

PUHCA FOR DUMMIES: An Electricity Blackout and Energy Bill Primer

A guide to the Public Utility Holding Company Act for harassed, over-papered, over-worked, sleep-deprived legislative aides, politicians, journalists, consumer advocates, governors, mayors and others concerned with the reliability and cost of electricity

By Lynn Hargis*
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[This primer is styled as answers from the PUHCA POOBAAH to questions from a hypothetical Capitol Hill aide new to the statute.]

Q. What is PUHCA and why should I care?

A. It's the Public Utility Holding Company Act (pronounced "pooh-ka," like Winnie the Pooh) and *you should* care about it if:

- You think high electricity and natural gas bills affect your constituents (and their voting habits);
- You think any of your constituents have invested in, or have pensions invested in, the stock markets;
- You think that the electricity crisis in California had something to do with crippling the 5th largest economy in the world;
- You don't want to go through another stock market crash and Great Depression;
- You think *this latest* blackout was bad!!

Q. Oh, you mean that 1935 depression-era Holding Company Act? Everyone says that it's out of date.

A. Much of the revolution-era U.S. Constitution dates from 1789, but it's not out of date. Neither is PUHCA. For example, PUHCA still extensively regulates the spread, size,

* Lynn Hargis served as assistant general counsel for electric rates at the Federal Energy Regulatory Commission (FERC) in the 1980s. For the past 17 years, she has worked as a lawyer advising clients on FERC and PUHCA regulatory matters. She joined Public Citizen, a national, nonprofit consumer advocacy organization, in 2003 out of concern about electricity deregulation.

types of business and finances of utility holding companies, so that they cannot loot or otherwise financially endanger their utility subsidiaries.

Q. What is a “holding” company, anyway?

A. A *holding* company owns or *holds* stock in another company; a *public utility holding company* owns or *holds* stock in an electric (or retail natural gas) utility.

Q. What exactly does PUHCA do?

A. PUHCA: (1) limits the geographic spread (therefore, size) of utility holding companies, the kinds of business they may enter, the number of holding companies over a utility in a corporate heirarchy, and their capital structure; (2) controls the amount of debt (thus, cost of capital), dividends, loans and guarantees based on utility subsidiaries (so the parents can't loot or bankrupt the utility subsidiary), and the securities that parent companies may issue; (3) regulates self-dealing among affiliate companies and cross-subsidies of unregulated businesses by regulated businesses; (4) controls acquisitions of other utilities and other businesses; and, (5) limits common ownership of both electric and natural gas utilities.

Q. (Sarcastically) Is that all?

A. Actually, no. PUHCA also limits the activities (and campaign contributions) of officers and directors of holding companies, has control over their accounts, books and records, and regulates them in a number of other ways.

Should Billionaires and Huge Oil Companies Own Our Public Utilities?

Q. Why do Warren Buffet and ChevronTexaco want to get rid of PUHCA?

A. PUHCA does not allow them to own and control utilities unless they give up their other businesses. (They can passively invest in them now.)

Q. Are you kidding? ChevronTexaco would have to give up its oil business? Buffet would have to give up Berkshire/Hathaway?

A. Correct. PUHCA was enacted because huge holding companies were using secure utility revenues to finance and guarantee other, riskier business ventures around the world, and 53 utility holding companies went bankrupt from 1929 to 1936 after the banks called in their loans.

Q. So PUHCA protects the financial health of public utilities that supply our electricity and retail natural gas?

A. Yes, by controlling their parent companies. Of course, PUHCA was also designed to *reduce over-concentration of economic power* in just a few companies. The top five oil

companies now control 50 percent of oil production in the U.S. If they also controlled public utilities, they would be too powerful for any government to regulate.

Q. But we could look at their books and records, couldn't we?

A. It is clearly impossible for a state (or even federal) utility commission, with its limited staff, to review, much less understand and control, the books and records of a huge conglomerate like ChevronTexaco or ExxonMobil. (The Enron Corp. books and records are a recent example of what a fruitless job that can be.)

Q. And would Warren Buffet even let them see his books and records?

A. Well, he just appealed to the Securities and Exchange Commission (SEC) the rejection of a request for confidentiality under other securities laws. Electricity companies generally seem to be demanding more and more confidentiality as they claim to be competitive and want to protect their "trade secrets."

Q. This is too complicated. I thought PUHCA was only a merger law?

A. Not at all. Holding companies that have to register with the SEC because they cannot qualify for an exemption (there are 65 of them currently) are subject to comprehensive financial *regulation* under PUHCA as discussed above.

Q. That all sounds highly burdensome! No wonder utilities want to kill PUHCA!

A. Well, it may be burdensome, but the credit rating agency Fitch Ratings recently gave the debt of four PUHCA-regulated subsidiaries of Xcel a solid "BBB" rating, even though its PUHCA-*exempt*, merchant power affiliate, NRG, has declared bankruptcy.

Q. In other words, the "burdensome" regulation under PUHCA has at least partially protected the financial health of Xcel?

A. Yes, among many other utility parents, and PUHCA has indeed made the U.S. electric utility industry the strongest in the world financially (and thus the most reliable), until the recent *partial PUHCA repeals* took effect. Now, the Wall Street Journal (among others) describes the electric industry as an "industry in chaos" and we, perhaps coincidentally, have had a major power outage over much of the country.

Q. You are suggesting....?

A. The choice for your legislator may be whether you want utilities to be "burdened" with regulation, or your *constituents* to be burdened with skyrocketing electric and natural gas utility bills, unreliable utility service and an unstable economy.

Q. Why does PUHCA state that it is designed to help state regulation?

A. PUHCA is designed to make state utility regulation more effective by requiring a holding company to incorporate in the same state as the utility it owns to obtain an exemption from PUHCA regulation. This incorporation presumably allows the state to regulate the holding company's finances to protect the utility. (A parent company can *incorporate* in only one state, although it can do business in many.)

Q. What if the parent company owns utilities in more than one state?

A. If a holding company holds stock in utilities in more than one state, then its finances and use of utility revenues and credit is extensively regulated by the SEC, as discussed above. No single state can regulate such finances, and such finances can strongly affect utility rates.

Q. Is this still effective?

A. An article in the July 30, 2003, Washington Post quotes the general counsel of the Kansas Corporation Commission, which has had recent experience with the current need for PUHCA in dealing with scandals at Westar Energy, saying:

“It would be a huge mistake to repeal [PUHCA] at this time.”

Q. So, who supports PUHCA?

A. State utility commissioners, particularly in states like Kansas, who have had recent experience with the need for PUHCA.

The credit ratings agencies Standard & Poor's and Fitch have both described the poor financial performance of utilities that are NOT regulated by PUHCA, even when owned by the same companies. They have suggested that the healthier parts of the electric industry are those that have been “protected” by PUHCA regulation. They note with concern the downward trend of utility ratings for merchant generators and power marketers as a result of partial PUHCA repeals.

Consumer advocates continue to say that PUHCA is a vital consumer protection statute. It protects utility ratepayers from higher costs of capital, cross-subsidization of non-utility businesses and excess costs from affiliate companies, including gas companies. Plus, it promotes local utility control and management. Consumer advocates claim that if PUHCA is *totally* repealed, there will be less reliability of service for consumers and far worse scandals and bankruptcies than those so far –involving Enron, Williams, NRG, Mirant, Dynegy and others – which resulted from partial PUHCA repeals.

Unions support PUHCA because they are concerned that deregulation will result in cuts in vital staff, training and maintenance to increase short-term profits.

Environmentalists are concerned that PUHCA deregulation will result in the constructions of unnecessary generation plants and transmission lines in the pursuit of profits.

Those concerned about the state of our economy support keeping PUHCA, because it has protected utility holding companies and their utility subsidiaries for the past 68 years; before that, they, and the economy, collapsed.

It's the Economy, Dummy

- Q. What does a utility law have to do with stocks, loans and the economy?
- A. The last time there was no PUHCA we had a Great Depression. The stock market crash started it, but the collapse of the utility holding companies caused the depression to go on and on into the 1930s.
- Q. Oh yeah? Why did a bunch of utility owners matter?
- A. Utility stocks were held by a very large number of people, as they are now. When the holding companies crashed, both large and small investors lost tens of millions of dollars in investments.
- Q. Well, why did the utility companies crash? People still needed electricity, even in a depression.
- A. Exactly. It was the parent companies, or “holding” companies that owned or held stock in the utilities, that collapsed because of their *non-utility* investments.
- Q. And that was because ...
- A. There is something about electric and natural gas utilities, with their captive, rate-paying consumers, that is irresistible to venture capitalists. They want to use those guaranteed revenues to invest in risky, potentially high-profit, non-utility schemes. They want to keep the profits, and have the utility's customers bear the risks and assume the debt (certainly, that's what Westar Energy's executives had in mind, according to the Kansas Corporation Commission, see below).
- The holding companies of the late 1920s and early 1930s were so highly leveraged (had so much debt), all supported by the operating utilities at the bottom of the corporate pyramid, that when the banks called in the loans after the crash of 1929, the utility holding companies went down in a heap. The economic consequences for the country were severe.
- Q. What was done to help people?
- A. Congress enacted PUHCA. Under it, utilities have to get rid of their non-utility businesses, and their use of utility credit and revenues are strictly regulated.
- Q. So, that's why a large oil or tobacco company can't own a utility?

A. Correct, unless it is willing to sell its oil or tobacco business. That's one reason a PUHCA-regulated electric utility holding company hasn't gone bankrupt in 68 years, as opposed to 53 bankruptcies in the early 1930s, plus defaults on interest payments by 23 others. Remember the tens of billions that the government bailout of the savings-and-loan industry cost? Well, utility investors, many of them retirees, would have no guarantees and would simply lose the value of their stocks if a utility holding company went belly up.

Q. PUHCA has protected utility holding companies from bankruptcies?

A. Yes. A registered utility holding company executive was overheard admitting that PUHCA has some value "*since it kept us out of the savings and loan debacle.*" A substantial achievement, I should think.

Q. But aren't utilities going bankrupt now?

A. Yes, the deregulated ones, and that's because of recent *partial* PUHCA repeals.

"An Electricity Industry in Chaos"

Q. You claim the Wall Street credit rating agencies think PUHCA is helpful?

A. In a July 31, 2003, article in the Wall Street Journal, a utilities analyst at Standard & Poor's credit rating agency commented on proposed PUHCA repeal:

"[W]hy would you dismantle anything that provides control over an industry that's been in chaos' for the past two years?"

Q. Why has the electricity industry recently been in chaos?

A. The same reports by Standard & Poor's on the continued downward trend of utility credit ratings have attributed this financial decline to the operations resulting from *partial PUHCA repeals* for merchant generation and power marketers.

Q. Then why do people argue that PUHCA repeal is necessary to get *more* investment in utilities, particularly in transmission lines?

A. People like Warren Buffet, known for making large profits for large investors, would like to make large profits on transmission lines but don't want to submit to regulation under PUHCA. (Actually, Buffet is now a passive investor, but he wants to *control* utilities without PUHCA regulation.)

Q. What's wrong with large profits? Are you against capitalism?

A. No. But my question to you is, why should your constituents pay Buffet a large return for something utilities could do for a much more modest return, under traditional utility

investment? How do you think we got the transmission grid that's there now? It was new once, and it was built by the utilities and their ratepayers for modest returns.

Q. But *everyone* says...

A. The “everyone” who says PUHCA is outdated and unneeded turns out to be the *electric utility industry*, both its traditional and so-called “independent” sides – often owned by the same owners, like Xcel and NRG – in other words, the utility industry that has opposed PUHCA since 1935. Utility owners gave upwards of \$20 million and paid lobbyists over \$126 million last year alone to kill PUHCA, and that doesn't count what wanna-be utility owners gave.

Q. What about the SEC? It supports PUHCA's repeal, doesn't it?

A. The SEC has supported the conditional repeal of PUHCA. However, the SEC hasn't done a study of the effects of *partial* PUHCA repeals since 1995. (One of these repeals wasn't even enacted until 1996.) The SEC therefore lacks a current factual analysis on which to evaluate the present effects of the statute and its *partial repeals* on utility financial health and consumer protection.

Q. What about the federal rate regulators – FERC?

A. FERC knows little about PUHCA, which is not surprising, since FERC has never had to enforce the statute but instead deals with utilities, not their parent companies. Indeed, FERC wasn't even aware that its Regional Transmission Company proposals would be affected by PUHCA, an obvious conclusion to anyone familiar with the Holding Company Act. Besides, PUHCA is also an important *investor-protection statute*, and FERC lacks experience in protecting utility investors.

Q. But doesn't FERC regulate utility finances under some other law?

A. FERC has, under its deregulation experiment, uniformly granted *blanket approvals* under the Federal Power Act for all stock issuances and loan guarantees based on utility assets for all electricity sellers that sell at market-based rates. And besides, PUHCA deals with the *parent companies* of utilities, while FERC has no jurisdiction over stock issuances or loan guarantees or other finances of parent companies.

Enron, PUHCA Exemptions and Power Marketers

Q. Are you saying the Enron debacle was a result of *partial PUHCA repeals*?

A. Absolutely. But PUHCA, even partially repealed, still kept Enron from owning more than one utility with captive customers, minimizing that kind of damage.

Q. How did it do that?

- A. Enron had a PUHCA “single state” exemption that required the company to reincorporate in Oregon, where its regulated utility was located. This at least allowed the Oregon state utility commission to prevent even more damage to the local utility and ratepayers.
- Q. Enron reincorporated in Oregon? I thought it was a Texas corporation, that tilted E sign in Houston and all.
- A. Enron *was* a Texas-headquartered company that PUHCA forced to move its incorporation to Oregon in order to own an Oregon utility and still be exempt from PUHCA regulation.
- Q. But that strategy to avoid PUHCA can’t be used often, can it?
- A. Right, only once per company. That’s why Enron owned only one PUHCA-regulated utility.
- Q. But didn’t Enron do lots of other bad things?
- A. Yes, and Enron also had at least three of the *new* exemptions from PUHCA: for owning exempt wholesale generators, foreign utility companies and power marketers (*the partial PUHCA repeals*).
- Q. Did Congress exempt power marketers from PUHCA?
- A. No. The SEC staff decided that electricity *contracts* weren’t “facilities” under PUHCA, even though the FERC decided the opposite under the Federal Power Act. That allows utility holding companies, like Enron, to do by contract transactions what they couldn’t do directly under PUHCA.
- Q. Does the SEC staff get to make those kinds of decisions?
- A. One wouldn’t think so, would one? But the SEC staff gave Enron a “no-action” letter.
- Q. So, I guess PUHCA still does do a lot of things when its enforced?
- A. You can assume Enron and all the other parent companies of utilities that are spending tens of millions of dollars to repeal PUHCA think that it does. And don’t forget political contributions from the “new investors” that want to get in on a good thing; that is, *electricity ratepayer revenues*, to use or misuse as they see fit.

Competition vs. Consolidation

- Q. Isn’t PUHCA’s repeal supposed to promote electricity competition?
- A. Most industry observers, including the SEC, if asked, will admit that PUHCA’s repeal will most likely lead to *massive consolidation of utility ownership*.

- Q. That doesn't sound competitive. Don't the antitrust laws take care of that?
- A. No. The antitrust enforcers (Department of Justice and Federal Trade Commission) have repeatedly told Congress that, unlike PUHCA, the antitrust laws have no structural limitations.
- Q. What does that mean in English?
- A. That the antitrust laws that protect competition: (1) don't prohibit only three or four parent companies from owning all the nation's utilities; and (2) would not stop utilities from owning other businesses or vice versa. In other words, ExxonMobile can own Southern Company, PG&E and Verizon, and still pass muster under the antitrust laws (and under FERC's merger rules, as well).
- Q. Well, at least the utilities won't have captive customers any more.
- A. Oh, yeah? Nothing in the current PUHCA repeal proposals takes away utility monopolies. The parent monopolists like Southern Company will just be *unregulated*.
- Q. Well, why limit widespread acquisitions of utilities by a company?
- A. PUHCA assumes there is a local interest in local utilities. PUHCA seeks to preserve local control and management over utilities.
- Q. But what about foreign companies? They now own U.S. utilities, right?
- A. A 1992 PUHCA exemption allowing American companies to own foreign utilities has been interpreted by the SEC as also allowing foreign utility owners to acquire U.S. utilities for the first time since 1935.
- Q. Did Congress mean to do that?
- A. The SEC says that it is not sure that Congress intended this result. Nonetheless, the SEC keeps approving foreign acquisitions of American utilities, subject to PUHCA regulation.
- Q. But what happens if PUHCA is repealed?
- A. The foreign parent companies won't be subject to U.S. utility financial regulation.
- Q. I don't want foreign companies owning my utility! Utilities are essential services — look at Iraq! Look at the blackout!
- A. The security issues involved with electric utilities can, we hope, be left to the appropriate government authority. But at least the issue of local control over rates and services is clearly a PUHCA *consumer* issue that should be debated, not ignored, by Congress, which seems to listen only to energy companies.

Westar Energy Scandal

- Q. You mentioned the Westar Energy scandal at the beginning of this discussion; what does it have to do with PUHCA?
- A. Westar Energy, the biggest utility in Kansas, asked certain members of Congress for a “grandfather provision on PUHCA repeal.” (See internal Westar Energy memo at www.citizen.org/cmep.) It seems that if PUHCA is repealed, Westar Energy will lose the exemption it now enjoys from the Investment Company Act, designed to protect investors, because of comparable PUHCA-provided regulation.
- Q. So if PUHCA is repealed since it is “redundant” because of other laws, the utilities will then get exemptions from those other laws?
- A. If they can afford a “seat at the table,” which Westar Energy apparently believed it could get if it made substantial campaign contributions to various members of the energy conference committee. (See Westar memos, www.citizen.org/cmep.)
- Q. Why does Westar Energy need an exemption from the Investment Company Act?
- A. The Kansas Corporation Commission found that the Investment Company Act would have prevented Westar Energy’s executives from self-dealing among affiliate companies in acquiring stock in a new, non-regulated part of the utility (that they thought would make them lots of money). The plan would have stuck the utility and its ratepayers with \$1.8 billion in debts for such businesses, which would be spun off from the utility to their new owners.
- Q. So what did the Westar Energy executives do?
- A. Westar Energy executives plotted to make contributions to certain members of Congress to get an exemption from the Investment Company Act when PUHCA was repealed, so they could go through with the sweetheart, insider deal. This plot came to light when company e-mails were released in an investigation of a related bank loan fraud.
- Q. I recall that the legislators involved said that the Westar Energy executives were just dreaming that the money would get them what they wanted?
- A. Well, Westar Energy *did* get the exemption inserted into last year’s House conference energy bill, as planned in the memos, even though the exemption was in neither bill that earlier passed the House or Senate and was opposed by the SEC.

Also, an attempt to delete the Westar exemption was voted down by Reps. Joe Barton of Texas, Billy Tauzin of Louisiana and other members of Congress who were targeted in the memos to either receive Westar Energy contributions directly or to designate them for others (like House Majority Leader Tom DeLay’s “immediate needs” for a political action committee called Texans for a Republican Majority).

- Q. So, you're telling me that Kansas electricity executives gave money, to be used to elect Republicans in swing Texas districts, so that the utility executives could make a financial killing on non-utility assets to be paid for by Kansas electricity ratepayers?
- A. You got it. Is this a great government, or what? They gave \$63,200 in total, but would reap millions from this deal.
- Q. Wow. But why does the Kansas Corporation Commission want to save PUHCA? Sounds like they took care of Westar Energy themselves, by killing the deal.
- A. Like Enron, Westar Energy had to subject itself to state regulation in order to be exempt from PUHCA. If there is no PUHCA, a utility's parent company can just incorporate in another state and avoid most state regulation.
- Q. At least the states can still regulate *retail* electric rates.
- A. Wrong. All "wholesale" electricity sales, those sales among PUHCA-exempt wholesale generators and power marketers, are subject to FERC, which now leaves their regulation to the "market" (e.g., Enron, Dynegy, Williams, NRG, Mirant, etc.). States are required to include these costs of electric power in retail rates under that 1789 revolution-era law, the U. S. Constitution; it's the part called the Supremacy Clause.

California, etc.

- Q. Next you're going to tell me that the mess in California was because of PUHCA exemptions!
- A. That's right, along with deregulation by FERC (and, of course, by the original California legislators who, perhaps inadvertently, handed their power supply over to FERC by requiring that all power be bought in the wholesale market). Those "out-of-state" electricity generators the governor kept complaining about, as well as a lot of in-state generators, and all the power marketers that FERC has been investigating for manipulating the market, were *all exempt from PUHCA* and subject only to FERC rate regulation. Moreover, California was required (once the retail rate freeze, endorsed by FERC to protect consumers from this market rate experiment, was lifted) to include wholesale power costs in retail rates, *see* the Supremacy Clause discussion, above.

"The Sector Vaporized Half a Trillion Dollars in Market Value"

- Q. What about the rest of the country?
- A. The July 2003 Standard & Poor's report states that of 183 utility downgrades issued last year, only 11 were for regulated utilities.
- Q. Any other evidence of harm from partial PUHCA repeals?

- A. An Aug. 6, 2003, article in *Newsday* reports: “In mid-July, Atlanta-based Mirant Corp. became the biggest corporate bankruptcy of the year. Days later, Maryland-based Allegheny Energy filed an emergency request with the [SEC] to borrow \$2.2 billion. Missouri-based Aquila Inc. begged Colorado’s Public Utility Commission to allow it to use utility assets as collateral – just to maintain daily operations. *The sector vaporized half a trillion dollars in market value.*” [ital. added] And it did it as a result of businesses based on the partial PUHCA repeals for generating plants, foreign utilities and power marketers.

Plus, this report and many others indicate that the worst is not over by any means.

Conclusion

- Q. You make it sound like the partial repeals of PUHCA have caused all of the utilities’ financial problems?
- A. That seems to be the consensus of the credit rating agencies.
- Q. Yet many people say what we need is *more* PUHCA exemptions, more risky financial investments, less regulation, more consolidation, back to the good old 1920s and ‘30s.
- A. Pouring water on a drowning man.... It’s a theory, I guess.
- Q. You say PUHCA repeal is bad for consumers, bad for investors, bad for the environment, bad for labor and bad for the economy. If that’s true, nobody in his or her right mind would vote to repeal PUHCA!
- A. Correct. You’re not such a dummy!
- Q. But then why have both houses of Congress proposed to repeal PUHCA?
- A. I’m sorry, this is a primer on how PUHCA works, not on how Congress works. (But see Westar Energy* discussion, above, for some possible answers.)

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To read more about PUHCA and other energy concerns, visit www.citizen.org/cmep.

* In all fairness to the current executives at Westar Energy, they recently adopted a plan to end contributions to political candidates. Unfortunately, Congress itself does not seem to have taken any such steps to end industry financial influence since the House Ethics Committee refuses to look into the Westar matter.