU Acquisitions Limited
 The Energy Group Limited
 Eastern Group plc
 Eastern Generation Limited
 Anglian Power Generators Limited

As the pyramid shows, 9 layers (each a holding company) separate Texas Utilities Company from its Anglian Power subsidiary, a structure comparable to the pyramids of Electric Bond & Share Co. and other giant holding companies of the 1920s and 30s. Ironically, TU, whose domestic utilities were previously owned by Electric Bond & Share (Ebasco), again owns at least four foreign companies that used to be part of Ebasco: Ebasco Cayman Islands Limited, Ebasco Services Singapore, Ebasco Energy of Switzerland, and Ebasco Services of Canada (see Appendix Texas Utilities Company for more information).

Case Study Conclusions

Ratepayers of the five electric utilities would be better off if their electric utilities were not owned by utility holding companies. The following evidence supports this conclusion.

- **From 1989 through 1998, the assets, revenues, and retained earnings of all three utility holding companies increased** (the only exception was a decrease in the retained earnings of Texas Utilities Company). For Central and South West (the parent holding company of Central Power & Light and West Texas Utilities), its assets increased 65 percent, its revenues 115 percent, and its retained earnings 24 percent. For Reliant Energy (until 1997 the parent holding company of Houston Lighting & Power), its assets increased 74 percent, its revenues 210 percent, and its retained earnings 20 percent (due to data restrictions for Reliant, these values are based on the period 1991 through 1998). For Texas Utilities Company (the parent holding company of Southwestern Electric Service and Texas Utilities Electric), its assets increased 129 percent, its revenues 241 percent, and its retained earnings decreased 50 percent.
- **To subsidize the expansion of their empires, the three utility holding companies relied in part on \$9.6 billion, which was collected from the ratepayers (as part of their electric bills) by the five electric utilities, which then gave it to the three holding companies in the form of dividends during the period 1989 through 1997.** Ratepayers of CPL and WTU

provided Central and South West with \$1.7 billion in profits; ratepayers of HLP provided Reliant Energy with \$2.7 billion in profits, and ratepayers of SES and TU Electric provided Texas Utilities Company with \$5.2 billion in profits.

- **All three utility holding companies have used ratepayer money to acquire foreign utilities and companies.** Central and South West has recently acquired companies in Brazil, Mexico, and the United Kingdom. Reliant Energy has recently acquired companies in Argentina, Brazil, Colombia, El Salvador, India, and Mexico, and has acquired a portion of a company headquartered in the Netherlands. Texas Utilities has recently acquired companies in Australia, China, Chile, Finland, Mexico, Norway, Sweden, and the United Kingdom.
- **As they were providing profits to the three utility holding companies, the ratepayers of all five electric utilities were paying higher annual electric bills (in terms of revenue per customer) at the end of 1997 than they were in 1989.** Ratepayers of Central Power & Light saw their electric bills increase 46 percent; 2 percent for West Texas Utilities; 9 percent for Houston Lighting and Power; 31 percent for Southwestern Electric Service; and 23 percent for Texas Utilities Electric. At the end of 1997, ratepayers of CPL, WTU, and SES were paying higher electricity bills than at any time in the previous eight years, whereas ratepayers of HLP and TU Electric were paying near study-time highs.
- **Meanwhile, as the three utility holding companies expanded their empires, 12,024 utility workers lost their jobs between 1989 and 1997.** CPL and WTU cut 709 and 387 jobs, respectively; HLP cut 4,877 jobs; and SES and TU Electric cut 40 and 6,011 jobs, respectively.
- **To make matters worse, the Texas Legislature may force ratepayers to hand over an estimated \$4.6 billion to the subsidiaries of the three utility holding companies in the form of a stranded cost bailout for bad investments in power plants.** Central and South West could receive a stranded cost bailout of \$1.6 billion, Reliant Energy \$1.5 billion, and Texas Utilities Company \$1.5 billion. Some of this money will then flow to the three utility holding companies, which can use it to further expand their empires.

¹ James Bonbright and Gardiner Means, *The Holding Company; Its Public Significance and Its Regulation*, New York: McGraw-Hill, 1932, at 4 (hereinafter cited as Bonbright and Means).

² Roger Newman, *Hugo Black, A Biography*, New York: Pantheon Books, 1994, at 175.

³ *Report of the National Power Policy Committee*, 74th Congress, 1st Session, House Doc. No. 137, March 12, 1935, at 3 (hereinafter cited as NPPC).

⁴ Alan Gasiorek, *Merger & Acquisition Valuation and Structuring*, Norcross, GA: Corporate Development Institute, 1997, at 209 (hereinafter cited as Gasiorek).

⁵ UN Center on TransNational Corporations, *TransNational Corporations in World Development* 32 (1983), cited in Phillip Blumberg, *Procedural Problems in the Law of Parent and Subsidiary Corporations*, Boston, MA: Little, Brown and Company, 1983, at 30 (hereinafter cited as Blumberg).

⁶ UN, *Transnational Corporations and Management Division, 1993 World Investment Report Studies* (cited in Survey, *Multinationals—Back in Fashion*, *The Economist*, Mar. 27, 1993), cited in Blumberg, note 5, at 30.

⁷ From the on-line version of the 1999 Fortune 500, <http://cgi.pathfinder.com/fortune/fortune500/500list.html>, viewed on May 11, 1999. Holding company status was determined by checking 10-K forms filed by each company with the Securities and Exchange Commission.

⁸ Douglas Hawes, *Utility Holding Companies*, New York: Clark Boardman Company, 1987, at 2-3 (hereinafter cited as Hawes).

⁹ Hawes, note 8, at 2-3; Bonbright and Means, note 1, at 56.

¹⁰ Bonbright and Means, note 1, at 57.

¹¹ NPPC, note 3, at 4, 5.

¹² Hawes, note 8, at 8-8.

¹³ Hawes, note 8, at 8-8 to 8-9.

¹⁴ Moody's Investors Service, Moody's Assess Risks in Utility Combinations and Spin-offs, *Electric Utility Sourcebook*, New York, 1996, at 79 (hereinafter cited as Moody's).

¹⁵ Hawes, note 8, at 8-6.1.

¹⁶ Hawes, note 8, at 9-6.

¹⁷ Although other types of "reorganizations" exist, they do not result in the creation of a holding company that owns subsidiaries, or they have special attributes for other types of corporate structures. For example, an "A" reorganization, also known as a statutory merger, occurs when "the acquiring corporation absorbs the acquired entity, ending its corporate life." The "B" reorganization, also known as "stock-for-stock exchange," occurs when "an acquiring corporation acquires the stock of a target corporation solely in exchange for the voting stock of the acquiring corporation." The "C" reorganization, occurs when "the acquiring corporation acquires substantially all of the assets of the target corporation solely in return for the voting stock of the parent" (Gasiorek, note 4, at 209, 212, and 216). The reverse triangular reorganization is a variation of an "A" type, as provided in the federal tax code. If done properly, A, B, and C reorganizations are tax-free events, but there are also taxable mergers and acquisitions.

¹⁸ Gasiorek, note 4, at 214.

¹⁹ Hawes, note 8, at 2-3 to 2-4.

²⁰ Numbers of utilities from Energy Information Administration, *The Changing Structure of the Electric Power Industry: An Update*, Washington, DC, 1996 (hereinafter cited as EIA 1996). Total Electric Plant In Service (w/o depreciation & amortization) for investor-owned utilities, \$567 billion; Public Generators, \$92 billion; Public Non-Generators, \$12 billion; Co-ops, \$59 billion; for a total of \$730 billion. All figures from Energy Information Administration, *Financial Statistics of Major U.S. Investor-Owned Electric Utilities 1996* (latest available), and *Financial Statistics of Major U.S. Publicly Owned Electric Utilities 1997*, Washington, DC.

²¹ Charles Phillips, Jr., *The Regulation of Public Utilities*, Arlington, VA: Public Utilities Reports, 1993, at 52 (hereinafter cited as Phillips).

²² U.S. Securities and Exchange Commission, *Financial and Corporate Report, Holding Companies Registered Under the Public Utility Holding Company Act of 1935 as of June 1, 1998*, and *Financial and Corporate Report, Holding Companies Exempt from the Public Utility Holding Company Act of 1935 Under Section 3(a)(1) and 3(a)(2) Pursuant to Rule 2 Filings or by Order as of November 1, 1997*, Washington, DC.

²³ *Ibid.*

²⁴ General Accounting Office, *Electricity Supply: Regulating Utility Holding Companies in a Changing Electric Industry*, GAO/RCED-92-98, April 1992, at 4.

²⁵ Hawes, note 8, at 6-1.

²⁶ Moody's, note 14, at 76.

²⁷ Blumberg, note 5, at 36; Constantinos Markides, *Diversification, Refocusing, and Economic Performance*, Cambridge, MA: The MIT Press, 1995, at 27 (hereinafter cited as Markides).

²⁸ Gasiorek, note 4, at 201 explains that "Tax-free acquisitions are referred to as 'reorganizations' in the Internal Revenue Code. The touchstone requirement for a reorganization is shareholder 'continuity of interest.' Continuity of interest is present when the original shareholders of an acquired entity receive consideration which provides them with continuing participation in the risks and returns of the now combined businesses. The rationale is that if the nature of acquired company's shareholders investment has not changed dramatically, then the shareholders have not terminated their original equity interest. Hence, there is not a taxable event." Nevertheless, any gain in value received by the acquiring company is later taxed and not permanently forgiven.

²⁹ Gasiorek, note 4, at 205.

³⁰ Howard Buskirk, "A Consultant's Tale: Ego, Not Dollars and Cents, Drive Many Utility Mergers," *Energy Daily*, March 10, 1999 (hereinafter cited as Buskirk).

³¹ Arthur Gottshalk, "Not All Energy Matches are Made in Heaven," *Journal of Commerce*, date unknown.

³² Buskirk, note 30.

³³ Markides, note 27, at 15-22.

³⁴ Markides, note 27, at 22-23, cites omitted.

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- ³⁵ Despite years of protests and interventions by consumers, investor-owned utilities spent hundreds of billions of dollars on nuclear power plants, which are more expensive than other methods of producing electricity, threaten the lives and safety of power plant workers and the communities in which they are located, and produce thousands of tons of radioactive waste, for which there is no safe or economical method of storage.
- ³⁶ Moody's, note 14, at 76.
- ³⁷ Moody's, note 14, at 77.
- ³⁸ See, for example, Ronald Binz and Mark Frankena, *Addressing Market Power*, Washington, DC: Competition Policy Institute, June 1998, Chapter 5 (hereinafter cited as Binz and Frankena).
- ³⁹ William Marcus and Jan Hamrin, *A Guide to Stranded Cost Valuation and Calculation Methods*, West Sacramento, CA: JBS Energy, Inc., 1997, at 39 (hereinafter cited as Marcus and Hamrin).
- ⁴⁰ NPPC, note 3, at 3.
- ⁴¹ See, for example, *Testimony of Anthony Ponticelli for the National Alliance for Fair Competition*, before the U.S. House of Representatives Committee on the Judiciary, June 4, 1997.
- ⁴² Phillips, note 21, at 177.
- ⁴³ Christopher Moser, *The Great Ratepayer Robbery*, Washington, DC: Safe Energy Communication Council, 1998.
- ⁴⁴ Blumberg, note 5, at 86.
- ⁴⁵ *Comment of the Staff of the Bureau of Economics of the Federal Trade Commission*, before the Public Utilities Commission of Texas, Project Number 17549, June 19, 1998, (hereinafter cited as FTC) at 2; *Comments of the U.S. Department of Justice*, in the matter of Promoting Wholesale Competition Through Open Access Nondiscriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, FERC Dockets RM 95-8-000 and RM 94-7-001, Washington, DC, August 7, 1995, (hereinafter cited as DOJ) at 4; Binz and Frankena, note 38, at 52-56.
- ⁴⁶ Phillip Blumberg and Kurt Strasser, *Problems of Parent and Subsidiary Corporations under State Statutory Law*, Boston: Little, Brown and Company, 1995, at 91-92 (hereinafter cited as Blumberg and Strasser 1995).
- ⁴⁷ Hawes, note 8, at 10-1.
- ⁴⁸ Hawes, note 8, at 10-4 to 10-6.2
- ⁴⁹ FTC, note 45, at 2; DOJ, note 45, at 3.
- ⁵⁰ Richard Hellman, *Government Competition in the Electric Utility Industry*, New York: Praeger Publishers, 1972, at 43 (hereinafter cited as Hellman). Also see Blumberg and Strasser 1995, note 46, at 98-99 for citations of cases involving disputes over affiliate transactions.
- ⁵¹ See, for example, *Testimony of Anthony Ponticelli for the National Alliance for Fair Competition*, *Testimony of Michael Travieso on behalf of the National Association of State Utility Consumer Advocates and the State of Maryland Office of People's Counsel*, and *Testimony of John O'Brien for the Wheeled Electric Power Company*, all before the United States House of Representatives Committee on the Judiciary, June 4, 1997.
- ⁵² Binz and Frankena, note 38, at 33.
- ⁵³ Binz and Frankena, note 38, at 53-4.
- ⁵⁴ Binz and Frankena, note 38, at 32.
- ⁵⁵ NPPC, note 3, at 4.
- ⁵⁶ Hawes, note 8, at 2-5 (cite omitted).
- ⁵⁷ Joel Seligman, *The Transformation of Wall Street*, Boston: Northeastern University Press, 1995, at 127.
- ⁵⁸ NPPC, note 3, at 5.
- ⁵⁹ Seligman, note 57, at 127.
- ⁶⁰ 15 U.S.C. §79.
- ⁶¹ Hawes, note 8, at 2-16 to 2-17.
- ⁶² Phillip Blumberg and Kurt Strasser, *Problems of Parent and Subsidiary Corporations Under Statutory Law Specifically Applying Enterprise Principles*, Boston: Little-Brown, 1992, at 42 (hereinafter cited as Blumberg and Strasser 1992).
- ⁶³ Energy Information Administration, *Public Utility Holding Company Act of 1935: 1935-1992*, Washington, DC, 1993 (hereinafter cited as EIA 1993).
- ⁶⁴ Phillips, note 21, at 633. Although called the "death sentence clause," it still allowed for the continued existence of utility holding companies, whereas President Roosevelt wanted to eliminate them entirely. The original draft of PUHCA would have eliminated practically all utility holding companies (Seligman, note 57, at 248).
- ⁶⁵ Scott Hempling, *Electricity Law: Current Topics 1999*, Silver Spring, MD, April 1999, at 93-95 (hereinafter cited as Hempling).
- ⁶⁶ Hempling, note 65, at 91-92.

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- ⁶⁷ Blumberg and Strasser 1992, note 62, at 32-33 (cites omitted).
- ⁶⁸ Seligman, note 57, at 262.
- ⁶⁹ Seligman, note 57, at 263.
- ⁷⁰ §79k(b)(1).
- ⁷¹ Hempling, note 65, at 97-98.
- ⁷² Hawes, note 8, at 3-20.
- ⁷³ Blumberg and Strasser 1995, note 46, at 73.
- ⁷⁴ NPPC, note 3, at 10.
- ⁷⁵ Hawes, note 8, at 2-15; Seligman, note 57, at 248; Philip Funigiello, *Toward a National Power Policy: The New Deal and the Electric Utility Industry, 1933-1941*, Pittsburgh: University of Pittsburgh Press, 1973, at 96; Michael Parrish, *Securities Regulation and the New Deal*, New Haven, CT: Yale University Press, 1970, at 175.
- ⁷⁶ §79a(b)(2).
- ⁷⁷ Hempling, note 65, at 98-99.
- ⁷⁸ Texas Utilities Company, 1998 SEC form 10-K.
- ⁷⁹ “New Century Energies Delays Link between Colorado, Texas Power Grids,” *The Denver Post*, February 9, 1999
- ⁸⁰ Ohio Consumers’ Counsel et al., *Notice of Appearance, Protest, Comments, Motion to Intervene before the U.S. Securities and Exchange Commission*, American Electric Power Company and Central and South West Corporation, File No. 70-9381, April 6, 1999, at 8.
- ⁸¹ *Ibid.*
- ⁸² Gasiorek, note 4, at 223.
- ⁸³ Gasiorek, note 4, at 227-8.
- ⁸⁴ Gasiorek, note 4, at 226.
- ⁸⁵ Marcus and Hamrin, note 39, at 33.
- ⁸⁶ Binz and Frankena, note 38, at 1.
- ⁸⁷ A **natural monopoly** exists if there are sufficient economies of scope or scale that make it more efficient for one company to provide a particular product or service than for many.
- ⁸⁸ Most of these provisions are taken from Michael E. Shapiro, *Utility Diversification: A Detour with Serious Risks for Ratepayers*, California Senate Office of Research, 1986.
- ⁸⁹ The three utility holding companies discussed in this study, Central and South West Corporation, Reliant Energy, and Texas Utilities Company, were chosen because their Texas electric utility subsidiaries sell electricity at retail to ratepayers residing in Texas and no other state. Nevertheless, Texas is served by other electric utility holding companies, including Enron Corporation, Entergy Corporation, New Century Energies, Inc., and TNP Enterprises, Inc.
- ⁹⁰ Public Utility Commission of Texas, *Report to the Texas Senate Interim Committee on Electric Utility Restructuring, Potentially Strandable Investment (ECOM) Report: 1998 Update* (hereinafter cited as PUCT). The utility bailout amounts used in this study are the 2001 benchmark (Commission base case), base market price, estimated costs over market including the effects of transition plans, as shown in Appendix A, p. 1.
- ⁹¹ PUCT, note 90.
- ⁹² From http://www.csw.com/About_CSW/energy/cswinter.html, viewed on April 9, 1999.
- ⁹³ Except for dividends paid by HLP, Reliant’s 10-Ks are not consistent for years prior to 1991. Therefore, this study uses data concerning Reliant’s assets, revenues, and retained earnings only for the years 1991 through 1998. Also, in 1997 the holding company merged into HLP, which became an operating holding company. Therefore, dividends paid by HLP during 1997 are assumed to have been paid to shareholders, thus 1997 dividends are not included in the total dividends paid by the operating company to its parent holding company.
- ⁹⁴ HLP’s industrial sales are very large, and since industrial sales took a major downturn between 1993 and 1995, total sales per customer also dropped steeply during this period, even though sales for residential and commercial customers increased. Since 1995, sales per customer have increased.
- ⁹⁵ PUCT, note 90.
- ⁹⁶ From <http://www.reliantenergy.com/into-internat.asp>, viewed on April 9, 1999.
- ⁹⁷ Southwestern Electric Service became a wholly-owned subsidiary of TU in 1993. Also, data showing dividends paid by SES are only available for the years 1993 to 1996.
- ⁹⁸ PUCT, note 90.
- ⁹⁹ The Public Utility Commission of Texas did not provide any estimates of stranded costs for SES.
- ¹⁰⁰ From http://www.tu.com/news_info/general_info/history.html, viewed on April 9, 1999.
- ¹⁰¹ From: http://www.tu.com/news_info/general_info/overview.html, viewed on April 9, 1999.