

# PUHCA REPEAL: IS THE TIME NOW?

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON  
FINANCE AND HAZARDOUS MATERIALS  
OF THE  
COMMITTEE ON COMMERCE  
HOUSE OF REPRESENTATIVES  
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## PUHCA REPEAL: IS THE TIME NOW?

THURSDAY, OCTOBER 7, 1999

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON COMMERCE,  
SUBCOMMITTEE ON FINANCE AND HAZARDOUS MATERIALS,  
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2123, Rayburn House Office Building, Hon. Michael G. Oxley (chairman) presiding.

Members present: Representatives Oxley, Tauzin, Gillmor, Cox, Shimkus, Towns, Barrett, Luther, Markey and Hall.

Staff present: Brian McCullough, majority professional staff member; David Cavicke, majority counsel; Robert Simison, legislative clerk; and Consuela Washington, minority counsel.

Mr. OXLEY. The subcommittee will come to order.

We are here today to examine the Public Utilities Holding Company Act of 1935, better known as PUHCA. You can say that this hearing concludes electricity week in Rayburn room 2123. I suspect many people out in the audience have been here for so long this week that we should have been considerate enough to put sleeping bags and a coffee pot here in the committee room.

The Finance and Hazardous Materials Subcommittee has a special interest in PUHCA because of the role of the SEC. Congress turned to SEC regulation in the 1930's in order to address shareholder and ratepayer abuses stemming from the perplexing structure of utility holding companies. But with the exception of PUHCA and maybe Glass-Steagall, we are living in the 1990's and not the 1930's. Investors are adequately protected by other measures. The responsibility for regulating utilities has long since been capably assumed by the State commissions and FERC. Increasingly, we are finding that consumers are better served by a competitive market than a regulatory regime. It is in this context that people are asking whether PUHCA is an asset or merely antiquated.

What particularly strikes me is that the SEC itself has in essence said that it wants out of this business. It is not often that you hear that from a regulatory agency. But in staff reports and today's testimony, the Commission has pointed out PUHCA's redundancy in real-world costs. I understand that some of our witnesses will state that PUHCA is standing in the way of a more robust national marketplace by hemming in not just a handful of registered holding companies, but discouraging many other utilities from moving into new markets.

Other witnesses will argue that PUHCA should be repealed only in conjunction with overall industry restructuring. One issue of particular interest to me is what degree of access to utility books and records is appropriate in the event of PUHCA repeal. Private companies are not public libraries, and the protection of sensitive internal information is a legitimate concern.

It is no secret that PUHCA repeal is being discussed in the context of larger issues. One valuable aspect of today's subcommittee hearing is we will have a chance to learn if on its merits as a securities statute PUHCA is still of any use, or, worse, doing harm.

That ends the Chair's opening remarks, and I will turn to the ranking member Mr. Towns.

Mr. TOWNS. Thank you very much, Mr. Chairman.

I have long maintained that electricity restructuring does not have to be done all at once or as a complete package. In fact, the Federal Energy Regulatory Commission took 3 years plus to write the rule to implement the last energy policy changes that were adopted by this committee. This suggests to me that where restructuring issues are involved, that they are very complex and require detailed scrutiny.

There are areas, however, which I believe the Federal Government can and should act on to facilitate utility restructuring. Those dozen or so utilities that are still subjected to PUHCA are at a clear disadvantage in comparison to their gas and electric utility competitors who are exempt from the act's control. The SEC has signaled that they believe that the time is long past for needed regulation by the Commission. Unfortunately, there are some voices who believe that no Federal forum should occur until we have a comprehensive restructuring bill.

I would hope that good policy would not simply be held hostage politically for the sake of a larger bill. If PUHCA repeal is the right action, then we should move forward without any preconditions or any hesitation.

It is my hope, Mr. Chairman, that regardless of the Commerce Committee's final determination on an electricity restructuring bill, that we will move to repeal the Public Utility Holding Act in the 106th Congress, and I anxiously wait to hear from the witnesses on this very, very important issue.

Thank you very much, Mr. Chairman, and I yield back the balance of my time.

Mr. OXLEY. The gentleman yields back. The chairman recognizes the vice chairman of the committee Mr. Tauzin.

Mr. TAUZIN. Thank you, Mr. Chairman.

This is an issue that is relatively important to me. We are here to address the simple question of whether or not it is now prudent to repeal the Public Utility Holding Company Act of 1935, whether it is time to enter the new millennium with a modern mentality.

Mr. Chairman, I believe we should repeal PUHCA as soon as possible. I asked my staff to look at the first couple of bills that I filed in Congress, I got here in 1980, and in 1982 as one of the first bills that I filed, House bill 6581, a bill sponsored by myself and John Breaux of Louisiana, who is now in the U.S. Senate. It is a simple bill, a stand-alone bill to repeal PUHCA. 1982. Essen-

tially we filed the same bill this year in 1999, House bill 2363, again to repeal PUHCA.

To repeal anything around here is not an easy task. I had a great friend of mine from the Southwest Energy Council, which I chaired, a five-State energy compact which I chaired as a State legislator in Louisiana. I was part of that energy compact in order to fight the regulatory laws here in Washington that were impeding the orderly development of energy markets in the part of the world that produces most of the energy for America.

And that young man had moved with me. He had gotten a job at FERC, and he came by to visit me in the first couple of weeks of my attendance here in Congress, and I remember him sitting down and telling me about all of his new responsibilities for the Federal Energy Regulatory Commission. And I smiled and I said, do you know that I got elected on a pledge to deregulate energy? I have a promise to see what I can do about abolishing FERC, and that means your job. And he smiled back and he said, Billy, I am now on the B team. I said, B team, what do you mean? He said, I will be here when you come, and I will be here when you leave. He is still here, and so is PUHCA, and so is FERC.

In 1935, you can make a case that PUHCA was important because it was enacted to address rising abuses out of pyramid corporate structures. In the 1930's, that was a real problem. At that time applicable State and Federal laws in place were inadequate to protect consumers and investors from arbitrary rate hikes. But since 1935, these laws have become much more comprehensive and sensitive to present marketing conditions. The ability of State commissions to regulate holding company systems together with the emergence of regulation under the Federal Power Act of 1935, the Natural Gas Act of 1938 have eliminated regulatory gaps that existed in 1935. The expanded ability of State commissioners and the FERC to regulate interaffiliate transactions has now, frankly, rendered PUHCA unnecessary.

Despite these developments, PUHCA remains on the books. PUHCA says to some energy companies, you can't do things that other competing energy companies can do. It says to some energy companies, you can't invest in efficiencies for your consumers that its competitors can invest in. And as we move toward deregulation of the energy markets, first as we have on the wholesale level and now as Mr. Barton is going to attempt to mark up a bill to deregulate on the retail level, what sense does it make to have my energy company inhibited in making efficiency investments that somebody else's energy company that will compete with it is not restricted in? What sense indeed in a free market?

Now, I realize today that, Mr. Chairman, you have got on the panel later on, representatives of the New Orleans City Council, which in 1982 opposed John Breaux and my efforts to appeal PUHCA, and in 1999 are still opposing our efforts. Some things never change. They will not convince me, and I will not convince them, and the fact that they are here still opposing it is an indication of how these old laws and structures remain on the books.

But let me say something in closing, Mr. Chairman. The reason I came to Congress as a representative of the great State of Louisiana, having served 9 years in the State legislature, fighting and

battling the mandates and regulations that came out of this committee, this Commerce Committee, the reason I ran for Congress was to get on this Commerce Committee and do what I can to tear down that awful fabric and awful scheme of regulations which inhibited my people, the people of Louisiana, from producing freely in a marketplace the energy that this country needed.

And we are still about that today. That task is not complete. It will be a little more complete, I hope, after this hearing and after Mr. Barton begins marking up his bill, because the Barton bill contains the PUHCA repeal that is contained in the bill that I filed in 1982 and the one that I filed this year.

Mr. Chairman, I remember coming to visit with the Reagan White House, pleading with them to do something about taxation of royalty owners in Louisiana. We were taxed at 90 percent; 90 percent of our income was taken by the Federal Government. That is how awful the regulations and taxes and inhibitions were on those of us who wanted to produce energy for America. We have made a lot of gains since those days. This is one that we need to win, too.

I want to close by saying that I can't stay. I have to be at a whip meeting. I am part of whip organization to try to get our legislation moving, and then I move over to the Presidential round table where Majority Leader Dick Armey and I will debate a much more important repeal than even PUHCA. We are going to debate repeal of the IRS Code and the IRS itself. I leave this issue in your good hands, Mr. Chairman.

Mr. OXLEY. Mr. Luther.

Mr. LUTHER. Thank you, Mr. Chairman. I don't have an opening statement.

Mr. OXLEY. The gentleman from California Mr. Cox.

Mr. COX. I just want to thank the chairman for focusing attention on this issue. I certainly share the interest that my colleague Mr. Tauzin just expressed in this.

It goes without saying that a hell of a lot has happened since 1935, so we are not being precipitous in focusing our attention on this. The Federal Power Act, the National Gas Act, FERC and everything else that the States are doing has eclipsed the state-of-the-art from 1935, and this is a very, very timely issue to take up at this point, and so I congratulate the chairman.

Mr. OXLEY. I thank the gentleman.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. PAUL GILLMOR, A REPRESENTATIVE IN CONGRESS  
FROM THE STATE OF OHIO

Mr. Chairman, I want to thank you for calling this second hearing on the subject of the Public Utility Holding Company Act (PUHCA). As you are aware, this Federal law has tremendous reach in our state of Ohio and I am glad we are taking to examine its implications.

Since our hearing largely expands upon the work this panel began a few weeks ago, I will not spend a great deal of time re-outlining my position on this issue. Rather, I want to take a brief moment to recognize and welcome a fellow "Buckeye" to our hearing.

Bill Lhota has been in the American Electric Power Company (AEP) system for almost 35 years, serving now as Executive Vice President. His current responsibilities include energy transmission and distribution services, as well as pricing functions and corporate, consumer, and environmental affairs for AEP's seven state territory. His counsel has been terribly helpful to me over the years and his insight

on PUHCA in a deregulating electric market will be most insightful. I look forward to hearing his testimony.

Again, Mr. Chairman, thank you for this time and I look forward to the panels we will hear from today.

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PREPARED STATEMENT OF HON. TOM BLILEY, CHAIRMAN, COMMITTEE ON COMMERCE

I commend you, Mr. Chairman, for holding this hearing today on PUHCA. This is a statute that crosses Subcommittee lines and I appreciate you holding this hearing in a timely fashion. The Securities and Exchange Commission administers the Act and therefore maintains a role in the legislative process regarding this aspect of electricity deregulation. This is a statute in the securities laws, and therefore an appropriate hearing for the Subcommittee on Finance and Hazardous Materials.

You have all heard me say I want competition for retail electricity consumers. Given that *competition* is now the engine driving market developments in the utility industry, PUHCA reform is widely supported. Combined with greater discipline imposed on holding companies by the markets, concerns about abusive practices by the holding companies have changed.

The SEC conducted a study of the Act and issued a report in 1996 on its findings. The Commission's recommendation then, as is still the case, is for *conditional* repeal. However, I believe that PUHCA repeal should be linked to competition. Competition is a far better protector of consumers than regulation. In 24 States, with 60% of the population, the decision has been made to move from monopoly control of retail rates, to competitive electricity sales. But in a case where there is no competition (which is the case for roughly 40% of the nation's ratepayers) some regulation is needed during the transition to a national marketplace for electricity.

Thus, I continue to believe that repeal of PUHCA, absent comprehensive deregulation legislation, is a mistake. Market power issues cannot be solved by PUHCA repeal without companion legislation that addresses the much larger competitive issues.

PUHCA repeal is a provision that has always been closely linked to comprehensive electricity deregulation and is therefore a timely hearing. The Subcommittee on Energy and Power is scheduled to markup comprehensive electricity deregulation legislation this month.

Thank you once again, Mr. Chairman. I look forward to hearing the testimony of our witnesses today.

Mr. OXLEY. The Chair now turns to the first panel. Let me introduce both of them. Mr. Douglas W. Smith, general counsel for FERC, and Isaac C. Hunt of the SEC. Welcome. Let's begin with Mr. Smith.

**STATEMENTS OF DOUGLAS W. SMITH, GENERAL COUNSEL,  
FEDERAL ENERGY REGULATORY COMMISSION; AND ISAAC  
C. HUNT, JR., COMMISSIONER, SECURITIES AND EXCHANGE  
COMMISSION**

Mr. SMITH. Mr. Chairman and members of the subcommittee, good morning. My name is Douglas Smith, and I am the general counsel of the Federal Energy Regulatory Commission. I am here today as a Commission staff witness and do not speak for the Commission or for individual members of the Commission.

I did want to note that Chairman Hoecker, the Commission's Chairman, regrets that he was not able to participate in this hearing personally. He was planning to participate before the hearing was rescheduled.

Mr. OXLEY. We were victims of the hurricane, and we appreciate your being here.

Mr. SMITH. My testimony will address the Public Utility Holding Company Act of 1935 and other related issues arising in the debate relating to the restructuring of the electric industry.

Competition is growing in bulk power markets, spurred by reforms of the Energy Policy Act of 1992 and the Commission's efforts to remove barriers to competition and to let markets—instead of regulators—determine the price of wholesale power. Competition in wholesale markets ultimately reduces prices for end users. Competition can still be impaired, however, by cross-subsidization and the exercise of market power.

As Congress considers reform or repeal of PUHCA, it is critical that regulators have an updated and effective set of tools to combat cross-subsidization and market power if the public is to benefit from competition in the generation sector. Thus, repeal of PUHCA is appropriate only if FERC and State regulators are given adequate authority to examine the books and records of companies affiliated or associated with public utilities, in order to prevent cross-subsidization of entrepreneurial ventures by captive utility customers. Such cross-subsidization occurs if utilities with captive customers pay an excessive price for goods and services purchased from affiliated or associated companies, or if they charge an inadequate price for goods and services provided to those companies.

If PUHCA is not repealed in its entirety, Congress should address the problem created by the court's decision in the Ohio Power case. Under that decision, FERC cannot examine the reasonableness or prudence of costs incurred by a public utility under a contract for nonpower goods or services with an affiliated company belonging to the same registered holding company. The result of this decision is that utility customers served by registered holding companies have less protection than customers served by nonregistered systems.

The impact of PUHCA reform proposals on competition and consumer interests should be evaluated in the context of accompanying proposals for Federal Power Act reforms. Review of public utility mergers under section 203 of the Federal Power Act remains essential to protect consumers against market power and other possible adverse effects of mergers, and the authority to conduct these reviews should not be compromised. The Federal Power Act should be amended to clarify the Commission's jurisdiction to review mergers of public utility holding companies. Moreover, to guard against undue concentration in generation markets that could undermine competition, section 203 review should be extended to transactions involving only generation facilities.

Ensuring fair access to essential transmission services is also critical to support competitive power markets. In this regard the Federal Power Act should be reformed to extend the Commission's open access transmission authority to all transmitting utilities in the lower 48 States, to reinforce the Commission's authority to promote regional management of the transmission grid through regional transmission organizations, and to establish a fair and effective program of mandatory reliability standards.

Several pending legislative proposals would also enhance Commission authority to remedy market power outside the context of a merger or rate review. These proposals would, for instance, permit the Commission, upon request, to assist a State commission that identifies market power problems in its retail market, but lacks adequate authority to address the problem. As the Commis-

sion seeks to move toward light-handed regulation of competitive markets, its ability to monitor the market and to identify and effectively remedy exercises of residual market power becomes more important.

Thank you again for the opportunity to offer my views this morning. I would be pleased to answer any questions you may have.

[The prepared statement of Douglas W. Smith follows:]

PREPARED STATEMENT OF DOUGLAS W. SMITH, GENERAL COUNSEL, FEDERAL ENERGY REGULATORY COMMISSION

Mr. Chairman and Members of the Subcommittee: Good morning. My name is Douglas Smith, and I am the General Counsel of the Federal Energy Regulatory Commission (Commission or FERC). I appear as a Commission staff witness, and do not speak on behalf of the Commission or any Commissioner. Thank you for the opportunity to appear before you today. My testimony will address the Public Utility Holding Company Act of 1935 (PUHCA) and other related issues in the restructuring of the electric utility industry.

My testimony makes three key points:

- (1) Repeal of PUHCA is appropriate only if FERC and the states are given adequate authority to examine the books and records of companies affiliated or associated with public utilities in order to prevent subsidization of entrepreneurial ventures by captive utility customers.
- (2) As the industry moves toward competitive power markets, regulators must have effective tools for addressing market power problems.
  - (a) Federal Power Act (FPA) review of public utility mergers remains essential to protect consumers against market power and other possible adverse effects of mergers.
  - (b) FPA merger review should be extended to cover generation-only mergers and utility holding company mergers.
  - (c) Regulators need effective tools to protect wholesale and retail customers from the exercise of market power that does not arise from a merger.
- (3) In order to address transmission market power and promote regional market efficiencies, Congress also should reinforce the Commission's authority to promote establishment of, and participation in, regional transmission organizations.

In sum, it is critical that regulators have an updated and effective set of tools to guard against cross-subsidization and the exercise of market power to ensure that the public benefits from competition in the generation sector.

I. INTRODUCTION

Let me begin by explaining the Commission's role in regulating the utility industry. In enacting Part II of the FPA in 1935, one of the primary Congressional goals was to protect electric ratepayers from abuses of market power, such as excessive or discriminatory rates imposed by utilities with a monopoly or other forms of market power. In furtherance of this goal, Congress directed the Commission to oversee sales for resale and transmission service provided by public utilities in interstate commerce. Under sections 205 and 206, the Commission must ensure that the rates, terms and conditions of these services are just, reasonable, and not unduly discriminatory or preferential. Under section 203, the Commission must review proposed mergers, acquisitions and dispositions of jurisdictional facilities by public utilities, and must approve such transactions if they are consistent with the public interest. The Commission's regulation under these sections applies only to "public utilities," which mainly include investor-owned utilities and exclude the federally-owned utilities, municipal utilities, and most rural electric cooperatives.

The traditional regulatory approach has been to regard electricity generation as a natural monopoly, and to address market power and protect ratepayer interests primarily by relying on cost-of-service rate regulation. In the 1980s and early 1990s, however, industry developments indicated that the interests of ratepayers could be better protected by competition in generation markets than by cost-based regulation for wholesale sales. The benefits of competition in place of traditional regulation were increasingly evident in other industries, such as trucking, railroads, telecommunications and natural gas. Also, prompted by a range of economic, legislative and technological factors, some competition among power generators already had begun developing in the electric industry. One key factor was the Public Utility Regulatory Policies Act of 1978 (PURPA), which opened the door for non-utility genera-

tors. In the Energy Policy Act of 1992, Congress strongly endorsed competition in wholesale power markets with amendments to the FPA and PUHCA.

The Commission has pursued this pro-competition focus by ordering open access to transmission facilities in Order No. 888, and in its merger and wholesale rate policies. The Commission's primary focus shifted from cost-based ratemaking for wholesale sales to creating the conditions for robust competition in the bulk power market. This transition has required the Commission to pay increasing attention to issues of market structure, market power, and market monitoring.

The growth of competition in the electricity industry has triggered debate on a wide range of possible changes in federal law. Chairman Hoecker and I have testified on some of these changes in other recent Congressional hearings. For example, we believe that Congress should adopt legislation bringing all transmission facilities in the lower 48 states within the Commission's open access transmission authority, and establishing a fair and effective program to protect bulk power reliability. Today, however, my testimony will focus on three issues—PUHCA reform; merger review and market power; and regional transmission organizations.

## II. PUBLIC UTILITY HOLDING COMPANY ACT

When PUHCA was enacted in 1935, the utility industry was dominated by a small number of holding companies. For various reasons, these companies and their utility subsidiaries were often able to evade effective regulation and, as a result, charge excessive rates for electric energy. PUHCA was intended primarily to restrict the abusive practices of these holding companies and to allow effective regulation of transactions between or among holding company subsidiaries. PUHCA was enacted simultaneously with Part II of the FPA, which provided the framework for Federal regulation of public utilities, as described above.

As a general matter, the Securities and Exchange Commission (SEC) regulates registered utility holding companies under PUHCA while, under the FPA, FERC regulates the operating electric utility and gas pipeline subsidiaries of the registered holding companies. The agencies often have responsibility to evaluate the same general matters, but from the perspective of different members of the holding company system and for different purposes. FERC focuses primarily on a transaction's effect on utility ratepayers. The SEC focuses primarily on a transaction's effect on corporate structure and investors.

With increasing competition in power markets, however, PUHCA may no longer advance consumers' interests. For example, acquisitions by registered holding companies generally must tend toward the development of an "integrated public-utility system." To meet this requirement, the holding company's system must be "physically interconnected or capable of physical interconnection" and "confined in its operations to a single area or region." This requirement tends to result in geographic concentrations of generation ownership, which in turn enhances market power and diminishes competition.

In the Energy Policy Act of 1992, Congress initially addressed the tension between PUHCA and competition. Congress allowed an exemption from PUHCA regulation for companies engaged exclusively in the business of selling electric energy at wholesale. By using this exemption, many new companies have begun competing in wholesale markets across the country. These new exempt wholesale generators (or EWGs) cannot compete for retail sales, however, even where States have allowed retail competition.

Many argue now that PUHCA should be repealed entirely. They assert that increasing competition in the electric industry, and improvements in state and federal rate regulation since the 1930s, make PUHCA an anachronism or, worse, an impediment to further competition. PUHCA's encouragement of regional concentration of generation ownership, for example, is undesirable in competitive markets. Thus, it is an appropriate time to reform or repeal PUHCA.

However, any legislation to reform or repeal PUHCA must ensure that FERC and the States have adequate authority to examine the books and records of all companies in a holding company system that are relevant to costs incurred by an affiliated or associated public utility. This type of authority will provide an effective tool to protect against affiliate abuse and ensure that captive utility consumers do not cross-subsidize entrepreneurial ventures. Absent this type of authority, utilities may be able to subsidize affiliated companies at the expense of captive customers by, for example, paying an excessive price for goods and services purchased from affiliated companies or charging an inadequate price for goods and services provided to affiliated companies. Cost allocation arrangements among such companies can also result in an improper shift of costs to captive customers.

If PUHCA is not repealed, Congress should at least address the Ohio Power problem. In a 1992 decision by the United States Court of Appeals for the District of Columbia Circuit, *Ohio Power Company v. United States*, 954 F.2d 779 (D.C. Cir. 1992), the court held that if a public utility subsidiary of a registered holding company enters into a service, sales or construction contract with an affiliate company, the costs incurred under that affiliate contract cannot be reviewed by FERC. The court reasoned that because the SEC has to approve the contract before it is entered into, FERC cannot examine the reasonableness or prudence of the costs incurred under that contract. FERC must allow those costs to be recovered in wholesale electric rates, even if the utility could have obtained comparable goods or services at a lower price from a non-affiliate.

The *Ohio Power* decision has left a significant gap in rate regulation of electric utilities. The result is that utility customers served by registered holding companies have less rate protection than customers served by non-registered systems. If the contract approval provisions of PUHCA are retained, this regulatory gap should be closed to restore FERC's ability to regulate the rates of utilities that are members of registered holding company systems.

### III. MERGER REVIEW AND MARKET POWER

As noted above, the Commission reviews proposed mergers, acquisitions and dispositions of jurisdictional facilities by public utilities, and must approve such transactions if they are consistent with the public interest. In a policy statement adopted in 1996, the Commission stated that, in assessing whether a proposed merger was in the public interest, it would consider the effects of the merger on competition, on rates and on regulation.

In most cases decided since then, the primary issue has been the effect on competition. Consistent with its overarching goal of promoting competition in wholesale power markets, the Commission seeks to ensure that mergers will not harm competition. If a merger is likely to harm competition, mitigation of this potential harm is required in order to ensure that the merger is consistent with the public interest.

Under this authority, the Commission has required merger applicants to prevent competitive harm by providing others with access to their transmission facilities, thus ensuring that the merger did not reduce the competitive options available to wholesale buyers and sellers. Similarly, the Commission has accepted commitments by applicants to turn over control of their transmission facilities to independent system operators (ISOs), as a way of ensuring the merger did not cause competitive harm. The Commission also has required rate protection for captive customers. These and other conditions and commitments imposed or accepted by the Commission have provided substantial benefits to the public and, thus, ensured that the mergers were consistent with the public interest.

I would also emphasize that, in the past few years, the Commission has improved the timeliness of its merger decisions significantly. In its 1996 policy statement on mergers, the Commission made a commitment to act on mergers within 90 days of the end of a 60-day public comment period (a total of 150 days). Since making that commitment, the Commission has received 30 merger applications and acted on 23 of them, the other seven having been filed only recently. The Commission set only three of these 23 cases for hearing. The Commission has met its target of acting within 150 days consistently. In fact, in a number of cases, the Commission has acted much more quickly, within 93-117 days. The Commission also has sought to authorize other corporate transactions as quickly as reasonably possible, often in as few as 35 days.

A few have argued that the Commission should no longer review mergers. They posit that the Commission's review is redundant of the efforts of the U.S. Department of Justice or the Federal Trade Commission. I disagree.

First, the Commission's day-to-day involvement with the electric industry gives it a valuable and detailed understanding of electricity markets as they are shaped by the transmission grid. This expertise can provide critical insights in assessing a merger's competitive effects.

Second, the Commission's duty to consider the public interest encompasses not only competitive effects but also other effects, such as possible increases in cost-based rates for transmission service. Since certain aspects of the utility industry are not subject to effective competition, the scope of inquiry conducted by the Commission helps to protect consumers from effects not considered by the antitrust agencies.

Third, the Commission's procedures permit public participation in a timely process to determine the public interest. This public review process remains important

in the context of today's electric industry, given the vital importance of the electric industry to American citizens and the national economy.

With the possible repeal of PUHCA's corporate structure restrictions, it is essential that the Commission's merger review under the FPA remains intact. The Commission's merger review is a key component of market oversight, especially in a competitive era. Congress should act to close two gaps in the Commission's jurisdiction over mergers, especially if the corporate oversight restrictions of PUHCA are eliminated.

The first such gap is that the Commission has no direct jurisdiction over transfers of generation facilities. It can review transactions involving a public utility only when they involve other facilities that are jurisdictional (such as transmission facilities or contracts for wholesale sales). Thus, although concentration of generation assets may directly affect competition in wholesale markets, transactions involving only generation assets may not be subject to FPA review.

Second, the Commission lacks direct jurisdiction over mergers of public utility holding companies. While the Commission has considered such mergers to involve jurisdictional indirect mergers of public utility subsidiaries of the holding companies, or changes in control over the jurisdictional facilities of the public utility subsidiaries, the FPA is not explicit on this point.

These jurisdictional gaps could be usefully addressed in the course of legislative reform. Appropriate legislative language can be found in H.R. 2944 (§ 401), offered by Representative Barton, H.R. 1828 (§ 502), offered by Representatives Bliley and Dingell on behalf of the Administration, and in H.R. 2050 (§ 110), offered by Representatives Largent and Markey.

Several pending legislative proposals would enhance the Commission's authority to address market power outside the context of mergers. For example, the Administration's proposed bill, H.R. 1828, would allow the Commission to address market power in retail markets, if asked to do so by a state lacking adequate authority to address the problem. It would also give the Commission explicit authority to address market power in wholesale markets by requiring a public utility to file and implement a market power mitigation plan. H.R. 2050, sponsored by Congressmen Largent and Markey, also contains provisions that would allow mitigation of market power, to the benefit of competition and consumers. Such provisions are particularly desirable in circumstances where a State lacks adequate authority to address market power issues and seeks FERC's assistance. As the Commission moves toward light-handed regulation, its ability to monitor the market and to identify and address exercises of residual market power becomes more important.

#### IV. REGIONALIZATION OF TRANSMISSION

For many decades, most public utility mergers have involved utilities that were adjacent or near to each other. In large part, this stems from PUHCA's integration requirement. As noted above, this requirement is hard to reconcile with expanding competition in generation markets. However, regional aggregation of transmission facilities can still provide substantial benefits. As Congress considers repealing PUHCA, Congress should also consider the need for new tools for promoting regional operation of transmission facilities.

On this point, the Commission currently is exploring (through a proposed rule-making issued in May of this year) how it might promote the formation of regional transmission organizations (RTOs) such as ISOs and independent companies that own and operate transmission facilities (transcos). An RTO that covers an appropriately configured region, has adequate operational control over the transmission grid, and is independent of the financial interests of power market participants, can address obstacles to competition by reducing rate pancaking, eliminating opportunities for bias in transmission operations, and allowing for more efficient and reliable operation and planning of the transmission grid.

Any legislation addressing the restructuring of the electric utility industry should reinforce the Commission's authority to promote regional management of the transmission grid through RTOs. RTOs should be the platform for bulk power competition and enhanced reliability, which are valuable consumer protections. Without reinforcement of our authority by Congress, efforts to develop RTOs may take longer than necessary and may not include transmission owners that are not public utilities, and therefore ultimately may fail to provide the full competitive opportunities achievable through regionalization of grid management. Authority to effectively promote RTO development is necessary to ensure that customers have access to as many competitive choices as the market can provide.

## V. CONCLUSION

As we seek to rely more heavily on competitive markets as opposed to traditional price regulation to protect the interests of wholesale electricity customers, regulators need appropriate tools to address cross-subsidization and market power problems that may threaten competition.

PUHCA reform is appropriately considered in the debate on comprehensive, pro-competitive electricity legislation. If Congress repeals PUHCA, Congress should simultaneously ensure that FERC and the states have adequate authority to examine the books and records of all utility affiliates and associates in order to prevent cross-subsidization by captive utility customers. If Congress does not repeal PUHCA in its entirety, the Ohio Power problem should be addressed, at a minimum, to ensure that FERC has adequate authority to review affiliate transactions to ensure just and reasonable rates and prevent cross-subsidization.

As the Commission and the Congress both seek to promote competition in bulk power markets, it is essential to effectively address market power. With respect to ensuring fair access to essential transmission services, reforms to the Federal statutory scheme are appropriate to extend the Commission's open access transmission authority to all transmitting utilities in the lower 48 States, reinforce the Commission's authority to promote regional management of the transmission grid through RTOs, and establish a fair and effective program of mandatory reliability standards. Moreover, it is critical to retain and update the FPA requirement for public interest review of mergers. Finally, providing ample regulatory authority to address market power problems in non-merger contexts is appropriate to foster competitive power markets.

Thank you again for the opportunity to offer my views here this morning. I would be pleased to answer any questions you may have.

Mr. OXLEY. Thank you, Mr. Smith.

Mr. Hunt, welcome back to the committee.

**STATEMENT OF ISAAC C. HUNT, JR.**

Mr. HUNT. Thank you, Mr. Chairman, members of the subcommittee. I am Commissioner Isaac C. Hunt, Jr., of the U.S. Securities and Exchange Commission. I am pleased to have this opportunity to testify before you this morning on behalf of the SEC regarding the Public Utility Holding Company Act of 1935. The Commission continues to support efforts to repeal the 1935 act and replace it with legislation that preserves certain important consumer protections.

During the first quarter of this century, the electric and gas utility industries had developed serious problems through the misuse of the holding company structure. The 1935 act was passed by Congress to address these problems. Reorganization and simplification of existing public utility holding companies in order to eliminate those abuses was a major part of the SEC's work in the years following the passage of the 1935 act.

By the early 1980's, the SEC had concluded that the 1935 act had accomplished its basic purposes, and its remaining provisions, to a large extent, either duplicated other State or Federal regulation or otherwise were no longer necessary to prevent the recurrence of the abuses that led to its enactment. The SEC concluded that many aspects of the 1935 act regulation had become redundant: State regulation had expanded and strengthened since 1935, and the SEC had enhanced its regulation of all issuers of securities, including public utility holding companies. In addition, institutional investors, such as pension funds and insurance companies, had become more sophisticated and demanded more detailed information from all issuers of securities than was previously available. Changes in the accounting profession and the investment banking

industry also provided investors and consumers with a range of protections unforeseen in 1935. Therefore, the SEC unanimously recommended that Congress repeal the statute.

Because the potential for abuse through the use of multistate holding company structures, and related concerns about consumer protection, continued to exist, and because of a lack of consensus for change, repeal legislation was not enacted in the early 1980's. Since that time, however, the SEC has continued its efforts to administer the 1935 act flexibly, to accommodate developments in the industry while adhering to the basic purpose of the statute. In addition, Congress has created a number of statutory exceptions to the regulatory framework of the 1935 act.

In the summer of 1994, in light of regulatory and other changes taking place in the utility industry, the SEC staff, at the direction of Chairman Arthur Levitt, undertook a study of regulation of public utility companies which culminated in a June 1995 report. Based on the report, the SEC has recommended that Congress consider three legislative options for eliminating unnecessary regulatory burdens. The preferred option is repeal of the 1935 act, accompanied by the creation of additional authority at the State and Federal level to permit the continued protection of consumers. The Federal Energy Regulatory Commission should have the authority to exercise jurisdiction over transactions among holding company affiliates. The FERC and State utility commissions should be able to review these transactions by having access to books and records. This course of action will achieve the economic benefits of unconditional repeal and also protect consumers.

The SEC is aware that proposals of comprehensive reform of energy legislation are under consideration by Congress. Repeal of the 1935 act could also be considered as part of this overall reform. The SEC continues to support a comprehensive approach to reform of the 1935 act.

The SEC has implemented many of the numerous administrative initiatives that were recommended in the report to streamline regulation. Despite the effects of these initiatives, developments in the utility industry are resulting in increased activity under the 1935 act, especially in the areas of mergers and acquisitions, diversification and affiliate transactions. These developments include the accelerating pace of competition initiatives at the State level, FERC's leadership in addressing open transmission and related structural issues, and the increasing internationalization of the utility industry.

These developments raise additional challenges in applying the act to an industry that bears little resemblance to the industry which existed in 1935. Moreover, during 1998, mergers resulted in the formation of three new registered holding companies. The SEC expects that several holding companies will be required to register under the act in the near future. Hence, continuation of the 1935 act in its present form will require additional resources.

The options of conditional repeal or an expansion of the SEC's exemptive of authority also raise the issue of resources. Repeal of the 1935 act would not achieve significant cost savings for the Federal Government, particularly if some of the responsibilities now handled by the SEC were carried out by the FERC. Expanded ex-

emptive authority, on the other hand, could require greater resources, in view of the need to evaluate and implement broad requests for exemptive relief. The SEC respectfully defers to the judgment of Congress as to whether the public interest is better served by separate independent repeal of the 1935 act or repeal as part of a larger legislative initiative.

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

And of course, Mr. Chairman, I would be pleased to answer your and the committee's questions.

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

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

Chairman Oxley, Ranking Member Towns, and Members of the Subcommittee: I am pleased to have this opportunity to testify before you on behalf of the Securities and Exchange Commission ("SEC"). The SEC continues to support repeal of the Public Utility Holding Company Act of 1935 ("1935 Act"). Repeal should be done in a manner that eliminates duplicative regulation while also preserving important protections for customers of utility companies in multistate holding company systems.

I. INTRODUCTION

The electric and gas utility industry had developed serious problems in the first quarter of the century through the misuse of the holding company structure.<sup>1</sup> The 1935 Act was enacted to address these problems. In the years following passage of the 1935 Act, the SEC worked to reorganize and simplify existing public utility holding companies in order to eliminate abuses.

In the early 1980's, the SEC unanimously recommended that Congress repeal the statute.<sup>2</sup> The SEC concluded that the 1935 Act had accomplished its basic purpose and that its remaining provisions, to a large extent, either duplicated other state or federal regulation or otherwise were no longer necessary to prevent recurrence of the abuses that led to its enactment. Many aspects of 1935 Act regulation had become redundant: state regulation had expanded and strengthened since 1935, and the SEC had enhanced its regulation of all issuers of securities, including public utility holding companies. In addition, institutional investors such as pension funds and insurance companies had become more sophisticated and demanded more detailed information from all issuers of securities than previously available. Changes in the accounting profession and the investment banking industry also had provided investors and consumers with a range of protections unforeseen in 1935.

Because the potential for abuse through the use of multistate holding company structures, and related concerns about consumer protection, continued to exist, and because of a lack of consensus for change, repeal legislation was not enacted in the early 1980s. Since that time, however, the SEC has continued its efforts to administer the 1935 Act flexibly to accommodate developments in the industry while adhering to the basic purpose of the statute. In addition, Congress has created a number of statutory exceptions to the regulatory framework of the 1935 Act.<sup>3</sup>

<sup>1</sup>These abuses included inadequate disclosure of the financial position and earning power of holding companies, unsound accounting practices, excessive debt issuances and abusive affiliate transactions. See 1935 Act section 1(b), 15 U.S.C. § 79a(b).

<sup>2</sup>See *Public Utility Holding Company Act Amendments: Hearings on S. 1869, S. 1870 and S. 1871 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 97th Cong., 2d Sess. 359-421 (1982) (statement of SEC).

<sup>3</sup>Most recently, Congress enacted the Telecommunications Act of 1996. Pub. L. 104-104, 110 Stat. 56 (1996). The Telecommunications Act permits registered holding companies, without prior SEC approval under the 1935 Act, to acquire and retain interests in companies engaged in a broad range of telecommunications activities.

## II. THE SEC'S STUDY

In response to continuing changes in the utility industry in recent years, and the accelerated pace of those changes, Chairman Arthur Levitt directed the SEC's Division of Investment Management in 1994 to undertake a study, under the guidance of then-Commissioner Richard Y. Roberts, to examine the continued vitality of the 1935 Act. The impetus for the study was the changing landscape in public utility regulation noted above, and the SEC's increasing need to respond flexibly in the administration of the 1935 Act. Its purpose was to identify unnecessary and overlapping regulation, and, at the same time, identify those features of the statute that remain appropriate in the regulation of the contemporary electric and gas industries.<sup>4</sup>

The SEC staff worked with representatives of the utility industry, consumer groups, trade associations, investment banks, rating agencies, economists, state, local and federal regulators, and other interested parties during the course of the study. In June 1995, the Commission released a report ("Report") of the staff's findings made during the study. Based on these findings, the SEC has recommended, and continues to recommend, that Congress repeal the 1935 Act. At the same time, however, the SEC also recommends enactment of legislation to provide necessary authority to the Federal Energy Regulatory Commission ("FERC") and the state public utility commissions relating to affiliate transactions, audits and access to books and records, for the continued protection of utility consumers.

The SEC supports conditional repeal of the 1935 Act for several reasons. As the Report indicates, portions of the 1935 Act, such as those governing issuance of securities, acquisition of other utilities, and acquisition of nonutility businesses by registered holding companies, largely duplicate other existing regulation and controls imposed by the market. Nevertheless, there is a continuing need to ensure the protection of consumers.

Electric and gas utilities have historically functioned as rate-regulated monopolies. There is a continuing risk that these monopolies, if left unchecked, could charge higher rates and use the additional funds to subsidize affiliated non-utility businesses to boost their competitive positions in other markets ("cross-subsidization"). As long as electric and gas companies continue to function as monopolies, the need to protect against the cross-subsidization of nonutility businesses will remain. An effective way to guard against cross-subsidization is audits of books and records and federal oversight of affiliate transactions.

Utility rates are regulated by state authorities, and regulators vary in the degree of scrutiny they give these rates. A survey of state regulation, undertaken in conjunction with the study, revealed that the states may not have adequate authority to perform audit and review functions with respect to multistate holding companies. The provisions of the 1935 Act provide significant assistance to these states in their effort to protect utility consumers. Earlier efforts to repeal the 1935 Act may have failed because they did not address this potential "regulatory gap" in consumer protection.

## III. PROPOSALS TO REPEAL THE 1935 ACT

Repeal of the 1935 Act may be accomplished either separately or as part of a more comprehensive package of energy reform legislation. Several bills have been introduced in both Houses of Congress during the current session that provide for the repeal of the 1935 Act, either as part of comprehensive energy restructuring or on a stand-alone basis. Five bills have been introduced in the House of Representatives (collectively, the "House Bills"). H.R. 2363, introduced on June 25, 1999 by Congressman Tauzin, Congressman Towns and several other members of Congress, would repeal the 1935 Act on a stand-alone basis. Four bills, including H.R. 1828, introduced by Chairman Bliley and Congressman Dingell (by request) on May 17, 1999, and H.R. 2050, introduced by Congressman Largent and Congressman Markey on June 8, 1999, would repeal the 1935 Act as part of broader energy-related

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<sup>4</sup>The study focused primarily on registered holding company systems, of which there are currently nineteen. The 1935 Act was enacted to address problems arising from multistate operations, and reflects a general presumption that intrastate holding companies and certain other types of holding companies which the 1935 Act exempts and which now number more than 100, are adequately regulated by local authorities. Despite their small number, registered holding companies account for a significant portion of the energy utility resources in this country. As of December 31, 1998, the nineteen registered holding companies owned more than \$170 billion of electric utility assets, approximately 25 percent of all assets owned by investor-owned electric utilities. Electric utilities owned by registered holding companies served 26.4 million customers, or approximately 22% of all electric customers in the United States.

legislation.<sup>5</sup> The House Bills share many common provisions. For example, the House Bills would provide the FERC with the right to examine books and records of registered holding companies and their affiliates that are relevant to costs incurred by associated utility companies, in order to protect ratepayers. The House Bills also would provide an interested state commission with access to such books and records (subject to protection for confidential information), if they are relevant to costs incurred by utility companies subject to the state commission's jurisdiction and are needed for the effective discharge of the state commission's responsibilities in connection with a pending proceeding. Finally, the House Bills would provide a transition period in which states, utilities and other parties affected by the change in the regulatory structure could prepare for the new framework. The House Bills accomplish many of the goals of the conditional repeal advocated by the SEC.<sup>6</sup>

As the SEC stated in testimony on similar bills introduced in the last Congress to repeal the 1935 Act, the House Bills do not give the FERC the authority it needs to oversee transactions among affiliates in holding company systems and, in this respect, do not reflect the SEC's preferred legislative option.<sup>7</sup> Provisions granting access to books and records provide the FERC and the state commissions with the authority they need to identify affiliate transactions, review their terms and evaluate their effects on utility costs and rates. However, the potential for cross-subsidization and consequent detriment to consumers remains, and the SEC believes it is important that the FERC have the flexibility to engage in more extensive regulation, if necessary. As a result, the SEC continues to support a broader grant of authority to the FERC to oversee these transactions, including, if the FERC deems it appropriate, prior review and approval of affiliate transactions.

The SEC notes that the Report recommended a transition period of at least one year in duration. The National Association of Regulatory Utility Commissioners has since suggested that a longer period is necessary, in view of the fact that many state legislatures only meet biennially. The SEC would have no objection to a longer transition period.

#### IV. OTHER RECOMMENDATIONS

The SEC Staff Report proposed two other legislative options: complete repeal of the 1935 Act and a grant of broader exemptive authority under the 1935 Act to the SEC.

The SEC believes that complete repeal is premature, because the monopoly power of the industry has not yet been completely eradicated and current state regulation varies. Some commentators contend, however, that the states have the ability, if they choose to exercise it, to create regulatory structures that will protect utility consumers in holding company systems to the same extent as they are protected by the 1935 Act. Complete repeal, like conditional repeal, would require a reasonable transition period. As noted above, some states may need over a year to enact new legislation or to add resources to meet the additional regulatory burden that would accompany unconditional repeal of the 1935 Act.

<sup>5</sup>H.R. 1587, introduced by Congressman Stearns on April 27, 1999, and H.R. 667, introduced by Congressman Burr on February 10, 1999, would also repeal the 1935 Act as part of comprehensive energy-related legislation.

Three Senate bills (S.516, S.1284 and S.1047) would repeal the 1935 as part of broader energy-related legislation. Another Senate bill, S.313, would repeal the 1935 Act on a stand-alone basis. The 1935 Act repeal provisions in the Senate bills are substantially the same as those in the House Bills other than for the provisions of H.R. 1587 and H.R. 2050 discussed below.

<sup>6</sup>There are some differences among the House Bills. For example, H.R. 1587, among other things, would exempt from its provisions holding companies currently exempt from registration under the 1935 Act. More significantly, H.R. 2050 provides that the 1935 Act would remain in effect for any holding company system that has a public utility subsidiary that provides retail electric or gas service in two or more states in which a state regulatory authority has not provided notice of retail competition pursuant to section 152 of the Public Utility Regulatory Policies Act of 1978 or which has not otherwise required distribution utilities to provide open access service. Repealing the 1935 Act on a company-by-company basis, based on a determination of the status of state initiatives, presents complexities and uncertainties that require further analysis.

<sup>7</sup>See *The Public Utility Holding Company Act of 1997: Hearings on S.621 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 105th Cong., 1st Sess. (1997) (testimony of Isaac C. Hunt, Jr., Commissioner, SEC); and *Regarding Repeal of the Public Utility Holding Company Act of 1935: Hearings on S.621 Before the Senate Comm. on Energy and Natural Resources*, 105th Cong., 1st Sess. (1997) (testimony of Barry Barbash, Director, Div. of Investment Management, SEC). See also *Testimony of Commissioner Isaac C. Hunt, Jr., Commissioner, SEC*, before the Subcomm. on Energy and Power, the House Comm. on Commerce, 106th Cong., 2nd Sess. (1999).

The third option is to provide the SEC with more authority to exempt holding company systems from the requirements of the 1935 Act.<sup>8</sup> An expansion of exemptive authority would not, of course, achieve the economic benefits of conditional or unconditional repeal of the 1935 Act, nor would it simplify the federal regulatory structure.<sup>9</sup> Further, this option would continue to enmesh the SEC in difficult issues of energy policy.

The SEC understands that many believe repeal of the 1935 Act should be accomplished as part of a more comprehensive package of energy reform legislation. The SEC respectfully defers to the judgment of Congress as to whether the public interest is better served by separate repeal of the 1935 Act or repeal as part of a larger legislative initiative.

#### V. ADMINISTRATIVE ACTION

The SEC continues to support a comprehensive approach to reform of the 1935 Act. The SEC has implemented many of the administrative initiatives that were recommended in the Report to streamline regulation.<sup>10</sup> Despite the effects of these initiatives, developments in the utility industry are resulting in increased activity under the 1935 Act, especially in the area of mergers and acquisitions, diversification and affiliate transactions. These developments include the accelerating pace of initiatives at the state level to implement competition, the FERC's leadership in addressing open transmission and related structural issues, and the increasing internationalization of the utility industry. For example, two foreign utilities have recently announced plans to acquire U.S. utility systems. The acquisitions, if completed, would result in two foreign registered holding companies.

These developments raise additional challenges in applying the Act to an industry that bears little resemblance to that which existed in 1935. Moreover, during 1998, mergers resulted in the formation of three new registered holding companies. The SEC expects that several holding companies will be required to register under the Act in the near future. Hence, continuation of the 1935 Act in its present form will require additional resources.

The options of conditional repeal or an expansion of the SEC's exemptive authority also raise the issue of resources. At present, sixteen full-time professional SEC employees are employed in the administration of the 1935 Act. Their work includes (1) analysis and disposition of various transactions for which the 1935 Act requires prior SEC authorization, (2) resolution of status issues under the 1935 Act, (3) audits of holding company systems and related companies, and (4) drafting and imple-

<sup>8</sup>The SEC's current exemptive authority is considerably narrower than the exemptive authority under other federal securities laws. A model of broader exemptive authority is contained in section 6(c) of the Investment Company Act of 1940, 15 U.S.C. § 80a-6(c), which grants the SEC the authority by rule or order to exempt any person or transaction from any provision or rule if the exemption is necessary or appropriate in the public interest and consistent with the protection of investors. See also section 206A of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6a; and section 36 of the Securities and Exchange Act of 1934, as recently amended by the National Securities Markets Improvement Act of 1996, 15 U.S.C. § 78mm (same).

<sup>9</sup>In the past, the SEC has testified before Congress with respect to concerns that arose after the decision by the U.S. Court of Appeals for the District of Columbia Circuit in *Ohio Power v. FERC*, 954 F.2d 779 (D.C. Cir.), cert. denied, 113 S.Ct. 483 (1992). See *Registered Holding Company Transactions: Hearing on the 1992 Ohio Power Decision Before the Subcomm. on Energy and Power of the House of Representatives Comm. on Energy and Commerce*, 103d Cong., 2d Sess. 35-48 (1994) (testimony of Richard Y. Roberts, Commissioner, SEC). The legislative repeal options discussed above would eliminate the problem of conflicting SEC and FERC decisions that were the subject of that decision.

<sup>10</sup>The Report recommended rule amendments to broaden exemptions for routine financings by subsidiaries of registered holding companies (see Holding Co. Act Release No. 26312 (June 20, 1995), 60 FR 33640 (June 28, 1995)) and to provide a new exemption for the acquisition of interests in companies that engage in energy-related and gas-related activities (see Holding Co. Act Release No. 26313 (June 20, 1995), 60 FR 33642 (June 28, 1995) (proposing rule 58) and No. 26667 (Feb. 14, 1997), 62 FR 7900 (Feb. 20, 1997) (adopting rule 58)). In addition, the Report recommended changes in administration of the Act that would permit a "shelf" approach for approval of financing transactions, relax constraints on utility acquisitions and streamline the approval process for such transactions. The Report also recommended an increased focus upon auditing regulated companies and assisting state and local regulators in obtaining access to books, records and accounts. Finally, the Report recommended that the Commission exercise more flexibility in granting exemptions from registration under section 3(a) of the Act, based on the facts and circumstances in each situation and, particularly, assurances from affected state commissions concerning effective state regulation. The Commission has issued three orders based on this approach. *NIPSCO Industries, Inc.*, Holding Co. Act Release No. 26975 (February 10, 1999)(section 3(a)(1)); *Houston Industries Incorporated*, Holding Co. Act Release No. 26744 (July 24, 1997)(section 3(a)(2)); and *AES, Inc.*, Holding Co. Act Release No. 27063 (Aug. 20, 1999), *motion to reconsider pending*, (section 3(a)(5)).

mentation of rulemaking proposals to reflect changes in the utility industry and in financial regulation. Repeal of the 1935 Act would not achieve significant cost savings for the federal government, particularly if some of these responsibilities were carried out by the FERC. Expanded exemptive authority, on the other hand, could require greater resources, in view of the need to evaluate and implement broad requests for exemptive relief.

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

Mr. OXLEY. Thank you, Mr. Hunt, both of you.

Let me begin by asking Mr. Hunt, it has been stated many times that PUHCA is a barrier to entry for companies that would otherwise enter the electric business. If you were Exxon, would you consider entering the energy business as long as PUHCA is on the books?

Mr. HUNT. As long as PUHCA were on the books, I would recognize that there might be serious constraints on the way I wanted to diversify if I entered that industry. I might choose to go into an industry regulated by one State regulatory agency rather than PUHCA, which arguably would have less restrictive burdens on it.

Mr. OXLEY. Your testimony states that the Division of Investment Management carefully considered issues relating to competition in the electric and gas industries. What are the benefits that increased competition in these industries have brought to investors, and can you compare the experience of the gas industry to the electric industry?

Mr. HUNT. In terms of competition?

Mr. OXLEY. Yes.

Mr. HUNT. In terms of competition, I think that the electric industry under PUHCA has probably had, I would think, more restrictions on it than has been the case in the gas industry.

Some of the restrictions in PUHCA require companies that have merged to be in the same geographic area. That is defined in various strange ways in PUHCA.

In the gas industry, being in the same areas sometimes means getting gas from the same source, but the utilities themselves can be in very diverse situations. We have had situations where a California gas utility acquired a North Carolina freestanding utility, gas, but they were considered to be in the same area because they got gas from the same source.

So the statute does have some anomalies in it in terms of how we regulate the electric and the gas industry.

Mr. OXLEY. Let me ask Mr. Smith that basic question, the comparison between the gas industry and the electric industry in relation to competition and growth.

Mr. SMITH. From the Commission's perspective, the growth of competition in the interstate natural gas industry is, one might say, one generation ahead of where competition is in the electric industry. In gas markets, the decontrol of natural gas wellhead prices in the early 1990's was coupled with the Commission's actions in Orders 436 and 636 to move away from regulation of the commodity itself and to regulate as monopoly services the interstate transmission of natural gas. I think we are moving in that direction in the electric industry.

The Commission's primary focus now is on encouraging competition among suppliers of electricity. One of the key elements of doing that is to regulate the essential transmission facilities so that sellers can deliver their electricity.

We still regulate some wholesale power sales under cost-based rates, but a lot of wholesale power sales now are done under market-based rates. We are regulating, in terms of actual cost of service regulation, fewer and fewer of the wholesale sales in the electric industry. In parallel with that, the States are moving toward use of open access to the distribution system and competitive retail markets, and away from cost-of-service rates for retail services. That is a State regulatory decision and not FERC's. That movement is one of the issues that is spurring this whole debate over electricity restructuring, because it raises the question of what changes are needed to Federal law in order to support States that want to move in that direction.

Mr. OXLEY. Let me ask one last question before I turn to our friend from New York.

As you know, some people have proposed sunseting the authority of FERC and the State commissions to review the books and records of holding companies and their affiliates after 2 years. What do you think of that proposal?

Mr. SMITH. I think that both FERC and the State regulators are going to need access to books and records as long as there are utilities with captive customers for whom you want to provide protection against cross-subsidization. If we were going to be in a world where there were no longer captive customers in 2 years, I think you could move away from books and records requirements. I don't expect that to be the case. I think it is highly unlikely.

Mr. OXLEY. Do you think it is highly unlikely even if PUHCA repeal takes place and the markets change, do you still think that there will be captive customers?

Mr. SMITH. At the retail level, unless there is Federal regulation requiring States to go to retail competition at a very accelerated schedule, I think it is highly unlikely. We are not going to have 50 States choosing retail competition in 2 years on their own.

Mr. OXLEY. Thank you.

The gentleman from New York Mr. Towns.

Mr. TOWNS. Thank you very much, Mr. Chairman.

Mr. Smith, you have had an opportunity to look at the pending bills. Will they provide FERC with the adequate authority to protect consumers and promote adequate competition? If not, what should we do?

Mr. SMITH. The chairman has said he supports PUHCA reform, along the lines that has been considered in both Houses over recent years, in conjunction with three or four other procompetitive reforms to the Federal Power Act. As I said in my statement, I believe that if the Commission has access to the books and records, it can do the regulation of cross-subsidization that it needs to do. My understanding—I wouldn't want to speak for the States, but my understanding is that NARUC, the association of the State regulatory commissioners, would also support the repeal of PUHCA with books and records access at least as part of a comprehensive package.

Mr. TOWNS. So the answer is yes?

Mr. SMITH. Yes.

Mr. TOWNS. Commissioner Hunt, your testimony says that the SEC supports repeal of PUHCA as long as repeal preserves important protections for customers. I think it is page 6 of your testimony, you state that the House restructuring bills accomplish many of the goals. I guess my question is what protection does the SEC believe should be preserved?

Mr. HUNT. Well, sir, what we think is that FERC and the State regulatory agencies should have access to books and records to make sure that affiliate transactions are conducted at fair prices and that captive consumers don't see their rates affected because of these affiliate transactions. So we think that the only way to do that is to have at the Federal level the FERC have access to the books and records to examine the terms of the transactions and for the States to have the same access to those books and records.

Mr. TOWNS. Thank you very much, Mr. Chairman. I yield back the balance of my time.

Mr. OXLEY. The gentleman yields back.

The gentleman from California Mr. Cox.

Mr. COX. Thank you. I think I will just pursue the same line of questioning because it is essentially what we are interested in. If everybody is for repeal of PUHCA, but we are now talking about what the landscape looks like in the future, I would like to continue to explore with you what vestige of PUHCA should live on, if any?

I take it from your response, Mr. Hunt, to the last question that what we are concerned with is monopoly power that requires rate regulation, because the concern about affiliate transactions is designed to protect consumers, right? Consumers probably would not need special protections for abuse of monopoly power if there were not monopolies?

Mr. HUNT. Well, I think, Mr. Congressman, part of our view is that the consumers, captive consumers, they need that protection from monopolistic power. They need agencies to examine affiliate transactions to make sure that those costs are not passed on in rates.

If there were truly a universal competitive environment, perhaps that power would not be needed, but it is not there now. It is not going to be there in 2 years. So we think that, yes, the consumer protection aspects of PUHCA are those aspects that need to be preserved for the foreseeable future.

Mr. COX. I think we are on the same page. The reason for the different treatment of holding companies is that they may be exercising monopoly powers?

Mr. HUNT. They may have a lot of power over how they conduct transactions with their affiliates. They buy goods and services from them at what cost? They sell goods and services to affiliate companies. What is the price at which they sell them? We think that, yes, consumers do need to be protected by having agencies that can examine those transactions to make sure that monopolistic power is not unfairly exercised.

Mr. COX. Right. So we are hanging our hat on the monopoly peg. But for that fact, I take it that there would be no reason to aban-

don our essential disclosure framework of the securities laws and to permit companies to make whatever foolish decisions they wish to make in their management, provided it is fully disclosed to the public.

For example, if abuses that were originally concocted for the purpose of manipulating the rate-setting regime continued after there were no longer a rate-setting regime, such as putting property on the books at inflated prices or even transacting for it at inflated prices, that would put the firm at a competitive disadvantage in a real competitive marketplace, and so we would expect that the market would take care of that.

Is there any reason 2 years from now, given what we expect the state of affairs to be, for there to be separate rules for the issuance of securities of holding companies?

Mr. HUNT. No, sir, we don't think so. We think that the Commission has developed and the accounting profession has developed to such an extent that we can get adequate disclosure of the terms under which securities are issued, whether by utility holding companies or any other companies. So we don't think that we need special accounting or disclosure rules for the issuance of securities by holding companies.

Mr. COX. That is very useful to know. And I would like to ask the same question with respect to the solicitation of proxies and insider trading. Are the rules applicable generally?

Mr. HUNT. The rules are applicable generally, and as I mentioned in my oral statement, Mr. Cox, we did do a staff study of the 1935 act in the 1980's, and a review of transactions by holding companies under securities laws hasn't indicated any need for special provisions under the securities laws for utility holding companies.

Mr. COX. And finally, if I may, Mr. Chairman, I think I understood you to say we don't need special rules for financial reporting under generally accepted accounting principles?

Mr. HUNT. I don't think so.

Mr. COX. Do we need any special rules with respect to dividend policy or self-tenders?

Mr. HUNT. We, sir, have not seen any problems arise in those areas that would require special rules for utility companies. Again, what we are concerned about in terms of what vestiges of PUHCA need to exist in the present environment are those remnants of PUHCA that will protect consumers. But in terms of the disclosure of transactions and what we consider the more typical securities laws, we see no reason for special provisions for utility companies.

Mr. COX. My understanding is that there are 19 companies that are registered under PUHCA; is that right?

Mr. HUNT. Nineteen, sir.

Mr. COX. Thank you very much.

Mr. OXLEY. The gentleman from Illinois Mr. Shimkus.

Mr. SHIMKUS. Thank you, Mr. Chairman.

Mr. HUNT, in your testimony you have currently 16 employees who are devoted to administration of the Holding Company Act, doing these 19 companies.

If PUHCA would be repealed, would the Commission see any savings as far as those employees?

Mr. HUNT. If PUHCA were repealed, I don't think that we would—I don't think we ever thought that we would see a significant overall Federal Government savings from the repeal of PUHCA because some of the functions, again, would be transferred to FERC and perhaps to the States. The Division of Investment Management has more than enough work, I think, in terms of regulating investment companies these days.

Mr. SHIMKUS. You know that we are very interested in all of these fees and charges and the big balance statement due there, so this may make that balance even higher if there were fewer employees. Just an editorial comment. You know that we are looking at those fees charged to people in the market.

Mr. HUNT. Yes, sir.

Mr. SHIMKUS. A lot of the deregulatory debate that has evolved—and of course PUHCA is always thrown into the thing. We had 2 days of hearings on the dereg, PUHCA is always one of the key ingredients. It has also come to the point of State-by-State movement. So if a State has no captive customers and no bundling of their charges, and it is one of those 19 companies inside the State, would there be an argument for that company to be absolved of its requirements under PUHCA?

Mr. HUNT. I think, if I understand your question, what we would like to see is that FERC and the State regulators—particularly FERC would still have the power to have access to the books and records to ensure that no transactions that utilities engaged in unfairly harmed consumers, particularly through affiliate transactions. So we still think that FERC should have the authority to access books and records.

Mr. SHIMKUS. But you are testifying for the SEC?

Mr. HUNT. Yes, sir.

Mr. SHIMKUS. Mr. Smith?

Mr. SMITH. Typically when we think about captive customers, we think about captive customers for sales of electricity either at retail or wholesale. Assuming that all of the States went to retail competition, you would still have regulated monopolies in the wires business. In distribution, for instance, you are likely to have a local monopoly.

Mr. SHIMKUS. You will have.

Mr. SMITH. These companies will have captive customers.

Mr. SHIMKUS. I think that is arguable.

Mr. SMITH. You would want to make sure that you had adequate protections to make sure that the charges for distribution, for instance, weren't cross-subsidizing entrepreneurial ventures.

Mr. SHIMKUS. But you would have the Public Utilities Commission which would have a role in doing that, so then we would have a duplication?

Mr. SMITH. Concerns about cross-subsidization of distribution would not be a FERC issue.

Mr. SHIMKUS. Let me ask my final question. Why should the FERC continue to review mergers given the authority of the Department of Justice and the FTC? If we have the Department of Justice and the FTC, why should you be in the role of reviewing the mergers?

Mr. SMITH. First, the Federal Power Act review of mergers looks at a broader range of issues than the antitrust laws, which are focused principally on competition issues. For instance, in reviewing mergers, the Commission looks at impacts on rates, which is essentially a competition issue if you are talking about market-based rates, but it is a separate regulatory issue if you are talking about cost-of-service-based rates. So we apply a public interest test, which is a broader test.

Second, the Commission and its staff have 60 years of expertise in the electric industry itself. One of the key issues in assessing competitive impacts for mergers is trying to understand the size and scope of the market in which you are assessing concentration.

Mr. SHIMKUS. I think the chairman is going to recess for the vote. I think that is going to be a big focus of debate as we move on the bill. Thank you, Mr. Chairman.

Mr. OXLEY. The Chair would note that we have a vote on the floor, and we have 7 minutes. If the gentleman can ask questions for 2 or 3 minutes, I can recognize him. Otherwise I would like to dismiss this panel and start with the second panel when we come back. The gentleman is recognized for 3 minutes.

Mr. MARKEY. This is a very important issue, and I don't know if the witnesses would mind staying. I can come back and have my allotted time.

Mr. OXLEY. Okay. The committee stands in recess for 10 minutes.

Mr. MARKEY. Thank you, Mr. Chairman.

[Brief recess.]

Mr. OXLEY. When we were last here, I was about to recognize my friend from Massachusetts, and I do so now.

Mr. MARKEY. Thank you, Mr. Chairman. I appreciate it.

Good news in today's National Journal, Congress Daily, "DeLay Wants Great FERC Role in Barton Dereg Bill." what it says here is that DeLay, perhaps the most powerful advocate of a restructuring bill, is concerned that Barton's bill does not give the Federal Energy Regulatory Commission enough authority to prevent utility monopolies from abusing their market power. The DeLay aide did not discuss specific remedies, but said a bill has got to have some kind of check on the system to protect the little guy from getting squashed. They don't like the Barton bill.

Do you agree with that, Mr. Hunt and Mr. Smith?

Mr. SMITH. Do I agree that we need to help keep the little guy from getting squashed? Yes.

Mr. MARKEY. And that you need additional authority beyond what is in the Barton bill to ensure that you can protect the little guy from getting squashed; do you agree with that?

Mr. SMITH. I think you heard our Chairman testify a couple of days ago on a number of modifications that he suggested to that bill that would aid our process.

Mr. MARKEY. So do you agree that you need more power in order to protect the little guy, Mr. Smith?

Mr. SMITH. Yes.

Mr. MARKEY. Mr. Hunt, do you agree that you need power than the Barton bill gives you in order to protect the little guy?

Mr. HUNT. We want to get out of protecting the little guy in the utility industry, Mr. Markey. We think that power should be in the hands of FERC.

Mr. MARKEY. So you think that FERC needs more power to protect the little guy?

Mr. HUNT. We think—as we have already said, Congressman Markey, we think that certainly the FERC needs power to access the books and records of any holding company now under our jurisdiction because of PUHCA so long as there are captive consumers of the utility products that need to be protected.

Mr. MARKEY. I understand that FERC currently addresses affiliate abuses by holding companies in the context of merger approvals.

Other than a complaint being brought alleging discrimination in wholesale rates, what are the other contexts in which FERC could address cross-subsidization and affiliate abuse transactions if Congress passed the Tauzin bill as presently drafted?

Mr. SMITH. I think those issues would most typically come up in mergers, as you mentioned, but also in our setting of cost-based rates for either transmission or wholesale sales.

Mr. MARKEY. So you can generally only deal with this in the context of the merger proceedings; is that right? All rate-making?

Mr. SMITH. Rate-making.

Mr. MARKEY. So what authority does the Commission have to take proactive steps to prevent the abuses outside of those?

Mr. SMITH. We don't look at affiliate issues outside of our reviews under Section 203, which relates to mergers, and under Sections 205 and 206, which relate to rates, terms and conditions.

Mr. MARKEY. Do we need to fix that?

Mr. SMITH. I am not sure that we need to fix that. We need to have the access to the information which allows us to make the right judgments to protect the little guys in the context of those proceedings. I am not sure we need an additional avenue.

Mr. MARKEY. Do you think that you have sufficient power to be able to deal with it even if you had access to the records? If you had access to the records, then you would have enough power to get the job done; is that what you are saying?

Mr. SMITH. I think we do. What we would do in a rate proceeding is use the information that we get to make a judgment as to whether there had been imprudent costs incurred by the entity that was charging cost-of-service rates. And if we concluded that there was, we would exclude those costs from the rates. So we would not be barring the transactions. We would be making sure that the company wasn't recovering those costs from captive customers.

Mr. MARKEY. So how many times has the Commission done that in the past year; that is, initiate a proceeding against a company that is charging unjust and discriminatory rates?

Mr. SMITH. I don't know the answer off the top of my head.

Mr. MARKEY. Have you ever done it?

Mr. SMITH. I am reminded that Ohio Power, for instance, which is one of the cases that I commented on earlier, was a case in which the Commission attempted to exclude imprudent costs from utility rates, and the DC Circuit found that we weren't permitted to do that because of PUHCA.

Mr. MARKEY. So in the absence of FERC, you are determining that there are some affiliate abuses which translate into unreasonable rates, and it is a rare day where you guys do that, and the FERC has no authority to address the issue unless a registered holding company merges with another; isn't that correct?

I am trying to help you get a little more authority, Mr. Smith, so you can do your job. These are friendly questions. They are meant for you to delimit how little authority you have in order to get the job done for the consumer, for the little guy. So we can advance the ball in the markup here.

Mr. SMITH. We would like to have sufficient authority to provide exactly the protections that you are describing.

Mr. OXLEY. The gentleman's time has expired.

Mr. MARKEY. Thank you, Mr. Chairman.

Mr. OXLEY. The gentleman from Wisconsin.

Mr. BARRETT. No questions.

Mr. OXLEY. We appreciate your testimony, and this panel is excused.

Mr. HUNT. Thank you, Mr. Chairman.

Mr. SMITH. Thank you.

Mr. OXLEY. The Chair calls Ms. Sharon Heaton, vice president and deputy general counsel, Columbia Energy Group; Mr. William J. Lhota, executive vice president, American Electric Power Company, from Columbus, Ohio, who will explain the collapse of the Buckeyes in the second half at a later time today; Mr. Marty Kanner, campaign coordinator, Consumers for Fair Competition; and Ms. Sherry Quirk, shareholder, Verner Liipfert, on behalf of New Orleans City Council. We will begin with Ms. Heaton.

**STATEMENTS OF SHARON HEATON, VICE PRESIDENT AND DEPUTY GENERAL COUNSEL, COLUMBIA ENERGY GROUP; WILLIAM J. LHOTA, EXECUTIVE VICE PRESIDENT, AMERICAN ELECTRIC POWER COMPANY, ON BEHALF OF REPEAL PUHCA NOW! COALITION; MARTY KANNER, CAMPAIGN COORDINATOR, CONSUMERS FOR FAIR COMPETITION; AND SHERRY A. QUIRK, SHAREHOLDER, VERNER, LIIPFERT, BERNARD, McPHERSON, & HAND, ON BEHALF OF NEW ORLEANS CITY COUNCIL**

Ms. HEATON. Mr. Chairman, members of the subcommittee, my name is Sharon Heaton, and I am deputy general counsel of the Columbia Energy Group, a holding company registered under the Public Utility Holding Company Act of 1935.

Formerly, I served as senior counsel on the Senate Banking Committee, where I worked on, among other things, issues related to PUHCA. I am submitting testimony today to the subcommittee on behalf of an ad hoc group of 11 electric and gas utility systems, with public utility operations in 20 States, collectively the Roundtable Group. On behalf of the Roundtable Group, I would like to thank you for inviting us to submit testimony in favor of legislation repealing PUHCA.

The subject of today's hearing is PUHCA repeal, is the time now? The simple answer is no. The right time was 20 years ago, but now will do. And the longer we wait to repeal this statute, the greater

the costs and disruptions in a rapidly evolving energy industry, with no apparent offsetting benefits.

PUHCA, a statute enacted nearly 65 years ago, was adopted to remedy certain stock market abuses of the 1920's. To prevent a recurrence of these abuses, Congress adopted the Securities Act of 1933, the Securities and Exchange Act of 1934, and a myriad of other securities laws and regulations. SEC was also formed to regulate and oversee the securities markets. Not yet aware of the effectiveness of the newly adopted securities laws and the recently created SEC, Congress enacted PUHCA in 1935 to regulate the corporate affairs of a single operational industry, companies that own utility companies. PUHCA is unique in that it is the only securities statute designed to regulate a single nonfinancial industry.

Simply put, the abuses that PUHCA was designed to prevent are already unlawful under other securities statute. Thus there is no continuing benefit to retaining PUHCA. However, there is a cost to allowing this statute to linger on the books. Continued application of PUHCA is denying electric and gas utilities the flexibility that they need to respond to the significant competitive, economic and regulatory changes occurring in this industry and throughout the world.

Let's remember what PUHCA does and what it does not do. PUHCA does not and was never intended to address rate regulatory issues. Local distribution matters are exclusively within the province of State regulators, while the setting of wholesale rates and other transactions by utilities relating to the transmission of electricity or of natural gas in interstate commerce is regulated by the Federal Energy Regulatory Commission. Repeal of PUHCA would not alter this allocation of jurisdiction and authority. PUHCA is intended, however, to regulate the corporate structure and financings of public utility holding companies and their affiliates.

There is no question but that this authority is redundant of that which the SEC already has under the Securities Act of 1933 and the Securities and Exchange Act of 1934. And in part for that reason, since 1982, the SEC has been on record favoring repeal of PUHCA. If PUHCA were simply unnecessary, its repeal would not be so important. But, in fact, PUHCA imposes structural and economic distortions on the energy industry that work to the detriment of energy consumers as well as shareholders.

With its mandate of a vertically integrated utility system confined to a single geographic region, PUHCA is a clearly a barrier to increasing competition in the electric and gas industries. It inhibits efficiency gains, limits new competitors in the marketplace, leads to differing regulatory rules for competitors that are holding companies, and contributes to inefficient investment decisions by utility management and shareholders. These costs are real, substantial and should not be continued.

Columbia Energy has a unique perspective on the importance of choice for consumers and competition in the utility industry. We have been a leader in the movement toward retail unbundling, allowing consumers, including homeowners, to choose their supplier of gas. We are proud that in Ohio alone 100 percent of our customers are eligible to participate in our choice program. Those cus-

tomers who have participated have saved more than \$32 million. In fact, overall, approximately 86 percent of Columbia Energy's nearly 2.1 million customers are eligible to participate in our choice programs.

Columbia Energy will continue to promote competition in its own businesses and advocate government policies that facilitate competition.

PUHCA should be repealed at the earliest possible date. Therefore, the Roundtable Group would support appropriate stand-alone legislation or the inclusion of satisfactory legislative language repealing PUHCA in an acceptable comprehensive bill.

There are two very important points to consider in this regard. First, given the difficulty over the last several years of crafting a comprehensive bill with broad bipartisan support, we would urge the subcommittee not to let striving for the perfect interfere with achieving the good. For this reason, the Roundtable Group urges the subcommittee to approve expeditiously comprehensive legislation containing those legislative elements around which a bipartisan consensus already exists, such as the repeal of PUHCA.

Second, PUHCA repeal should be clean, without lingering vestiges of this statute. There should be no price to pay for repeal of PUHCA. We raise this issue only because some forms of PUHCA repeal previously suggested contain unnecessarily onerous provisions that undermine the benefits of PUHCA repeal. The Roundtable Group respectfully suggests that the subcommittee consider beginning with the PUHCA language of H.R. 2944 which was introduced by Joe Barton.

My written testimony, which I submit for the subcommittee's consideration and I request to be included in the record, contains specific comments on the PUHCA provisions of H.R. 2944. As the SEC has known for almost 20 years now, PUHCA is an archaic law that has long since served its purpose. The Roundtable urges this subcommittee to approve legislation repealing PUHCA now.

Thank you, Mr. Chairman for the opportunity to submit this testimony to the subcommittee.

[The prepared statement of Sharon Heaton follows:]

PREPARED STATEMENT OF SHARON HEATON ON BEHALF OF THE ROUNDTABLE GROUP

Mr. Chairman, Members of the Subcommittee, my name is Sharon Heaton, and I am Deputy General Counsel of the Columbia Energy Group ("Columbia Energy"), a holding company registered under the Public Utility Holding Company Act of 1935 ("PUHCA"). Formerly, I served as Senior Counsel on the Senate Banking Committee, where I worked on, among other matters, issues related to PUHCA. I am submitting testimony today to this Subcommittee on behalf of an *ad hoc* group of 11 electric and gas utility systems, with public utility operations in about 20 states (collectively, the "Roundtable Group")<sup>1</sup> On behalf of the Roundtable Group, I would like to thank you very much for inviting us to submit testimony in favor of legislation repealing PUHCA.

The subject of today's hearing is "PUHCA Repeal: Is the Time Now?" The simple answer is "No. The right time was 20 years ago, but now will do." And the longer we wait to repeal this statute, the greater the costs and disruptions in a rapidly evolving energy industry, with no apparent offsetting benefits.

PUHCA, a statute enacted nearly 65 years ago, was adopted to remedy certain stock market abuses of the 1920s. To prevent a recurrence of these abuses, Congress adopted the Securities Act of 1933, the Securities and Exchange Act of 1934, and

<sup>1</sup>A complete list of the companies forming the Roundtable Group is set forth in Attachment 1.

a myriad of other securities laws and regulations. The Securities and Exchange Commission (“SEC”) was also formed to regulate and oversee the securities markets. Not yet aware of the effectiveness of the newly adopted securities laws and the recently created SEC, Congress enacted PUHCA in 1935 to regulate the corporate affairs of a single operational industry—companies that own energy utility companies. PUHCA is unique in that it is the only securities statute designed to regulate a single non-financial industry.

Simply put, the abuses that PUHCA was designed to prevent are already unlawful under other securities statutes. Thus, there is no continuing benefit to retaining PUHCA. However, there is a cost to allowing this statute to linger on the books—continued application of PUHCA is denying electric and gas utilities the flexibility they need to respond to the significant competitive, economic and regulatory changes occurring in this country and throughout the world.

Let’s remember what PUHCA does, and what it does not do. PUHCA does not, and was never intended to, address rate regulatory issues. Local distribution matters are exclusively within the province of state regulators, while the setting of wholesale rates and other transactions by utilities relating to the transmission of electricity or of natural gas in interstate commerce are regulated by the Federal Energy Regulatory Commission (“FERC”). Repeal of PUHCA would not alter this allocation of jurisdiction and authority. PUHCA is intended, however, to regulate “the corporate structure and financings of public-utility holding companies and their affiliates.” There is no question but that this authority is redundant of that which the SEC already has under the Securities Act of 1933 and Securities and Exchange Act of 1934. And in part for that reason, since 1982 the SEC has been on record favoring repeal of PUHCA.

If PUHCA were simply unnecessary, its repeal would not be so important. But in fact PUHCA imposes structural and economic distortions on the energy industry that work to the detriment of energy consumers as well as utility shareholders. With its mandate of a vertically integrated utility system confined to a single area or region, PUHCA is clearly a barrier to increasing competition in the electric and gas utility industries. It inhibits efficiency gains, limits new competitors in the marketplace, leads to differing regulatory rules for competitors that are holding companies, and contributes to inefficient investment decisions by utility management and shareholders. These costs are real, substantial and should not be continued.

Columbia Energy has a unique perspective on the importance of choice for consumers and competition in the utility industry. We have been a leader in the movement toward retail unbundling—allowing consumers, including homeowners, to choose their supplier of gas. We are proud that in Ohio one hundred percent of our customers are eligible to participate in our Choice Program. Those customers who do participate have saved more than \$32 million. In fact, overall, approximately 86 percent of Columbia Energy’s nearly 2.1 million customers are eligible to participate in our Choice Program. Columbia Energy will continue to promote competition in its own businesses, and advocate government policies that facilitate competition.

PUHCA should be repealed at the earliest possible date. Therefore, the Roundtable Group would support appropriate “stand alone” legislation or the inclusion of satisfactory legislative language repealing PUHCA in an acceptable “comprehensive” bill. There are two very important points to consider in this regard. First, given the difficulty over the last several years of crafting a “comprehensive” bill with broad bi-partisan support, we would urge the Subcommittee not to let striving for the perfect interfere with achieving the good. For this reason, the Roundtable Group urges the Subcommittee to approve expeditiously “comprehensive” legislation containing those legislative elements around which a bi-partisan consensus already exists, such as the repeal of PUHCA. Second, PUHCA repeal should be clean, without lingering vestiges of this statute. There should be no “price” to pay for repeal of PUHCA. We raise this issue only because some forms of PUHCA repeal previously suggested contain unnecessarily onerous provisions that undermine the benefits of PUHCA repeal.

In considering drafting legislation to repeal PUHCA, the Roundtable Group respectfully suggests that the Subcommittee consider beginning with the PUHCA provisions of H.R. 2944, the Electricity Competition and Reliability Act, which was recently introduced by Congressman Joe Barton. Attachment 2 contains a copy of Subtitle B of H.R. 2944 with our recommended changes.

The only substantive amendment to H.R. 2944 recommended by the Roundtable Group would add a sunset date for both the FERC and state access to books and records provisions. The effective date for PUHCA repeal is subject to a transition period presumably to allow time for the states and FERC to prepare for additional oversight of holding companies. An additional transition period should be provided by maintaining the books and records requirements of H.R. 2944, but only for a lim-

ited time period. For example, Congress could establish a sunset date two years after PUHCA repeal becomes effective. The Roundtable Group clearly believes that FERC and state regulators should have access to all those books and records that are necessary to regulate jurisdictional utility subsidiaries within a holding company system. However, in an increasingly competitive environment, regulators, and in many case competitors, should not be permitted go on “fishing expeditions” through the books and records of non-regulated affiliates which happen to be part of a holding company system. We must balance the interests of fair competition and adequate regulation.

Most certainly, if PUHCA is repealed through “comprehensive” legislation designed to encourage utility competition, the affiliate oversight and access to books and records provisions now contained in H.R. 2944 are simply unnecessary. The competitive forces unleashed through such a measure should be more than adequate to substitute for additional regulation.

As the SEC has noted for almost 20 years now, PUHCA is an archaic law that has long since served its purpose. The Roundtable Group urges this Subcommittee to approve legislation repealing PUHCA now.

Thank you again, Mr. Chairman, for the opportunity to submit this testimony to the Subcommittee.

#### ATTACHMENT 1

##### LIST OF ROUNDTABLE GROUP

CMS Energy Corporation; Columbia Energy Group; Consolidated Natural Gas Company; Duke Energy; Edison International; MDU resources Group, Inc.; NiSource, Inc.; Public Service Enterprise Group; Reliant Energy, Inc.; Sempra Energy; and TXU Corp.

1 filed with the State commission a plan to provide, within  
2 two years after the date of such filing, open access to such  
3 facilities.

4 "(b) FOREIGN COMMERCE.—A retail electric supplier  
5 located in a foreign country which is a party to the North  
6 American Free Trade Agreement shall not sell electric en-  
7 ergy to retail electric consumers in the United States  
8 through local distribution facilities owned, controlled, or  
9 operated by a local distribution company in the United  
10 States unless all local distribution facilities owned, con-  
11 trolled, or operated by the retail electric supplier, or any  
12 affiliate thereof, and located in such country are subject  
13 to open access."

14 (b) EFFECTIVE DATE.—The amendments made by  
15 subsection (a) shall take effect one year after the date of  
16 the enactment of this Act.

17 **Subtitle B—Public Utility Holding**  
18 **Company Act of 1935**

19 **SEC. 511. DEFINITIONS.**

20 For purposes of this subtitle:

21 (1) The term "affiliate" of a company means  
22 any company 5 percent or more of the outstanding  
23 voting securities of which are owned, controlled, or  
24 held with power to vote, directly or indirectly, by  
25 such company.

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1           (2) The term "associate company" of a com-  
2       pany means any company in the same holding com-  
3       pany system with such company.

4           (3) The term "Commission" means the Federal  
5       Energy Regulatory Commission.

6           (4) The term "company" means a corporation,  
7       partnership, association, joint stock company, busi-  
8       ness trust, or any organized group of persons,  
9       whether incorporated or not, or a receiver, trustee,  
10      or other liquidating agent of any of the foregoing.

11          (5) The term "electric utility company" means  
12      any company that owns or operates facilities used  
13      for the generation, transmission, or distribution of  
14      electric energy for sale.

15          (6) The terms "exempt wholesale generator"  
16      and "foreign utility company" have the same mean-  
17      ings as in sections 32 and 33, respectively, of the  
18      Public Utility Holding Company Act of 1935, as  
19      those sections existed on the day before the effective  
20      date of this subtitle.

21          (7) The term "gas utility company" means any  
22      company that owns or operates facilities used for  
23      distribution at retail (other than the distribution  
24      only in enclosed portable containers or distribution  
25      to tenants or employees of the company operating

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1 such facilities for their own use and not for resale)  
2 of natural or manufactured gas for heat, light, or  
3 power.

4 (8) The term "holding company" means—

5 (A) any company that directly or indirectly  
6 owns, controls, or holds, with power to vote, 10  
7 percent or more of the outstanding voting secu-  
8 rities of a public utility company or of a holding  
9 company of any public utility company; and

10 (B) any person, determined by the Com-  
11 mission, after notice and opportunity for hear-  
12 ing, to exercise directly or indirectly (either  
13 alone or pursuant to an arrangement or under-  
14 standing with one or more persons) such a con-  
15 trolling influence over the management or poli-  
16 cies of any public utility company or holding  
17 company as to make it necessary or appropriate  
18 for the protection of utility customers with re-  
19 spect to rates that such person be subject to the  
20 obligations, duties, and liabilities imposed by  
21 this subtitle upon holding companies.

22 (9) The term "holding company system" means  
23 a holding company, together with its subsidiary com-  
24 panies.

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1 (10) The term "jurisdictional rates" means  
2 rates established by the Commission for the trans-  
3 mission of electric energy in interstate commerce,  
4 the sale of electric energy at wholesale in interstate  
5 commerce, the transportation of natural gas in inter-  
6 state commerce, and the sale in interstate commerce  
7 of natural gas for resale for ultimate public con-  
8 sumption for domestic, commercial, industrial, or  
9 any other use.

10 (11) The term "natural gas company" means a  
11 person engaged in the transportation of natural gas  
12 in interstate commerce or the sale of such gas in  
13 interstate commerce for resale.

14 (12) The term "person" means an individual or  
15 company.

16 (13) The term "public utility" means any per-  
17 son who owns or operates facilities used for trans-  
18 mission of electric energy in interstate commerce or  
19 sales of electric energy at wholesale in interstate  
20 commerce.

21 (14) The term "public utility company" means  
22 an electric utility company or a gas utility company.

23 (15) The term "State commission" means any  
24 commission, board, agency, or officer, by whatever  
25 name designated, of a State, ~~municipality, or other~~ ✓

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1 ~~political subdivision of a State~~ that, under the laws  
2 of such State, has jurisdiction to regulate public util-  
3 ity companies.

4 (16) The term "subsidiary company" of a hold-  
5 ing company means—

6 (A) any company, 10 percent or more of  
7 the outstanding voting securities of which are  
8 directly or indirectly owned, controlled, or held  
9 with power to vote, by such holding company;  
10 and

11 (B) any person, the management or poli-  
12 cies of which the Commission, after notice and  
13 opportunity for hearing, determines to be sub-  
14 ject to a controlling influence, directly or indi-  
15 rectly, by such holding company (either alone or  
16 pursuant to an arrangement or understanding  
17 with one or more other persons) so as to make  
18 it necessary for the protection of utility cus-  
19 tomers with respect to rates that such person  
20 be subject to the obligations, duties, and liabil-  
21 ities imposed by this subtitle upon subsidiary  
22 companies of holding companies.

23 (17) The term "voting security" means any se-  
24 curity presently entitling the owner or holder thereof

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1 to vote in the direction or management of the affairs  
2 of a company.

3 **SEC. 512. REPEAL OF THE PUBLIC UTILITY HOLDING COM-**  
4 **PANY ACT OF 1935.**

5 The Public Utility Holding Company Act of 1935 (15  
6 U.S.C. 79a and following) is repealed, effective 12 months  
7 after the date of enactment of this Act.

8 **SEC. 513. FEDERAL ACCESS TO BOOKS AND RECORDS.**

9 (a) IN GENERAL.—Each holding company and each  
10 associate company thereof shall maintain, and shall make  
11 available to the Commission, such books, accounts, memo-  
12 randa, and other records as the Commission determines  
13 are necessary to identify costs incurred by a public utility  
14 or natural gas company that is an associate company of  
15 such holding company and necessary or appropriate for  
16 the protection of utility customers with respect to jurisdic-  
17 tional rates.

18 (b) AFFILIATE COMPANIES.—Each affiliate of a hold-  
19 ing company or of any subsidiary company of a holding  
20 company shall maintain, and make available to the Com-  
21 mission, such books, accounts, memoranda, and other  
22 records with respect to any transaction with another affil-  
23 iate, as the Commission determines are necessary to iden-  
24 tify costs incurred by a public utility or natural gas com-  
25 pany that is an associate company of such holding com-

1 pany and necessary or appropriate for the protection of  
2 utility customers with respect to jurisdictional rates.

3 (c) HOLDING COMPANY SYSTEMS.—The Commission  
4 may examine the books, accounts, memoranda, and other  
5 records of any company in a holding company system, or  
6 any affiliate thereof, as the Commission determines are  
7 necessary to identify costs incurred by a public utility or  
8 natural gas company within such holding company system  
9 and necessary or appropriate for the protection of utility  
10 customers with respect to jurisdictional rates.

11 (d) CONFIDENTIALITY.—No member, officer, or em-  
12 ployee of the Commission shall divulge any fact or infor-  
13 mation that may come to his or her knowledge during the  
14 course of examination of books, accounts, memoranda, or  
15 other records as provided in this section, except as may  
16 be directed by the Commission or by a court of competent  
17 jurisdiction.

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for

18 SEC. 514. STATE ACCESS TO BOOKS AND RECORDS.

19 (a) IN GENERAL.—Upon the written request of a  
20 State commission having jurisdiction to regulate a public  
21 utility company in a holding company system, and subject  
22 to such terms and conditions as may be necessary and ap-  
23 propriate to safeguard against unwarranted disclosure to  
24 the public of any trade secrets or sensitive commercial in-  
25 formation, a holding company or its associate company or

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"(e) SUNSET. -- The provisions of this Section 513 are hereby repealed, effective  
December 31, 2003.

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1 affiliate thereof, wherever located, ~~shall~~ produce for in-  
2 spection books, accounts, memoranda, and other records  
3 that—

that provides  
goods or services  
to, obtains goods  
or services from,  
or engages in  
any transaction  
with such public  
utility company,  
shall

4 (1) have been identified in reasonable detail in  
5 a proceeding before the State commission;

6 (2) the State commission determines are nec-  
7 essary to identify costs incurred by such public util-  
8 ity company; and

9 (3) are necessary for the effective discharge of  
10 the responsibilities of the State commission with re-  
11 spect to such proceeding.

12 (b) EFFECT ON STATE LAW.—Nothing in this section  
13 shall preempt applicable State law concerning the provi-  
14 sion of books, accounts, memoranda, or other records, or  
15 in any way limit the rights of any State to obtain books,  
16 accounts, memoranda, or other records under Federal law,  
17 contract, or otherwise.

18 (c) COURT JURISDICTION.—Any United States dis-  
19 trict court located in the State in which the State commis-  
20 sion referred to in subsection (a) is located shall have ju-  
21 risdiction ~~to enforce compliance with~~ this section.

with  
respect  
to

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text

22 **SEC. 515. EXEMPTION AUTHORITY.**

23 (a) RULEMAKING.—Not later than 90 days after the  
24 date of enactment of this Act, the Commission shall pro-  
25 mulgate a final rule to exempt from the requirements of

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“(e) SUNSET. -- The provisions of this Section 514 are hereby repealed, effective

December 31, 2003.

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1 section 514 any person that is a holding company, solely  
2 with respect to one or more—

3 (1) qualifying facilities under the Public Utility  
4 Regulatory Policies Act of 1978;

5 (2) exempt wholesale generators; or

6 (3) foreign utility companies.

7 (b) OTHER AUTHORITY.—If, upon application or  
8 upon its own motion, the Commission finds that the books,  
9 accounts, memoranda, and other records of any person are  
10 not relevant to the jurisdictional rates of a public utility  
11 company or natural gas company, or if the Commission  
12 finds that any class of transactions is not relevant to the  
13 jurisdictional rates of a public utility company, the Com-  
14 mission shall exempt such person or transaction from the  
15 requirements of section 514.

16 **SEC. 516. AFFILIATE TRANSACTIONS.**

17 Nothing in this subtitle shall preclude the Commis-  
18 sion or a State commission from exercising its jurisdiction  
19 under otherwise applicable law to determine whether a  
20 public utility company, public utility, or natural gas com-  
21 pany may recover in rates any costs of an activity per-  
22 formed by an associate company, or any costs of goods  
23 or services acquired by such public utility company from  
24 an associate company.

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**1 SEC. 517. APPLICABILITY.**

2 No provision of this subtitle shall apply to, or be  
3 deemed to include—

4 (1) the United States;

5 (2) a State or any political subdivision of a  
6 State;

7 (3) any foreign governmental authority not op-  
8 erating in the United States;

9 (4) any agency, authority, or instrumentality of  
10 any entity referred to in paragraph (1), (2), or (3);

11 or

12 (5) any officer, agent, or employee of any entity  
13 referred to in paragraph (1), (2), or (3) acting as  
14 such in the course of his or her official duty.

**15 SEC. 518. EFFECT ON OTHER REGULATIONS.**

16 Nothing in this subtitle precludes the Commission or  
17 a State commission from exercising its jurisdiction under  
18 otherwise applicable law to protect utility customers.

**19 SEC. 519. ENFORCEMENT.**

20 The Commission shall have the same powers as set  
21 forth in sections 306 through 317 of the Federal Power  
22 Act (16 U.S.C. 825e-825p) to enforce the provisions of  
23 this subtitle.

**24 SEC. 520. SAVINGS PROVISIONS.**

25 (a) IN GENERAL.—Nothing in this subtitle prohibits  
26 a person from engaging in or continuing to engage in ac-

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1 tivities or transactions in which it is legally engaged or  
2 authorized to engage on the date of enactment of this Act  
3 , if that person continues to comply with the terms of any  
4 such authorization, whether by rule or by order.

5 (b) EFFECT ON OTHER COMMISSION AUTHORITY.—  
6 Nothing in this subtitle limits the authority of the Com-  
7 mission under the Federal Power Act (16 U.S.C. 791a and  
8 following) (including section 301 of that Act) or the Nat-  
9 ural Gas Act (15 U.S.C. 717 and following) (including sec-  
10 tion 8 of that Act).

11 **SEC. 521. IMPLEMENTATION.**

12 Not later than 12 months after the date of enactment  
13 of this Act, the Commission shall—

14 (1) promulgate such regulations as may be nec-  
15 essary or appropriate to implement this subtitle; and

16 (2) submit to the Congress detailed rec-  
17 ommendations on technical and conforming amend-  
18 ments to Federal law necessary to carry out this  
19 subtitle and the amendments made by this subtitle.

20 **SEC. 522. TRANSFER OF RESOURCES.**

21 All books and records that relate primarily to the  
22 functions transferred to the Commission under this sub-  
23 title shall be transferred from the Securities and Exchange  
24 Commission to the Commission.

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1 **SEC. 523. EFFECTIVE DATE.**

2 This subtitle shall take effect 12 months after the  
3 date of enactment of this Act.

4 **SEC. 524. CONFORMING AMENDMENT TO THE FEDERAL**  
5 **POWER ACT.**

6 Section 318 of the Federal Power Act (16 U.S.C.  
7 825q) is repealed.

8 **Subtitle C—Public Utility**  
9 **Regulatory Policies Act of 1978**10 **SEC. 531. PROSPECTIVE REPEAL.**

11 (a) **NEW CONTRACTS.**—After the date of enactment  
12 of this Act, no electric utility shall be required to enter  
13 into a new contract or obligation to purchase or to sell  
14 electric energy or capacity pursuant to section 210 of the  
15 Public Utility Regulatory Policies Act of 1978.

16 (b) **EXISTING RIGHTS AND REMEDIES NOT AF-**  
17 **PECTED.**—Nothing in this section affects the rights or  
18 remedies of any party with respect to the purchase or sale  
19 of electric energy or capacity from or to a facility deter-  
20 mined to be a qualifying small power production facility  
21 or a qualifying cogeneration facility under section 210 of  
22 the Public Utility Regulatory Policies Act of 1978 pursu-  
23 ant to any contract or obligation to purchase or to sell  
24 electric energy or capacity in effect on the date of the en-  
25 actment of this Act, including the right to recover the  
26 costs of purchasing such electric energy or capacity.

Mr. OXLEY. Thank you, Ms. Heaton. And all of the testimony will be made part of the record under unanimous consent.

The Chair would recognize my friend from Ohio to introduce the next witness.

Mr. GILLMOR. Thank you, Mr. Chairman, and I am pleased to recognize a long-time friend, Bill Lhota. He is not only one of the foremost public utility executives, but is an outstanding citizen in Ohio. I won't tell them all of the many things that we did years ago, Bill, but it is a pleasure to see you here.

Mr. OXLEY. By the way, the Chair was a witness to some of those.

Mr. GILLMOR. Don't you tell either.

Mr. OXLEY. The gentleman from Ohio, when I introduced Mr. Lhota, initially, I said he was going to explain the second half collapse of the Buckeyes against the Badgers, and now I see a Badger down there, so this is getting really tense.

Mr. GILLMOR. I wish somebody would explain that.

#### STATEMENT OF WILLIAM J. LHOTA

Mr. LHOTA. Thank you. I appreciate the opportunity to be here, and I assure you that I will make no efforts to explain the complexities of Ohio State football.

I appreciate the opportunity to be here. I am Bill Lhota, executive vice president of American Electric Power. AEP is a registered holding company subject to the Public Utility Holding Company Act of 1935, or PUHCA.

I wish to commend you, Mr. Chairman and members of the subcommittee, for your efforts during this congressional session and those efforts of the past several Congresses to support PUHCA repeal. I also thank you for the opportunity this morning to express the views of the Repeal PUHCA Now! Coalition.

I was invited today to testify on the subject PUHCA repeal; is the time now? As the name of our coalition suggests, we have been advocating the repeal of PUHCA now since the group's inception in 1994, and now is the time to do so. AEP, along with other members of our coalition, have supported PUHCA repeal since the early 1980's when the SEC recommended that Congress repeal PUHCA. Again in 1995, following a year-long study conducted by the SEC that included the participation of all interest groups, Federal, State and local regulators, consumer groups, rating agencies and academia, the SEC again recommended PUHCA repeal with certain consumer safeguards. Indeed, Mr. Chairman, the support for PUHCA repeal efforts is reflected in the fact that our language has been included in more comprehensive restructuring bills than that addressing any other issue. Republicans and Democrats as well as the administration have proposed these bills.

With this obvious consensus on the need for PUHCA's repeal, the question before us today is whether PUHCA should be repealed now or delayed until Congress decides when and if to enact comprehensive restructuring legislation.

As I have mentioned, we have always supported past recommendations that PUHCA should be repealed on its own without the need to wait for comprehensive legislation. Certainly should Congress begin to move a comprehensive restructuring bill, the coa-

lition supports the inclusion of PUHCA repeal language without tying repeal to retail customer choice.

I will take a few minutes to explain why PUHCA needs to be repealed now. Any delay in PUHCA repeal, Mr. Chairman, continues to hamper true competition in the States that have under State law offered retail choice. PUHCA is a barrier to entry that prevents companies from fully participating in noncontiguous retail markets.

Mr. Chairman, I would like to point out that a little over 70 percent of the U.S. population lives in States that have approved programs that provide for retail choice. For many of our members, competition is upon us or is soon to come. We need the flexibility to compete now. Deferring PUHCA repeal limits registered companies' ability to offer new products and services to customers while our competitors move forward.

Persistent delay in PUHCA repeal unfairly constrains the gas holding companies while Congress decides what to do about electricity restructuring. Registered gas holding companies are restricted under PUHCA like registered electric companies. This is simply unfair.

Consistent delay of PUHCA repeal favors foreign interests over U.S. utilities. Foreign companies can acquire U.S. utilities that U.S. companies cannot.

Mr. Chairman, and the members of this subcommittee, it may be a particular interest to you that stalling PUHCA repeal disadvantages PUHCA companies in the financial markets. There will be continued delay in our ability to issue new types of securities that could lower our cost of capital. PUHCA prohibits without SEC approval the issuance of any newly created securities that have been embraced by the market and issued by other utilities. PUHCA may also limit the use of our generally accepted financial risk management products. Surely at some point, Mr. Chairman, this inequity must end.

Mr. Chairman, our coalition supports the PUHCA repeal provisions of the Barton bill, H.R. 2944, and the Tauzin-Towns bill, H.R. 2363. These bills provide for the replacement of PUHCA with a reformed PUHCA. The legislative language contained in these bills is a product of more than 4 years of negotiation and congressional scrutiny. It addresses the concerns of SEC, FERC and State regulators. It guarantees FERC and the States access to books and records of the registered holding companies and their associate companies to protect the ratepayers. It continues all existing authority for the FERC and the States to review affiliate transactions.

The coalition strongly opposes any language to tie PUHCA repeal to retail choice in the States where we operate, and any proposal that creates a new exemption under PUHCA on the companies offering retail choice. This approach is unfair, unworkable and anti-competitive.

Mr. Chairman, I would like to conclude by emphasizing to you and the members of the subcommittee that only Congress can repeal PUHCA, and the time to act is now. Thank you, again, Mr. Chairman and members, for your interest in this important issue, and I will be glad to respond to questions at the appropriate time.

[The prepared statement of William J. Lhota follows:]

PREPARED STATEMENT OF WILLIAM J. LHOTA, EXECUTIVE VICE PRESIDENT, ENERGY DELIVERY AND CUSTOMER RELATIONS, AMERICAN ELECTRIC POWER CORPORATION ON BEHALF OF THE REPEAL PUHCA NOW! COALITION

Mr. Chairman and Members of the Subcommittee: The Repeal PUHCA Now! Coalition is pleased to submit this testimony to address the need to repeal the Public Utility Holding Company Act (otherwise known as PUHCA). The Repeal PUHCA Now! Coalition is a group of electric and gas companies which has supported enactment of legislation repealing PUHCA as recommended by the Securities and Exchange Commission in a report to Congress in 1995. Member companies include registered and exempt electric and gas utility holding companies restricted under PUHCA. The Repeal PUHCA Now! Coalition believes it is essential that PUHCA repeal legislation be enacted into law this year. Simply put, repealing PUHCA repeals an Act that serves as a barrier to competition, a barrier to state restructuring efforts and a barrier to consumer benefits.

The Coalition commends the Subcommittee for conducting a hearing on PUHCA so that the need and urgency for repeal may be made again this Congress. As discussed below, the Coalition believes that PUHCA repeal must be considered independently, on its own merits. Indeed, keeping the 64-year old statute in place frustrates competition, is a barrier to entry, and actually promotes industry concentration. When this occurs, the case for repealing PUHCA now is overwhelming.

#### I. INTRODUCTION

As everyone here knows, the electric utility industry is changing rapidly. A little over 70% of the U.S. population live in the twenty-three states that have now approved customer choice programs. Other states are considering similar measures. As electricity markets become more and more competitive, the unnecessary limitations of PUHCA on certain utility holding companies and their subsidiaries are not compatible with the current and evolving state of the industry. PUHCA is outdated, duplicative and no longer serves the interests of consumers or investors as noted in the SEC's 1995 report which recommended that PUHCA be repealed. PUHCA has become a regulatory anachronism, a barrier to competition and innovation. It imposes unneeded restrictions, significant costs, and confers no real benefit. The time to act to repeal PUHCA is now and the Repeal PUHCA Now! Coalition urges the Congress to pass PUHCA repeal legislation this year.

PUHCA repeal should not be held hostage to the important debate about the potential further restructuring of the electric industry, or whether comprehensive federal electricity legislation is needed to benefit all consumers nationwide. From state to state and here in Washington, the members of the Repeal PUHCA Now! Coalition have been very active in this debate. But the Congress must realize that electric utility restructuring issues impact all stakeholders in the electric utility industry, not just the eighteen (18) active registered holding companies and one hundred fifty-one (151) exempt electric holding companies. These electric utility restructuring issues deserve serious study, discussion and debate. This discussion and debate is well underway in the Congress. Already in this Congress, there are no less than twelve bills, including the Administration's bill, currently pending in the Congress that would in various respects restructure the electric utility industry. As the number and scope of the various bills reflect, the issues are as contentious as they are complex. As a result, no meaningful consensus has emerged on whether, or if so, when Congress should enact comprehensive electricity legislation. A truly durable consensus will not develop overnight. Moreover, there is no public policy reason to support postponing PUHCA repeal until a restructuring bill is passed. Thus, the Repeal PUHCA Now! Coalition strongly urges that the debate on future electric policy move forward separately from consideration of PUHCA repeal legislation.

Keep in mind, Mr. Chairman, that serious debate and discussion of these global electric policy issues has only developed in the last two Congresses. Conversely, a full merits review of PUHCA repeal started over seventeen years ago. In 1982, the SEC found that PUHCA's statutory objective had been achieved and recommended PUHCA repeal to Congress. In the intervening seventeen years, the case has been overwhelmingly built to show that conclusion was correct. Significantly, in 1995, after conducting another full study that included public hearings and participation of whether PUHCA continues to have relevance given the significant statutory and regulatory developments since 1935, the SEC again concluded that PUHCA was no longer needed. With appropriate consumer protection provisions to assure effective regulation of utilities, repeal was the preferred option.

The Repeal PUHCA Now! Coalition agrees. The SEC's 1995 report supporting PUHCA repeal is clear and irrefutable. Indeed, it has now been over twenty-five years since the SEC accomplished the goals Congress set for it under PUHCA in

1935. We agree with the SEC that leaving PUHCA in place unduly burdens a segment of the industry, as well as the SEC, and at a cost to society that far exceeds any potential benefits.

Repealing PUHCA is important not just to the companies that for over 64 years have borne the burden of its regulatory requirements, and whose ability to respond to existing competition is handicapped by that Act, but to other utilities—both gas and electric—as well. On this issue, gas and electric registered holding companies are united: we all need the ability to respond more freely and flexibly to market opportunities emerging daily as the States restructure retail electric markets and respond to vigorous competition in the wholesale markets.

Similarly, holding companies now exempt from the Act's requirements again both gas and electric—also seek repeal. The potential application to them of the Act's full strictures, and the current imposition of limits on their ability to serve customers geographically or through additional utility services, hinders innovation and frustrates an exempt holding company's ability to compete in wholesale and retail markets.

While the future structure of the electric industry remains open to debate, there is a much clearer picture with respect to the natural gas industry. The gas industry has already experienced significant and historic regulatory and competitive changes. All the gas registered companies now face competition in virtually every facet of their business. Yet they remain subject to additional regulation over their lines of business, corporate structures and financing that their competitors do not have. This is because PUHCA's regulations impose higher costs and less flexibility on them, which hampers them in meeting the demands of intensely competitive gas markets. Thus, repeal of PUHCA, that is, repeal of PUHCA with appropriate consumer safeguards, is essential in providing these gas companies with a level playing field on which to compete and develop innovative products and services. PUHCA should be repealed while the regulatory agencies and legislatures, including Congress, consider further changes in energy policy as applied to the electric industries.

## II. THE BURDENS OF PUHCA

Registered holding companies and their subsidiaries face burdensome and limiting requirements under PUHCA. These burdens, which create severe disadvantages when compared to other industry participants, include:

Our non-utility subsidiaries and we generally are restricted in our ability to issue or sell securities, or alter the rights and powers of security holders, without prior SEC approval. As a result, (a) our capital structures are much more limited, (b) our ability to take advantage of new financing opportunities, especially in dynamic capital markets, is more limited, and (c) our ability to use several types of financial structures that are now widely accepted and used throughout the rest of our industry are not available to us without SEC approval.

We are limited to serving utility customers as a "single integrated" utility system, which seriously restricts the geographic scope of our utility operations as well as the size and diversity of our utility services to customers. As a result, registered holding company system companies are hampered in offering services to others, even in our core business, either by significantly expanding our operations or investing in other utilities, as can be done by exempt holding companies and non-holding company utilities. Although multi-state utility expansion is possible through a non-holding company, divisional structure, (i.e., as a single operating company with no separate utility subsidiaries), most companies do not choose this structure. In some states this structure is illegal and in many states it would not be permissible under developing state codes of conduct designed to separate utilities from competitive businesses.

We generally need prior approval from the SEC before our affiliates and subsidiaries can enter into contracts with each other. As a result, certain costs may be "trapped" due to overlapping jurisdiction between the SEC and the state commissions and opportunities to cut costs or to operate with efficiencies, available on short notice, may not be available to registered holding company subsidiaries.

Without SEC approval, we are unfairly restricted from diversifying into other lines of business—under existing SEC interpretations, because we are limited to operating a single integrated utility business, plus only such other businesses as "reasonably incidental, or economically necessary or appropriate" to the operation of an integrated utility business. Even with some recent SEC initiatives, business opportunities that would help additional economic development in our service territories, and even business opportunities that if allowed to operate freely would save our customers money, may be foreclosed to us. In addition, even where there are limited exemptions, they often contain technical requirements that prevent the use of effi-

cient business structures or restrict or limit the manner in which registered companies can employ shareholder capital.

PUHCA restricts registered electric holding company acquisitions of natural gas distribution companies. Historically, the SEC has been reluctant to view an electric system and a natural gas system as capable of constituting a "single integrated public utility system". The agency has allowed electric registered holding companies to "retain" a gas system only if it determines that the antiquarian standards of the Section 11 "ABC Clauses" are met. This requirement effectively precludes most existing electric registered holding companies from acquiring even a neighboring gas system and gaining the competitive convergence benefits enjoyed by numerous combination (electric and gas) exempt holding companies or non-holding company utility systems. A registered holding company may satisfy the "ABC clauses" only if it acquires or merges with an existing combination company and it can demonstrate to the SEC that the otherwise stranded utility assets would be uneconomic or not viable.

Even the exempt holding companies, although free of virtually all of the specific corporate restrictions in PUHCA, are limited to serving utility customers in a specific geographic area, lest they lose their exemption. They also must be concerned about diversification, because the SEC has the power to revoke their exemption under the so-called "unless and except" clause. Finally, even exempt holding companies are subject to the "two bite" requirements under PUHCA, which require SEC approval in the event of certain acquisitions.

Although they were important at the time of the Act's passage, the draconian nature of these restrictions and the penalty for noncompliance make little sense today, especially as other federal and state regulatory agencies have evolved, the capital markets have matured, and the utility industry is restructuring. In the 64 years since 1935, the governance of securities markets has become much more effective and efficient. The SEC's authority under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 is very broad and the requirements under those laws assure that investors receive appropriate and timely information upon which to make informed investment decisions. Moreover, there is extensive financial and corporate information available commercially through hundreds of magazines, newsletters, on-line computer services, and network sources, which enable the markets to respond within hours of significant events. Nationally recognized rating agencies, such as Moody's and Standard & Poor's, constantly evaluate our management, financial integrity, and operations and rate our securities accordingly. As a capital-intensive industry, we are especially dependent on access to the financial markets and ultra-sensitive to changes in the cost of our capital. Thus, we are committed to maintaining financial integrity while striving for flexibility through assuring a strong capital structure and favorable securities ratings by such agencies.

Similarly, other federal and state utility regulatory agencies, including the FERC and the state utility commissions, clearly have significant jurisdiction, staff support and the means to regulate multi-state utility systems in 1999; this regime largely was absent in 1935 at the time PUHCA was adopted. The standardization of utility accounting, better staffing and more clearly defined regulatory jurisdictional requirements have all made rate-regulation more effective.

In light of the changes the electric industry is experiencing today, and especially in light of the authority that already exists in the SEC under the federal securities laws, the FERC and the state commissions regarding the securities markets and rate matters, even the SEC, the regulatory body charged with administering PUHCA, has formally stated that PUHCA has become redundant regulation and should be repealed. PUHCA lacks the flexibility to allow regulated companies to adapt to new circumstances. Its model of the utility industry simply no longer comports with the reality of where the industry is heading, which is where the other regulators including the FERC, the State legislatures and State Commissions are pushing. We need permanent relief today from the unnecessary regulatory burdens imposed by the Act.

### III. DISADVANTAGES FACED BY REGISTERED HOLDING COMPANIES UNDER PUHCA CONCERNING FINANCINGS

PUHCA restricts any registered holding company system company from issuing any security or exercising any rights generally affecting the holders of an outstanding security of such company, with certain exceptions for so-called "routine financings." PUHCA does allow these companies to engage in certain routine financing activities only by making certain filings with the SEC or if the financing qualifies under one of its limited exceptions. PUHCA requires the same information to

be filed as is already required to be filed under the Securities Act of 1933, in many instances, thus creating duplicative filing and disclosure requirements. PUHCA thus creates additional filing requirements with the SEC's PUHCA office, which in the case of certain applications, the SEC has wide discretion to reject.

Under the complex filing system created by PUHCA, registered holding company systems face a disadvantage, as compared to exempt companies and all other public utility and non-utility companies within the U.S., when issuing certain securities. As an initial matter, both registered and exempt companies must register securities to be issued to the public with the SEC as required by the 1933 Act. However, PUHCA may require additional filings for the registered holding company system company. This additional filing, which may require affirmative action by the SEC, results in delay, added expense, and inevitably to missed opportunities in financial markets.

A similar hurdle exists for certain registered holding company system companies, resulting in added delay and expense, even with respect to the issuance of exempt securities in Rule 144A, transactions or financings under Rules 501, 502, 503, and other rules permitting exempt financing transactions under the 1933 Act. These rules allow exempt company subsidiaries to sell certain securities to qualified investors while utilizing abbreviated disclosure requirements set forth under the 1933 Act unencumbered by PUHCA. PUHCA, however, still requires registered holding company systems to make these additional filings unless the transaction qualifies for one of the limited exemptions under PUHCA.

Another major handicap faced by registered holding companies is the delay and expense involved in organizing financing subsidiaries. While exempt holding companies and other public utilities face virtually no restrictions, registered holding company systems generally must obtain SEC authority to organize new subsidiaries and to provide needed guarantees by the registered holding company or certain affiliates. Therefore, registered holding company systems suffer increased costs of financing which effectively penalizes the registered holding company systems compared with other utilities and public companies for no apparent policy reason given the 1933 Act and other federal and state regulatory requirements.

Even upon the filing of additional disclosure, PUHCA contains additional unnecessary restrictions given the requirements under the 1933 Act and the 1934 Act. These additional criteria put registered holding company systems at a disadvantage by increasing a company's cost of capital, both in restricting the types of securities that can be issued with SEC approval and increasing the delay before permitted securities can be issued in instances where SEC approval is required.

The SEC has attempted to provide limited administrative relief by amending its rules to permit certain routine financing transactions by subsidiaries of a registered holding company without SEC approval and issuing so-called "omnibus financing orders" authorizing a broad range of transactions by registered holding company systems. These attempts fall short of the relief that is needed, however, by failing to adequately expand the types of securities permitted to be issued by registered holding company system companies and by continuing to require state commission approval of regulated subsidiary financings. The "omnibus orders" generally permit a specific company to issue securities similar to those already permitted under PUHCA, such as certain common stock, first lien mortgage bonds, bank loans, unsecured debt, certain guarantees of securities of affiliates, or refunding debt. On the other hand, the orders overly restrict the issuance of even these securities, by setting forth conditions that are unnecessary in today's financial market place. For instance, "omnibus orders" have disallowed financings where the effective cost of money on debt securities exceeds a gross spread over comparable term U.S. Treasury securities which is consistent with comparable investment grade securities. Thus, even permitted securities may be disallowed due to a structure that, though perhaps perfectly acceptable in the financial markets, is deemed too risky by the SEC at a particular time.

In addition to the aforementioned restrictions, "omnibus orders" generally further do not provide for the issuance, or restrict the use, of many types of securities that have been embraced by the securities markets over the past few years. Significantly, the omnibus orders generally permit the issuance of only enumerated securities, thus preventing registered holding company systems from taking timely advantage of new or recently created securities. Furthermore, the inflexibility of PUHCA and the immense burden of continually filing applications may frustrate the timely use of recently created financial products already commonly accepted by the market. Examples include the requirement to obtain specific SEC approval, in some instances, before issuing Trust Originated Preferred Securities (TOPrS) and Quarterly Income Preferred Securities (QUIPS), or using caps, collars, and other derivatives transactions to hedge against the risk inherent in certain securities.

Further evidence of the unfairness in this area is reflected in the disparate treatment of registered gas companies. PUHCA restricts the SEC's ability to approve long-term debt of registered electric holding companies except in narrow cases involving the few combined companies and under "emergency" circumstances. Thus, in most instances, unlike registered gas utility holding companies, registered electric holding companies are not permitted to issue long-term debt securities. Registered gas holding companies, therefore, are able to take advantage of certain financial products at the holding company level such as TOPrS and QUIPS, while electric utility holding companies can only issue those securities at the subsidiary level. This disadvantage sometimes results in the issuance of securities in amounts smaller than that generally regarded as efficient in the capital markets due to investors' preference for large, liquid issues. All other things being equal, smaller issue sizes cost more than large, more liquid issues. This restriction clearly prevents the electric registered holding companies from taking full advantage of their asset base. The SEC has continued to impose these restrictions in the face of the market discipline that has been imposed in recent years by the assignment of ratings on securities issues by the nationally recognized rating agencies and the disclosure requirements under the 1933 Act and the 1934 Act.

These limitations and additional approval requirements under PUHCA disadvantage registered holding company systems by effectively raising their cost of capital. For example, as previously mentioned, under current regulations and "omnibus orders," registered holding companies are restricted in the types of new financing which they may incur as well as the financial hedging tools which they may use to lower their cost of capital. Exempt companies, and other public companies, are free to take advantage of new, innovative financial products widely offered by reputable U.S. investment banking firms and thus can more easily achieve a lower cost of capital while maintaining financial stability. On the other hand, PUHCA restrictions often hinder a registered holding company system from taking full advantage of these opportunities and, in doing so, compete on a "level playing field" with exempt holding companies and non-utility companies in effectively financing their operations.

There is no area where this inequity is clearer than in the inability for registered holding company systems to take advantage of a state public utility commission's order for recovery of stranded costs without SEC approval. Many states have enacted statutes that provide the opportunity for utilities to recover stranded or transitional costs in order to prepare for retail competition. Such recovery is through the issuance of transition bonds that securitize transition charges to be collected from customers over time. Transition bonds typically are structured in such a way that they are rated triple-A. However, even though state public utility commissions pursuant to specific state legislation authorize the issuance of these transition bonds, registered holding company systems must then ask the SEC for authority to enter into these transactions. Additionally, many of the financing documents must be filed with both the state commission and pursuant to the SEC's Securities Act of 1933 and to require a third filing with PUHCA introduces yet another layer of redundancies and costs without providing any additional control. Exempt companies clearly have an immense edge by being able to engage in these financing transactions to issue transition bonds and recovering stranded costs with lower transaction costs and without potential interference or delays under PUHCA.

In the SEC's 1995 report recommending repeal of PUHCA, the Division of Investment Management suggested that "the SEC permit registered companies wider latitude to structure the types and terms of their securities to the demands of the market in order to achieve the lowest possible capital costs." However, the SEC has yet to find the flexibility it needs under PUHCA to allow registered holding company systems the opportunities to achieve the lowest possible capital costs. Again, the time to repeal PUHCA is now.

#### IV. DEBUNKING THE MYTHS ABOUT PUHCA

There is strong bipartisan support for PUHCA reform. In the last two Congresses, PUHCA repeal bills have had cosponsors from both sides of the aisle. Both Democratic and Republic Administrations, dating back to the Reagan Administration, support PUHCA repeal. While not everyone may agree on all the details of potential federal electric utility restructuring legislation, there is strong support that the time for PUHCA to be repealed is now. With this in mind, it may be helpful to address several of the "last gasp" arguments against repeal.

## MYTH NO. 1: PUHCA PREVENTS UTILITIES FROM EXERCISING MARKET POWER.

Contrary to the myths about PUHCA preventing the exercise of market power, PUHCA actually perpetuates market concentration. Companies subject to PUHCA generally are confined within geographic boundaries consistent with the “integration” standard. While at one time this was considered a way of stopping growth, and enabling federal and state utility regulation to mature, it has instead led to a concentration of the utility market. This market concentration that occurs in a monopoly situation serves to impede competition and frustrate state restructuring programs. If PUHCA stays in place, it will only perpetuate a monopoly situation for those consumers in that service territory.

Now the Coalition realizes that some have asserted that it is essential to retain PUHCA in order to limit what they call “concentration of market power” as the electric industry restructures. Those who make that assertion simply do not understand the role PUHCA has played. As stated earlier, PUHCA is a corporate structure and securities statute. Its main goal was corporate simplification, not establishing or setting specific rates for utility services. We cannot emphasize enough that PUHCA’s existing provisions actually increase the likelihood of concentrations in particular markets, because the “integration requirements” and geographic restrictions of the Act limit both registered companies and exempt companies to retail utility holdings in particular areas, and restricts the ability of more distant companies to acquire, construct or operate facilities that could compete with the local utility. PUHCA effectively keeps new entrants out of markets, and keeps registered companies from engaging in competitive lines of business. Indeed, PUHCA as it stands requires utilities to limit acquisitions to nearby utilities—ones that can be integrated or that do not result in a loss of exempt status. Those nearby utilities are the ones most likely to have presented the possibility of competition.

PUHCA was originally enacted to prevent abuses by utility companies by restricting growth and advancements at a time when there were little or no state or federal utility regulatory controls available. While this approach served us well in 1935, it is now outdated and serves as an impediment and a barrier to a competitive market, especially at the retail level.

PUHCA was not designed as, and is not, a utility or rate regulation statute. PUHCA is primarily a law dealing with corporate governance and securities issues. Aside from the fact that it has outlived its usefulness because of changes in the way we regulate and review securities transactions, PUHCA might be viewed as an energy matter only from the standpoint that the companies it governs happen to be in the energy sector. Regulating public utilities when they provide electricity services to consumers is governed by other significant laws. These laws, most notably the Federal Power Act, the Natural Gas Act, and other state utility laws, deal with the rates consumers pay for electricity and gas services. PUHCA does not. In fact, PUHCA repeal bills introduced and vetted in the last two Congresses, with consumer protection provisions, actually will help state and federal public utility regulators do their ratemaking job. To withhold PUHCA repeal from moving forward due to concerns about market concentration in a time when competition in the retail market is rapidly moving forward sends conflicting policy signals. Competition is good, unless you are a registered holding company. A competitive, free market, over the long-term, provides low prices and efficiencies for our consumers, but long-term benefits will be denied the consumers served by the 18 active registered holding companies.

## MYTH NO. 2: REPEALING PUHCA WILL CREATE A REGULATORY GAP.

Repealing PUHCA will not create a regulatory gap, it will eliminate one. Ever since the U.S. Supreme Court issued the *Ohio Power* decision, PUHCA’s requirements that affiliate contracts be “at cost” have prevented FERC and state regulators from applying a market test to lower costs of services for wholesale and retail consumers in most cases. This decision, in large measure, has protected utilities’ costs in rate bases and, to a significant degree, has preempted FERC and state regulators from disallowing the recovery of certain costs. With the repeal of PUHCA, this regulatory gap will be eliminated once and for all. The rate regulators, will properly have, at both the wholesale and retail levels, the authority to determine the allocation and reasonableness of costs incurred by the utility in the provision of necessary services and whether or not such costs should be recovered in rates. Currently PUHCA hinders such rate regulation.

Yet, despite the need to repeal this outdated act, many are concerned that repeal of PUHCA is a repeal of consumer protections. This is simply not true.

It is important to remember that there are more than 3,000 entities currently providing electric and gas service to consumers. Of these, approximately 170 are hold-

ing companies. However, approximately 151 holding companies are exempt from PUHCA, leaving PUHCA to regulate the 18 active registered holding companies. Repealing PUHCA does not mean these registered holding companies will no longer be regulated. It only means they will be regulated under a number of other statutes, including all state public utility laws, the Federal Power Act, and the Natural Gas Act. There will be no regulatory gap if PUHCA is repealed.

Yet the cries continue that PUHCA cannot be repealed because it protects consumers. What about the majority of individuals who are served by utilities not covered by PUHCA? Who is currently protecting them?

Repealing PUHCA will not hurt consumers. Retaining the status quo will. If a consumer is served by a company regulated under PUHCA, that company is restricted from entering into competitive transactions, expanding into new business areas and improving efficiencies that stand to benefit the consumer.

In fact, stand alone PUHCA repeal bills introduced and vetted in the last two Congresses provide continued protection for consumers, while eliminating unnecessary agency duplication and deleting arcane provisions that no longer serve a public interest purpose. These repeal bills actually *improve* certain important aspects of federal and state utility regulation. Some have argued that this may be financially burdensome to states; however, the ongoing restructuring of the electric utility system has imposed significant new responsibilities on the states, involving numerous companies and issues. The states have been in the lead in taking on these responsibilities. Surely, with the experience the states have had to date with restructuring issues, they will be able to effectively deal with any potential resource issues.

The various stand alone PUHCA repeal bills introduced and vetted during the last two Congresses also fully provide for protection of consumers by providing access to books and records, by maintaining accountability procedures, by providing for review of affiliate transactions, while continuing FERC and State commission rate regulation and audit authority. These are a far more direct means of addressing market concerns and protecting consumers than PUHCA of 1935 can provide in today's market.

The Repeal PUHCA Now! Coalition recognizes that some state commissioners and other ratepayer advocates have expressed concern that state authority would not be sufficient to obtain the necessary information for proper discharge of state regulatory action. They are concerned that there would be a continuing need, after repeal of PUHCA, for federal audit authority and federal oversight of system transactions that would pass costs through to ratepayers. The Coalition understands those concerns. We also understand the significant difference between repealing the Act while providing for certain safeguards, and simply transferring the existing burdensome requirements to a new forum. We believe PUHCA repeal legislation, such as the PUHCA repeal provisions of H.R. 2944, H.R. 2363, and S. 313, can fully address these concerns and include provisions to provide appropriate access to books and records.

With regard to books and records, all utility companies know full well that the books and records of the utility company must be available to regulators for their review. The burden will remain on a utility to demonstrate that its proposed rates are just and reasonable. Similarly, we understand and can accept a review of the books and records of those affiliates that deal with the utility company and that would thereby pass costs through in rates. Regulators should have access to all information that is relevant in reviewing and establishing rates for electric services. However, there are undoubtedly some affiliates in a diversified company that will not pass costs through to ratepayers, or whose activities are so removed from the utility activities that access to their books and records would be of no legitimate value for ratemaking or cost allocation purposes. The key test is what access actually is necessary for the effective and proper discharge of duties of the regulatory authority involved.

As to the oversight of affiliate transactions, again we understand the interest of regulators in reviewing those transactions involving the utility, and which will cause the incurrence of costs to be passed through to ratepayers. Indeed, many state regulatory commissions already review transactions between a utility and its affiliates, and no further authority is needed. Here again, to the extent it affects rates, we do not oppose reasonable affiliate transaction provisions in a PUHCA repeal bill. However, we can also envision a number of transactions between affiliates completely apart from the operating utility companies, and which would not cause the incurrence of costs to the utility. Where the affiliate contractual arrangements are not related to costs to be incurred or passed through in the utility's regulated rates, separate regulatory review of the interaffiliate transactions would be unnecessary.

## MYTH NO. 3: MORE UTILITIES WILL MERGE IF PUHCA IS REPEALED.

As noted earlier, the competitive transformation of the utility industry is underway. Twenty-three states have now enacted restructuring legislation or regulations. Similar to every other heavily regulated industry that has undergone a competitive transition, some consolidation of service providers is inevitable. But contrary to myth, consolidation will not occur exclusively because of PUHCA repeal, and whatever consolidation takes place will not escape significant regulatory review and oversight.

It is important to recognize several facts about mergers and market power assertions if PUHCA is repealed. First, the very same expert agencies and departments who today substantively review mergers will do so after PUHCA is repealed. FERC will retain all of its merger authority. It has recently updated its merger policy in light of changes occurring in the electric utility industry. Without PUHCA, FERC will still review future mergers unconstrained by any new Ohio Power or other similar regulatory conflicts at the federal level. State Commissions will still have their authority to approve, block or condition mergers that they have today under state law. State legislatures that wish to require that a utility company operating in that state must be incorporated in that state and remain fully subject to the state's authority regarding its securities and other corporate matters, can continue to do so. PUHCA's repeal will have no effect on that. The Department of Justice will retain its antitrust authority, and the FTC its Hart-Scott-Rodino authority. The only thing that will change when PUHCA is repealed is that after all of those approvals are given, the SEC will no longer have the unnecessary and duplicative regulatory burden of again stating its deference to the decisions the other regulatory agencies previously have reached.

Mr. Chairman, let us be clear: when PUHCA is repealed, no merger will occur without the same full regulatory scrutiny that occurs today. If there are efficiencies and benefits to be gained, those mergers should go forward. If there are not, there is ample regulatory authority in the hands of knowledgeable and fully empowered regulators to stop them.

Simply put, we believe that the nation's state and federal regulators have ample authority and the ability to review potential mergers and to protect the consumer. There is no deficiency of federal and state utility regulatory means and authority requiring PUHCA to stay in place to effectively review and govern the inevitable consolidation of the utility industry. Removing the SEC from reviewing mergers will not diminish these protections.

## MYTH NO. 4: PUHCA CANNOT BE REPEALED UNTIL RETAIL COMPETITION IS ESTABLISHED.

Effective retail competition can not be established unless and until PUHCA is repealed. PUHCA's requirements and restrictions unduly limit and burden virtually any utility company owning or operating any utility assets for the production, transmission, transportation or distribution of electric energy, or manufactured or natural gas, within the United States. As discussed more fully below, not Congress, the states, or the FERC can create a truly competitive environment with PUHCA remaining in place.

In reviewing the issues that may need to be addressed this year, Congress should keep in mind the level of activity concerning retail choice in the states and at the FERC. As you know, almost every state currently has some type of electricity restructuring proceeding underway. As previously stated, twenty-three states have established retail competition frameworks.

Congress has wisely given the states and FERC significant time and latitude in picking the pace, method and means for achieving retail competition. This approach has allowed the states to proceed with retail competition tailored to their own regional circumstances. This has provided Congress and regulators critical information and experience to make informed decisions about any potential comprehensive federal legislation.

Based upon the evidence to date, the states that are restructuring are in fact moving forward without federal intervention. From California to New York, Arizona to Arkansas, Maine to Maryland, the states have passed laws or regulations to establish retail competition. Thus, the real question for the Congress to focus on is whether the sixty-four year old statute is impeding the numerous state initiatives to restructure retail electric markets. Does PUHCA help or hurt the existing and future efforts to establish state ordered retail competition?

In the Coalition's view, keeping PUHCA in place will hurt state ordered establishment of retail electric competition. Simply put, the scope of retail competition will

be artificially constrained and truncated by a number of PUHCA's regulatory restrictions. Let us give you several examples.

PUHCA forbids domestic Exempt Wholesale Generators ("EWGs") from selling power at retail. As a result, many low-cost generation suppliers refrain from making retail sales because of PUHCA-related concerns. This applies to all entities—whether registered, exempt or non-holding companies. Indeed, any generation supplier wishing to avoid a holding company structure would face potential PUHCA jurisdiction if it were to setup a subsidiary and that subsidiary were to make retail sales.

Registered holding companies interested in making retail sales from facilities that are distant from their franchised retail service areas must face the geographic constraints of PUHCA's "integration" standard, which, as noted above, generally restricts registered company "utility" operations to a regional scope. This means, for example, that a registered holding company based in the Eastern U.S. would be effectively excluded from selling retail power from a facility located in California. Similarly, an exempt holding company can risk its exempt status by undertaking non-EWG sales outside the geographic boundaries defined by Sections 3(a)(1) and 3(a)(2). Thus, for example, a utility holding a Section 3(a)(1) "intrastate" exemption cannot make substantial retail sales outside the state where the utility is incorporated and conducts most of its utility business. This does not promote economic efficiency or a robust retail generation market.

In addition, many state restructuring laws call for or are contemplating the separation of generation and transmission/distribution assets into separate corporate entities. This aspect of restructuring can cause particular problems for both registered and exempt holding companies. Think about it: can a 64-year-old piece of legislation be applied to a different utility business than was conceivably envisioned in 1935? PUHCA was not designed to be flexible. PUHCA mandates a single geographically and operational integrated structure, not well adapted to an evolving industry as a result of federal and state restructuring competition initiatives. As noted earlier, PUHCA isolates electric and gas systems to limited, discrete geographic areas. The requirement under PUHCA that registered holding companies maintain a single, integrated utility business has quickly become problematic as governmental entities and a growing competitive market pressures companies to restructure. As electric utilities are compelled by state legislation, regulation or competitive forces to either "unbundle" utility functions and assets in an effort to restructure their businesses along product lines or comply with corporate unbundling requirements, the conflicts with PUHCA are becoming acute.

PUHCA controls this "unbundling" process unnecessarily. Yet the "unbundling" already has begun as a result of FERC's "open access" transmission orders, the twenty-three state restructuring plans already under way, the Public Utility Regulatory Policies Act of 1978 ("PURPA"), and the Energy Policy Act of 1992 ("Policy Act"). This "unbundling" has produced significant new players with geographically widespread utility properties. Since the new players under PURPA and the Policy Act are exempt from PUHCA, how can PUHCA's geographic integration requirements be significant and necessary to this changing industry?

There is another aspect of PUHCA's integration requirements, which may be at odds with retail competition unbundling of functions and services. Registered holding company systems are required to operate in an integrated manner. This requirement has led to centralized electric system planning, construction, and the use of: (a) companies providing common management, financial, accounting and planning services, among other services, for all companies, utility and non-utility alike, in the same system, (b) fuel companies serving various affiliated companies and (c) companies operating power plants for various affiliated companies. In addition, for registered holding company systems and their integrated operations, it has been a prevalent practice to have common officers, and in many cases, common directors among affiliated companies. Will these integrated planning, service and personnel requirements be appropriate and workable in a disaggregated and competitive electric business where flexibility is necessary?

A number of registered holding companies have divested or are planning to divest their electric generator assets and will operate in restructured systems where their retail customer base will be open to competition. It is unclear that the integration standard will have any relevance under such circumstances.

For a multistate registered holding company, PUHCA is a major concern as states move forward to competition. PUHCA restricts our ability to compete. This is attractive to our "unregulated" competitors as they move forward unimpeded. PUHCA restricts the types of business we can invest in, where we can invest and how much capital we can deploy. Restricted investments, required integration systems and financial prohibitions severely impact our structural and financial ability to respond to a rapidly moving competitive retail market. If a level playing field is sought, for

a competitive market, PUHCA stands out as a significant barrier to achieving this goal.

Technology is another issue. PUHCA was adopted in a world without computers, without reliable transmission systems, without regional power pools, without reliable long-distance communication. Technology was one reason for PUHCA's geographic integration limits. Obviously, technology has rendered PUHCA, and its integration requirements, obsolete.

A prominent feature of current FERC policy and most state restructuring frameworks is the establishing of so-called Regional Transmission Organizations ("RTOs")—whether they are an independent transmission company ("Transco") or an Independent System Operator (or "ISO"). These RTOs typically assume in some fashion control of the regional or statewide electric transmission grid in order to assure further non-discriminatory access and efficient, reliable system operation.

PUHCA presents a potential regulatory dilemma for some RTOs, since these entities may, depending on the facts, fall under the definition of "electric utility company" under Section 2(a)(3) of PUHCA—that is, an RTO will "operate facilities used for the generation, transmission, or distribution of electric energy for sale..." Indeed, in order to perform their mandate effectively, RTOs must necessarily exercise operational control over transmission grid facilities.

RTOs are not the kind of public utility entities that PUHCA was designed to regulate. Yet because RTOs could, under certain circumstances, be deemed to be PUHCA "electric utility companies", any person or company which might be regarded as exerting a "controlling influence" over an RTO could in turn be deemed a "holding company" potentially subject to full PUHCA regulation. This is a very real concern. To be sure, the SEC Staff has issued a no-action letter concurring that the California ISO is not a PUHCA "electric utility company" because it is an "instrumentality" of the State of California, based on the State legislature's restructuring directive. However, the means of RTO creation varies from region to region, and most RTOs will operate on a regional, rather than a statewide basis, and with or without state authority. The PUHCA uncertainties associated with the structure and operations of RTOs may cast a regulatory cloud over a vital aspect of state and federal restructuring efforts. It is unclear how the SEC will deal with this critical issue, especially now that most of the RTOs that have been approved to date have been and are also power pools, which have not been regarded as creating a holding company structure for member utilities. Thus, on the one hand, RTOs will be critical to successful restructuring efforts. On the other hand, PUHCA may impede RTOs from developing regionally, with broad-based membership.

The corporate or functional unbundling features of current restructuring programs can also be highly problematic for utilities holding a Section 3(a)(2) exemption. Section 3(a)(2) provides an exemption for holding companies that carry on the bulk of their utility activity at the parent company level, with only minor utility subsidiary operations. Thus, for example, if a parent utility company must transfer to a subsidiary company substantial generation assets to comply with state initiated restructuring law, it may no longer qualify for a Section 3(a)(2) exemption, since the bulk of its utility operations may now be conducted downstream at the subsidiary level.

In addition, restructuring mandates may effectively compel a utility to create a new holding company over generation, transmission/distribution, and non-utility subsidiaries, as a means of assuring effective corporate separation (unbundling) of utility functions and safeguarding against potential cross-subsidization. The creation of such a top-tier holding company with no utility assets of its own, however, precludes retention of a Section 3(a)(2) exemption (which requires that the parent holding company also be a utility company).

In sum, over the long-road PUHCA will hinder state restructuring efforts. PUHCA is an entry barrier, impeding robust retail competition. State driven restructuring presents potential problems for the ability of registered companies to comply with PUHCA's requirements and compete in newly created retail markets. Registered companies are subject to the "integration" standard, which demands, among other things, that utility operations be component parts of a vertically integrated system. This standard clearly clashes with emerging competitive systems based on unbundled service, independent system operators, and power exchanges. And, ironically, state restructuring requirements will likely endanger certain utilities' existing exemptions and thus compel them to become registered holding companies.

Leaving PUHCA intact as state restructuring proceeds will create perverse incentives, as companies recreate "PUHCA Pretzels" especially regarding transmission assets—to comply with PUHCA's broad reach, restructure their products and services, and to compete in retail electricity markets. This federal barrier to state en-

acted retail competition reforms can only be removed by the Congress. That is why PUHCA repeal legislation should be signed into law this year, and without the need for “comprehensive” federal restructuring legislation.

#### V. PENDING PUHCA REPEAL PROPOSALS

The Coalition supports legislation that repeals PUHCA and replaces it with a streamlined regime that provides for adequate measures to provide consumer protections as a stand-alone measure. We support Congressmen Tauzin (R-LA) and Towns (D-NY), and their cosponsors in their bipartisan effort to enact H.R. 2363, the “Public Utility Holding Company Act of 1999,” to ensure that another Congress does not conclude without considering PUHCA repeal. We support its companion Senate bill, S. 313 by Senators Shelby (R-AL) and Dodd (D-CT). We also support the PUHCA repeal provisions of H.R. 2944, the “Electricity Competition and Reliability Act,” introduced by Congressman Barton (R-TX).

Some background is necessary to understand the genesis and evolution of the provisions of H.R. 2363, S. 313, and H.R. 2944. These provisions arose out of the SEC’s 1994-1995 yearlong study on PUHCA’s continued relevance in today’s evolving electric and gas markets and sophisticated utility oversight. The SEC study began in July, 1994, with a round-table hearing at which consumer groups, securities rating agencies, Local, State and Federal regulators, and industry representatives all analyzed PUHCA’s effectiveness and continued with an invitation to all interested parties to submit comments on all aspects of PUHCA, pro and con. The SEC received thousands of pages of comments, with only one out of over 110 participants suggesting that PUHCA should not be repealed or reformed. All other interested parties agreed that PUHCA needed significant revisions. And today, no knowledgeable party that understands the role of PUHCA argues that PUHCA should not be significantly reformed. Those that argue for delay or for the continuation of PUHCA do so are unmindful of the overwhelming case made for repeal by the objective experts.

Following the SEC’s 1995 report to Congress, a bipartisan bill was drafted incorporating the consumer protection provisions the SEC recommended. This bill was introduced in the 104th Congress. (S. 1317 by Senators D’Amato (R-NY) and Sarbanes (D-MD), et al.). S. 1317 was voted out of the Senate Banking Committee after extensive hearings and mark-up and was awaiting final consideration by the full Senate before that Congress adjourned. A companion bill (H.R. 3601 by Congressman Tauzin, et al.) was introduced in the House but was not reported out of committee, notwithstanding several extensive hearings on the SEC’s report and proposed legislation before the House Commerce Subcommittee on Energy and Power and the then Subcommittee on Telecommunications and Finance.

In the 105th Congress, a similar PUHCA repeal bill was introduced in the Senate. (S. 621 by Senators D’Amato, et al.). It too was reported out of the Senate Banking Committee with amendments designed to provide additional consumer protections but, again, Congress adjourned prior to action by the full Senate. A companion bill to that Senate bill was introduced in the House. (H.R. 3976 by Congressman Tauzin, et al.). And again, notwithstanding additional committee hearings on the need to repeal PUHCA, no action was taken by the House.

Thus, the PUHCA repeal provisions of H.R. 2944, and the PUHCA repeal bills, H.R. 2363 and S. 313, reflect several years of negotiations and collaboration between the FERC, the SEC, NARUC, Congressional staff, as well as various industry stakeholders. They represent a carefully developed and negotiated compromise and are ripe for congressional action. They set forth sufficient consumer protection provisions in a regulated, yet evolving restructured market. These bills grant FERC in wholesale rate proceedings, and the State commissions in retail rate proceedings, access to books and records of holding companies and their associate companies for the review of costs proposed to be recovered by regulated public utilities in their jurisdictional rates. These bills allow FERC and the state commissions to exercise their existing authority to review affiliate transactions between regulated and non-regulated associate companies within holding company systems. FERC is empowered to determine which utilities will be exempt under the new PUHCA, including those currently exempt from PUHCA of 1935 and those currently free from FERC jurisdiction. Additionally, the bill continues all existing authority FERC and the States have under the Federal Power Act and all applicable State laws, respectively, to protect consumers.

In the event that Congress is unwilling to repeal PUHCA as a stand-alone bill this year, the Coalition supports legislative language that has similar provisions to the PUHCA repeal provisions of H.R. 2944, and the PUHCA repeal bills, H.R. 2363

and S. 313, and, as discussed below, several of the bills already introduced this Congress contain these provisions.

The Coalition strongly opposes, however, any language that conditionally repeals PUHCA. As discussed more fully below, there exists no substantive reason why PUHCA repeal should be tied to retail competition.

PUHCA repeal provisions similar to the PUHCA repeal provisions of H.R. 2944, and the PUHCA repeal bills, H.R. 2363 and S. 313, have been reproduced in four bills introduced in this Session of Congress. Although essentially the same, each are different and will be discussed in greater detail.

H.R. 667, "The Power Bill," introduced by Congressman Burr (R-NC), contains language identical to the stand-alone bill introduced by Congressman Tauzin in the 105th Congress (H.R. 3976). It does not condition the repeal of PUHCA of 1935 recognizing that PUHCA stands in the way of effective competition within the several States. It requires the keeping of certain books and records by holding companies and their subsidiary companies and provides FERC and the States access to such records if deemed relevant to disallow any cost recovery in a rate proceeding. Like the H.R. 2363, it authorizes FERC to exempt companies from these requirements. However, unlike H.R. 2363 that provides for a 12-month effective period from date of enactment, the Burr bill provides for an 18-month effective period. Thus, it is identical to S. 313 that has been reported out of the Senate Banking Committee and is awaiting final action by the full Senate in the 106th Congress.

H.R. 1587, the "Electric Energy Empowerment Act of 1999," introduced by Congressman Stearns (R-FL), contains language similar to the unconditional repeal PUHCA legislation introduced in the 104th Congress prior to the original Senate Bill being amended. But for relatively minor differences in the stated purpose of the repeal section, its provisions are identical to H.R. 3601 by Congressman Tauzin, et al., and S. 1317 by Senator D'Amato, et al., of the 104th Congress. While the Coalition does not object to these provisions of H.R. 1587, it should be noted that the provisions of H.R. 667, H.R. 1828 and H.R. 2363 contain amendments adopted by the U.S. Senate and incorporated in subsequent PUHCA repeal bills since the 104th Congress. (See H.R. 3976 by Congressman Tauzin, et al., and S. 621 by Senator D'Amato, et al., of the 105th Congress). These amendments clarified certain definitions and provided for certain exemption authority by the FERC. Like Tauzin's H.R. 2363, the Stearns bill's provisions become effective one year from date of enactment.

H.R. 1828, the "Comprehensive Electricity Competition Act," introduced on behalf of the Administration by Congressmen Bliley (R-VA) and Dingell (D-MI), contains repeal provisions virtually identical to the Tauzin and Burr bills. Like the Burr bill, Bliley's bill repeals PUHCA 18 months after the date of enactment. With this effective date, these provisions are identical to those of S. 313 awaiting final consideration by the full Senate.

H.R. 2050, the "Electric Consumers' Power To Choose Act of 1999," introduced by Congressmen Largent (R-OK) and Markey (D-MA), contains PUHCA repeal provisions similar to those of H.R. 2363 but differs in one major way. PUHCA of 1935 is not unconditionally repealed as in H.R. 2363 but rather only if all but one of the states within the service territory of public utilities of a holding company system provides for retail electric or gas access. If two or more states within the service territory of a registered holding company system have not provided for retail access, PUHCA's onerous restrictions continue to apply.

The Coalition strongly opposes this provision. This approach is at odds with the consensus that now exists on the Committee that Congress should not mandate retail access on the states. Thus, Congress should not enact any legislation that ties PUHCA repeal to whether the states order retail access in their respective states.

H.R. 2050 also differs from H.R. 2363 in two less significant ways. First, the provisions are effective 18 months from date of enactment. Second, an "exempt telecommunications company" (ETC) authorized in the Federal Telecommunications Act of 1996 is added to the list of those entities exempted from the PUHCA provisions. The Coalition prefers a 12-month effective date since sufficient time has elapsed for states to address any perceived regulatory gaps since the 1995 SEC report recommending repeal but has supported bills with an 18-month effective date. The Coalition does not object to the exemption of ETCs.

As described more fully under our attempt to debunk the several myths surrounding PUHCA's repeal, PUHCA repeal should not be held up for full-fledged competition. The current restrictions under the Act are preventing the affected companies from offering many services now that would benefit consumers. There cannot be effective competition if the electric and gas utility segment of the competitive market continues to be hampered by the Act. And even in those states that have not or do not provide for retail competition, PUHCA is not needed to protect consumers.

There also has been one proposal suggesting that another class of exemptions be created under PUHCA rather than repealing the Act. Current holding companies registered under PUHCA would be permitted to become exempt from PUHCA's restrictions if each of the public utilities of a holding company's system unilaterally offers retail choice to its customers even if their respective States have not mandated retail choice.

There are several problems with this approach. First, all experts agree that PUHCA should be repealed now because it (1) unnecessarily prevents companies from becoming competitive, (2) is not necessary as part of today's regulatory regime even without retail competition and, (3) because it has accomplished its goals. An exemption would continue an unnecessary, burdensome regime for which no continuing purpose exists.

Second, many exempt companies today support PUHCA repeal because it limits their flexibility and efficiencies both structurally and financially. Adding another exemption simply increases the burdens on all exempt companies. Rather than removing obstacles to competition and efficiencies, this proposal would perpetuate them.

Third, such a provision is punitive to companies operating in the several States that have decided for local reasons not to offer retail choice to its citizens at this time. It is unclear how companies can offer such choice to its customers they are obligated to serve in such states. PUHCA companies are faced with a clear dilemma: If a State does not believe allowing a company the ability to offer choice, the only real option left is the sale of the company to an entity that is not subject to PUHCA. What are the public policy goals of such a proposal?

#### VI. CONCLUSION

In conclusion, the Repeal PUHCA Now! Coalition believes it has addressed the various issues of concern that have been raised about repeal of this statute which, as the SEC has noted, is outdated and no longer needed. Consumer protections will still be provided, market power problems are not compounded and regulatory guardians will still vigorously oversee the exercise of market power through review of rates and merger activities. If we are for fair wholesale and retail competition, where numerous firms compete under similar regulatory restrictions, then removal of PUHCA is a key component to a competitive environment. We urge the Congress to repeal PUHCA this year.

Mr. OXLEY. Thank you, Mr. Lhota.  
Mr. Kanner.

#### STATEMENT OF MARTY KANNER

Mr. KANNER. I would submit that the question is less when and whether to repeal PUHCA, and more whether we want to advantage the competitive interests of one segment of the industry or rather to advantage the interests of competition.

PUHCA—as was previously stated, PUHCA does not directly address rate regulation. It does, however, create a structure to facilitate effective regulation to protect consumers and to prevent unfair competition.

And I believe that those goals, those underlying objectives of PUHCA, remain equally valid and, in fact, more important as the industry evolves and as we go toward that competitive end state.

I agree that consumers are better under competition, as you said, Mr. Chairman. That is exactly the ideal that we should strive for. However, we need to create the conditions in which competition can, in fact, survive. Stand-alone PUHCA repeal would impede competition, not advantage. It would increase the ability—it would increase concentration in the industry, with certain players becoming larger and larger, rather than fostering the emergence of more and different types of competitors. It would facilitate subsidized ventures in which utilities would be able to leverage their monopoly functions, their continued monopoly control of distribution and transmission to subsidize their competitive ventures, whether those

are in energy sales in different parts of the country or in businesses unrelated directly to energy, but in other services like appliance installation and repair, securities, other things. And then last, it would put consumers at risk of bearing the costs of those other ventures if they prove not to be successful.

It was stated earlier that in a competitive marketplace, if a business is successful, if they innovate, if they are entrepreneurial, they bear the benefits, and if not, they bear the risks. When you have companies that have one foot in each camp, part regulatory, part monopoly, and part a competitive venture, then it is not the company that bears those risks, but rather the consumers in that regulated venture. That is not the type of market we believe we need to end up with.

Can PUHCA be repealed? Absolutely, Mr. Chairman. But we need to do it with provisions which advance competition and protect consumers. Many of those were detailed today in the earlier panel by Mr. Smith, the FERC general counsel. As he said, we need to make sure if we want competition that all players play by the same rules in that highway of commerce, the Nation's transmission system. We need to make sure that the vestiges of market concentration, of market power, do not inhibit competition in the generation market. We need to make sure that mergers are all reviewed to ensure that we don't unduly create an increase in competition.

There are certain types of mergers under PUHCA that are reviewed that would not be reviewed in the absence of PUHCA. The bills before you today, the stand-alone PUHCA provisions, don't grant FERC the authority to look at holding-company-to-holding-company mergers or the disposition of generation assets. That needs to be accomplished.

And last, we need to make sure that we have vigorous provisions that address affiliate cross-subsidization. As long as there is that one foot in the regulated business, there is the ability to cross-subsidize competitive ventures. That is not fair to the consumers that bear the risks and costs. That is not fair to the competitors in those other business lines. We need to make sure that there are effective provisions dealing with affiliate transactions. The access to books and records isn't something that can be repealed in 2 years because utilities will continue to be regulated monopolies in the distribution and transmission functions.

Last, Mr. Chairman, we need to make sure that the underlying objectives of PUHCA, again, creating a structure in which competitors and consumers are protected, is upheld. We don't have to do that in the same regulatory model. We can go to the competitive model, but we need to make sure that we are creating the conditions necessary for competition to exist and thrive.

[The prepared statement of Marty Kanner follows:]

PREPARED STATEMENT OF MARTY KANNER ON BEHALF OF CONSUMERS FOR FAIR  
COMPETITION

Mr. Chairman, members of the Committee, I am Marty Kanner. I am testifying today on behalf of Consumers for Fair Competition (CFC), a coalition of residential

and industrial consumer representatives, small business interests, local regulators, public interest groups, and public and private utilities.<sup>1</sup>

CFC was formed to advance policies necessary to promote effective competition—and necessary to provide the intended consumer benefits of lower rates, increased efficiencies and innovation, and diversity of supply options. The coalition believes meaningful competition will not take hold or survive if steps are not taken to address the market dominance of incumbent utilities.

You will hear assertions that the Public Utility Holding Company Act (PUHCA) is no more than an out-dated statute intended to protect investors from fraudulent securities practices. Don't be misled. Congress enacted PUHCA as a companion statute to the Federal Power Act. PUHCA establishes passive restraints on the structure of the electric utility industry in order to mitigate market power, preclude practices abusive to captive consumers, and facilitate effective regulation.

Stand-alone PUHCA repeal, as embodied in several bills introduced in the House, eliminates these structural protections. Moreover, they do not include the policy prescriptions needed to promote meaningful competition.

Such action will expose captive consumers to a myriad of potential risks. Rather than ushering in competition as repeal proponents would have you believe, stand-alone PUHCA repeal will have substantial anti-competitive repercussions and retard the development of a vibrantly competitive electricity market.

The current administration of PUHCA has clear limitations. However, its underlying purpose—the mitigation of market power and prevention of interaffiliate transactions and utility diversifications that threaten captive ratepayers—is the best policy option for a successful transition to a competitive marketplace. It is for that reason that every major consumer group—as well as numerous other interests—opposes stand-alone PUHCA repeal.

CFC has prepared model legislation, for inclusion in comprehensive restructuring legislation, that provides the necessary checks on potential anti-competitive behavior. With adoption of these provisions in a comprehensive bill, Congress could repeal PUHCA.

#### UNDERLYING PURPOSE OF PUHCA

As noted above, PUHCA establishes certain structural safeguards to protect consumers and facilitate effective rate regulation. Under the Act:

- Multi-state utility holding companies must be physically and operationally integrated in order to ensure economic benefits and facilitate effective regulation;
- Holding company acquisitions are limited in order to promote economic and operational efficiencies and prevent undue concentration;
- Multi-state utility holding company diversification activities are restricted in order to maintain a focus on the core business of utility service to captive consumers, limit financial risks to ratepayers, and protect businesses in unregulated industries from anti-competitive cross-subsidies;
- Inter-affiliate transactions are limited in order to prevent undue favoritism and self-dealing; and
- Capital structures and holding company investments are regulated in order to protect captive ratepayers from unwarranted financial risk.

Proponents of PUHCA repeal would have you believe that the Act only regulates the 15 multi-state holding companies that are “registered” under the Act. In fact, PUHCA’s “passive restraints” effectively regulate the corporate behavior of the remaining investor-owned utilities that have structured their operations in a manner designed to avoid the restrictions applicable to registered holding companies.

In some cases, the benefits outlined above have been diluted by lax regulation by the Securities and Exchange Commission (SEC) or circumscribed by targeted amendments adopted by Congress. But such past actions do not justify wholesale repeal. Rather they require a careful consideration of the following questions:

- What structural protections are needed to facilitate and maintain a competitive market?

<sup>1</sup> American Public Power Association, Electricity Consumers Resource Council (ELCON), Enron, Friends of the Earth, Madison Gas & Electric, Missouri River Energy Services, National Association of State Utility Consumer Advocates (NASUCA), Northern California Power Agency, Ohio Municipal Electric Association, Office of Ohio Consumers Counsel, Transmission Access Policy Study Group (TAPS), Wisconsin Public Power Inc., National Alliance for Fair Competition (members include: Air Conditioning Contractors of America, Air Conditioning & Refrigeration Wholesalers Association, American Supply Association, Associated Builders and Contractors, Independent Electrical Contractors, Petroleum Marketers Association of America, Plumbing, Heating and Cooling Contractors—National Association, National Electric Contractors Association, Sheet Metal and Air Conditional Contractors National Association)

- What form, extent and duration of regulation is needed in a competitive market?
- Are further targeted amendments to PUHCA sufficient to redress a regulatory redundancy or changed circumstances?
- What—as noted economist Alfred Kahn put it—is the best possible mix of inevitably imperfect regulation and inevitably imperfect competition?

#### CONSUMER PROTECTIONS ARE STILL NEEDED

Proponents of stand-alone PUHCA repeal argue that the statute is unneeded, a relic of a bygone day when all functions of the industry were monopolistic, state commissions were in their infancy, and securities regulation was undeveloped. As Congressman John Dingell once noted: “times have changed, but human nature has not.”

It is not “evil” that businesses seek market dominance. It is the nature of business. The difference between the utility industry and other businesses, however, is the continued monopoly structure of distribution and transmission function (and the retail energy service business in many states). This straddling of monopoly and competitive markets warrants continued structural protections.

An office supply store might cross-subsidize staplers with paper clips, but a dissatisfied customer can always go elsewhere to buy paper clips. A company might diversify into another business line and face financial losses or even ruin—but there are no captive customers that suffer the consequences.

A dissatisfied utility customer cannot simply shop elsewhere; nor is that customer insulated from the bad business decisions of its supplier.

Closer scrutiny reveals that consumers can face considerable risks under stand-alone PUHCA repeal.

#### *1. Financial Repercussions of Poor Financial Practices*

As noted above, PUHCA discourages diversification into non-utility businesses and regulates capital structure. In the absence of these protections, holding companies can diversify into risky ventures, pledge utility assets as collateral, and loan funds from utility operations to non-utility affiliates. Such actions can raise the cost of capital for the utility, siphon funds that should be invested in the core utility operations, and result in unnecessarily high rates.

None of the pending PUHCA-repeal proposals requires holding companies to exclusively use non-recourse debt, preclude inter-affiliate loans, or otherwise insulate captive consumers from risky financial transactions.

#### *2. Cross-Subsidization Taxes Consumers*

Holding companies can subsidize non-regulated ventures with captive ratepayer funds or resources.

For instance, a holding company could establish an affiliate to market surplus power from its generating facilities. The underlying costs of the facilities are paid by captive ratepayers. The affiliate marketer simply covers the variable cost of production and captures significant profits—for the holding company—from its power sales.

The stand-alone PUHCA repeal proposals do not affirmatively prohibit cross-subsidization, and state regulation is inadequate to prevent siphoning of ratepayer dollars in a holding company structure.

#### *3. Consumers Fail to Benefit From Successful Diversification*

As noted above, consumers face potential risk from failed unregulated ventures. They also may benefit—through lower rates—if such ventures are successful.

A holding company could transfer a formerly rate-based, low-cost generating plant to an unregulated marketing affiliate—without pre-approval by all the relevant state commissions—for the embedded cost of the facility, thereby denying captive retail customers of the economic benefit of the facility and potentially exacerbating stranded cost exposure.

Alternately, a holding company could build a fiber optic system, with a small portion used for core utility operations (such as load control), and the remaining capacity operated as or leased to a competitive telecommunications provider. Given the economies of scale in fiber optic cable, captive utility customers could pay the majority of the underlying costs and not receive the economic benefits of the use of the remaining facilities.

The PUHCA repeal proposals limit state commission review of the transfer of assets and fail to require fair compensation to consumers for the transfer of ratepayer financed assets.

#### 4. *Captive Retail Service Becomes the Poor Stepsister*

The provision of quality, affordable retail electric service to captive customers is likely to suffer. Holding companies will transfer the best and brightest personnel to those affiliates that hold the greatest potential for financial reward. Local utilities may become the corporate backwater.

One registered holding company established a subsidiary to manage and operate nuclear plants for other utilities. Despite assurances to local regulators, the top nuclear personnel of the utility spent most of their time on the subsidiaries activities, potentially degrading the operation and economic efficiency of the “core” utility’s nuclear plants.

Given the limited resources of regulatory agencies and the difficulty of tracking personnel, neither state commission nor FERC rate regulation can remedy such actions.

#### COMPETITIVE PROTECTIONS ARE STILL NEEDED

The structural restrictions of PUCHA not only protect consumers, they also encourage fair competition.

##### 1. *Competitors Protected From Unfair Cross-Subsidization*

By limiting diversification into non-regulated businesses, PUCHA protects competitive industries from the entrance of players that can tap monopoly markets for unfair competitive advantage.

In the absence of PUCHA, a holding company could establish an affiliate, as outlined above, to market surplus power from rate-based facilities, with the affiliate simply covering the variable cost of production. In such a circumstance, a non-utility competitor would have to sell power at a rate that recovered both fixed and variable cost, while the holding company affiliate had its fixed costs subsidized by captive ratepayers.

None of the PUCHA-repeal proposals protect competitors from unfair cross-subsidization.

##### 2. *Undue Favoritism to Affiliates*

As a result of their monopoly status, utilities possess access to key customer information. For instance, a utility could have exclusive knowledge of the operational efficiency (and potential market for cost-effective upgrades) of the motors of an industrial customer. Such information would provide an affiliate energy services company with an unfair competitive advantage. Similarly, knowledge of customer consumption patterns, price sensitivity, and power quality requirements could provide advantages to affiliate equipment suppliers, equipment installers, and retail marketers. This information can be passed on directly to affiliates, or through the transfer or rotation of key personnel.

None of the PUCHA repeal proposals require holding companies to provide competitors with comparable access to information obtained from monopoly affiliates.

##### 3. *Market Concentration*

Registered holding companies are dominant market players. One even made light of this fact in its annual report—musing that it was an 800-pound gorilla.

Repeal of PUCHA facilitates increased growth and market concentration. While intermittently enforced, the Act requires acquisitions to advance the public interest, provide enhanced economic and operational efficiency, maintain physical integration and not result in undue concentration. Absent these requirements, the industry is likely to further consolidate. Holding company acquisitions of distant utilities are unlikely to be reviewed by the state regulators of the acquiring holding company—due to a lack of legal authority—and even FERC’s revised merger guidelines do not appear to discourage such actions. Moreover, FERC lacks legal authority to review holding company to holding company mergers.

In addition, PUCHA precludes the acquisition of gas utilities by registered electric holding companies (or electric utilities by gas holding companies). The authority of FERC to review such “convergence” mergers is limited.

If PUCHA is repealed on a stand-alone basis, the industry is likely to become dominated by a few large companies—the antithesis of a competitive market, which is characterized by a multiplicity of participants and the absence of barriers to market entry.

The proposals before you fail to revise FERC’s merger authority to screen the competitive implications of proposed mergers or establish clear authority to review gas and electric combinations or holding company to holding company mergers.

#### 4. *Selective Market Entry*

Stand-alone PUHCA repeal will enable holding companies to participate in those retail markets that are open to competition—either as pilot projects or under state retail competition plans. As noted above, it is possible for these competitive ventures to be cross-subsidized by captive retail customers of the holding company.

But while holding companies will receive the potential benefits of retail competition, they are not subject to the challenges of competition in their “home” market.

Stand-alone PUHCA repeal enables holding companies to leverage government-sanctioned market power—their retail monopolies—to engage in competitive markets.

#### THE CASE FOR STAND-ALONE PUHCA REPEAL IS NOT COMPELLING

Proponents of stand-alone PUHCA repeal advance a variety of unconvincing arguments.

- They argue that the Act was only intended to protect investors, ignoring the clear—and expressly intended—consumer benefits;
- They argue that it will advance competition, ignoring the potential anti-competitive consequences;
- They argue that it is necessary to establish retail energy services company, ignoring the case-by-case action (and pending SEC rule) to enable such ventures;
- They argue that PUHCA discourages domestic investment, while ignoring the myriad of legal, domestic investment opportunities and their own business decisions to invest abroad in search of higher returns;
- They argue that states will be the primary protectors of consumers, while ignoring—and not redressing—the legal limitations of state commissions.

To the extent that PUHCA poses legitimate restrictions—for instance duplicative securities regulation or an inability to purchase generating assets for direct sales in competitive retail markets—then Congress should consider targeted amendments; not wholesale repeal.

#### HOW TO ADVANCE CONSUMER AND COMPETITIVE INTERESTS

PUHCA repeal, in the absence of appropriate safeguards, will harm consumers. And the transition to competition will fail if a competitive structure is not established.

CFC has drafted model legislation to guide Congress in moving toward a competitive market.

The coalition urges Congress to:

- Ensure that the transmission grid operates independent of electricity market participants;
- Alleviate overly-concentrated generation markets that will sustain high prices, entry barriers and inefficient markets;
- Scrutinize the competitive implications of all utility mergers;
- Provide enforceable standards to prevent utility cross-subsidization.

These authorities would be tied to the competitive condition of the marketplace. Regulatory action would trigger only when the likelihood of market failure was present.

#### CONCLUSION

Stand-alone PUHCA repeal should not be seen as the “appropriate first step” toward competition. True competition rewards efficiency and penalizes inefficiency. Stand-alone PUHCA repeal provides utility-holding companies with the benefits of competition, without the associated risks. The risks are borne by consumers and competitors.

Given these severe policy implications, PUHCA repeal must be considered only within the context of comprehensive legislation. In that way, Congress can determine the extent and form of regulation needed to supplement the discipline of a competitive market. It is worth noting that, in California—a state on the leading edge of implementing retail competition—the Public Utility Commission adopted a resolution opposing stand-alone PUHCA repeal.

The members of Consumers for Fair Competition stand ready to assist this Committee in crafting those policies needed to promote effective competition and consumer protection.

Mr. OXLEY. Thank you.

Ms. Quirk.

**STATEMENT OF SHERRY A. QUIRK**

Ms. QUIRK. Thank you, Mr. Chairman.

I am here today happy to address this subcommittee to talk about a fair transition to competition. We are pleased to discuss the future of PUHCA. Because New Orleans is served by a utility subsidiary of a registered holding company, Entergy, we believe that the concerns of the city council may assist the subcommittee members in understanding how PUHCA helps retail regulators protect captive consumers and why repealing PUHCA before comprehensive restructuring legislation is passed is a bad idea.

We are not aware of a single consumer group that supports stand-alone PUHCA repeal. The City Council of New Orleans has assumed the unique position of regulator of retail electric and gas rates. The council serves in the same capacity as a State utility commission and seeks to ensure that retail electric and gas consumers in the city are provided affordable and reliable service.

One footnote I would drop here is we noticed in Ms. Heaton's testimony some marked up amendments to the repeal PUHCA language. We note that one amendment would actually repeal the vote of the citizens of New Orleans to establish regulatory authority, and we would note very strong objection to having the vote of the citizens overturned in that way.

Continuing, because a repeal of PUHCA on a stand-alone basis threatens both the affordability and reliability of retail electric and gas service in New Orleans, the council opposes the passage of bills which don't include appropriate consumer and power market protections. Many States have sought to introduce retail competition plans to lower rates for consumers. Louisiana, a relatively low-cost State, has not decided to pursue retail competition presently. The city council has made a similar decision for the time being. However, if Congress repeals PUHCA without accompanying consumer and market power provisions, the relative low cost of electric rates in New Orleans will be jeopardized. This is because PUHCA limits diversification and requires utility companies to separate utility and nonutility industries so that captive utility consumers in New Orleans do not subsidize business ventures elsewhere in the U.S. and abroad.

The SEC has jurisdiction over contracts and relationships among the various affiliates whether they are in the energy area or outside. By preventing cross-subsidization of other industries, PUHCA was intended to help the States keep rates low and affordable.

Some proponents of stand-alone PUHCA repeal have argued, however, that State law and State rate-making authority can protect retail consumers in the absence of PUHCA. These arguments are misleading for several reasons. First, the commerce clause of the Constitution prevents State regulators from regulating utility businesses in other States. States cannot effectively police interstate affiliate transactions.

Second, the SEC's own report proposing PUHCA reform even acknowledged that many States lacked the authority to regulate utility holding company operations in the same manner as under PUHCA.

Third, the judicial doctrine of Mississippi Power & Light raises questions about State rate-making authority where the FERC has

blessed the recovery of costs in the wholesale rate from an affiliate. And in this respect, the books and records provisions in H.R. 2363 offer little in the way of benefit for retail regulators. By allowing utilities to diversify without giving State regulators the tools to address affiliate and market power abuses, merely giving access to books and records is like throwing a drowning person a lifeline with no one attached to the other end.

In addition to affordability, the council worries about reliability. With the repeal of PUHCA, the lines between regulated and non-regulated industries will disappear, and while the rates for retail consumers may be regulated, the city council will have no certainty that power sales will continue in a reliable manner.

Consider the possible scenario where power costs increase due to demands for electricity brought about by hot weather. If a State regulator is relying on its utility to supply power to captive rate-payers from generation facilities which are supposed to provide system supply, but the utility can make more money by selling power in the competitive market, how can the regulator be sure that the utility will not make off-system sales that would bring in more revenues than the regulated sales? With limited resources and an octopus corporate chart, how will any State regulator ever unravel this knot?

I am not here today to pick on Entergy. Entergy is a fine corporate citizen of New Orleans and an excellent utility, but without PUHCA's structural restrictions, Entergy and other registered are between a rock and a hard place, caught between their fiduciary to shareholders to maximize profits and an obligation to serve consumers. It is essential to recognize this quandary and provide structural protections so that utilities have clear rules of the road.

What should this subcommittee do to address the regulatory holes that would appear with stand-alone PUHCA repeal? We would suggest meaningful market power protections which have been discussed here, effective RTOs, codes of conduct to separate regulated and nonregulated activities, audit authority, and repeal of Mississippi Power & Light.

The city council believes that the biggest problem with PUHCA repeal without comprehensive legislation is human nature. If part of your business was regulated so that you knew that every dime of cost would be recovered plus profit, and part was subject to competitive forces, where would you allocate your high costs and poor investments?

Thank you for the opportunity to testify, and I will welcome your questions.

[The prepared statement of Sherry A. Quirk follows:]

PREPARED STATEMENT OF SHERRY A. QUIRK, ON BEHALF OF THE CITY COUNCIL OF  
NEW ORLEANS

Thank you, Mr. Chairman and members of the Subcommittee for the opportunity to appear before you today to discuss the Public Utility Holding Company Act of 1935 ("PUHCA" or "Act"). My name is Sherry Quirk, and I am testifying on behalf of the City Council of New Orleans ("Council"). I serve as regulatory counsel to the City Council.

The Council is the governing authority of the City of New Orleans ("City" or "New Orleans") and exercises legislative power under the City's Home Rule Charter. The Council has, by vote of its citizens, assumed the rather unique position of regulator of retail electric and gas service in New Orleans. In this role, the members of the

Council serve in the same capacity as state utility Commissioners. The members of the Council therefore seek to ensure that retail electric and gas consumers in New Orleans are provided affordable and reliable service.

As a regulator of retail electric rates in the City of New Orleans, the City Council relies on PUHCA to protect customers served by the area's multi-state registered holding company, the Entergy Corporation. The proponents of stand-alone PUHCA repeal have characterized their efforts as non-controversial, but in reality, stand-alone repeal would seriously harm electricity consumers throughout the United States. Because the repeal of PUHCA on a stand-alone basis threatens both the affordability and reliability of retail electric and gas service in New Orleans, the Council opposes the passage of bills such as H.R. 2363 introduced by Congressman Tauzin (R-LA). The Council believes that the repeal of PUHCA outside of comprehensive legislation is untimely, unwarranted, and unwise.

#### *PUHCA and Consumer Protection*

PUHCA was enacted in response to widespread market power abuses by mammoth holding companies in the early part of this century. During the 1920s and 1930s, the massive size and incredibly complex structures of public utility holding companies, and the increased concentration of control they held over the electric power system, caused concern at both the state and the federal levels. Although states tried to control interstate holding companies and utility subsidiaries by enacting their own laws, holding companies created organizational structures that extended across state lines and placed the holding companies beyond the reach of the state commissions.

In a letter urging Congress to pass PUHCA, President Franklin D. Roosevelt stated:

We seek to establish the sound principle that the utility holding company so long as it is permitted to continue should not profit from dealings with subsidiaries and affiliates where there is no semblance of actual bargaining to get the best value and best price... Except where it is absolutely necessary to the continued functioning of a geographically integrated operating utility system, the utility holding company with its present powers must go... It is a corporate invention which can give a few corporate insiders unwarranted and intolerable powers over other people's money. In its destruction of local control and its substitution of absentee management, it 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...<sup>1</sup>

The principal purpose of PUHCA was to prevent the reoccurrence of holding company abuses. Among the abuses that PUHCA sought to address was:

- Issuance of securities on the basis of fictitious or unsound asset values.
- Issuance of securities by subsidiary companies under circumstances such that the company must support an over capitalized structure.
- An absence of arm's-length bargaining, resulting in subsidiary companies paying excessive charges for services, construction work, equipment, and materials.
- Allocation of charges by the holding company among its subsidiaries in different states to avoid regulation by state commissions.
- Control a holding company has over its subsidiaries, affecting the policies of the subsidiaries to complicate and obstruct state regulation of the subsidiaries.
- Extension of holding companies designed to bear no relation to economy of management and operation or to the integration and coordination of related operating properties.
- Lack of economy of management and operation, efficiency and adequacy of service, effective public regulation, and economies in raising capital.

In addition to providing the Securities and Exchange Commission ("SEC") with the stability to ensure that, in the future, RHCs would not engage in market power abuses, PUHCA also provided a mechanism for reorganizing and simplifying the structures of registered holding companies ("RHCs") that wanted to retain their holding company structure (e.g., the SEC section 11 work).<sup>2</sup>

<sup>1</sup> President Franklin D. Roosevelt, Message from the President of the United States Transmitting a Report of the National Power Policy Committee With Respect to the Treatment of Holding Companies (1935), *reprinted in* Senate and House of Representatives Hearings, Legislative History of the Public Utility Holding Company Act of 1935, at 2309-311) ["Message from President Roosevelt"].

<sup>2</sup> Until approximately 1955, the SEC's administration of the Act focused primarily on the first function of PUHCA (e.g., reorganizing the industry under section 11 "integration requirement"). At the time PUHCA was enacted, registered holding companies controlled approximately 80 per-

Continued

PUHCA was intended to prevent holding companies from taking absolute control of the utility at the expense of the customer. A cornerstone of PUHCA's goal of protecting consumers is a philosophy of decentralization. In his letter encouraging Congress to enact PUHCA, President Roosevelt wrote, "Most of us agree that we should take control and the benefits of the essentially local operating utility industry out of a few financial centers and give back that control and those benefits to the localities which produce the business and create the wealth."<sup>3</sup>

The Energy Policy Act of 1992 amended PUHCA and established two new classes of exempt entities—exempt wholesale generators ("EWGs") and foreign utility companies ("FUCOs"). These PUHCA-exempt categories served to encourage RHC diversification through investments in foreign utilities and generating facilities. After passage of the PUHCA amendments and pursuant to its regulatory authority, the SEC promulgated Rule 53—a "safe harbor" provision that allows a RHC that meets certain conditions to finance and invest up to 50 percent of its retained earnings in foreign ventures. Under its rules, the SEC may authorize exemptions to this 50 percent investment limitation. Additionally, the SEC promulgated Rule 58 to allow an RHC to invest in "energy-related companies" as long as the aggregate investment does not exceed the greater of \$50 million or 15 percent of the consolidated capitalization of the RHC.

For approximately 60 years, PUHCA has provided important consumer protections for the ratepayers of RHCs, as well as assurances to investors that these companies are financially responsible. Under PUHCA, the SEC is the only regulatory body with the authority to regulate the complicated financial transactions of RHCs, including intra system transactions and diversification into unregulated businesses. Together, PUHCA's provisions ensure that RHCs pay sufficient attention to the needs of the system operating companies so that ratepayers obtain a reliable level of service at a reasonable price.

#### *Now is Not the Time for PUHCA Repeal*

In this Congress, a number of bills with the sole purpose of repealing PUHCA have been introduced. H.R. 2363, the "Public Utility Holding Company Act of 1999," introduced by Congressman Tauzin, would repeal PUHCA effective 12 months after enactment. In repealing PUHCA, the Tauzin bill would eliminate vital consumer protection provisions at a time when utility ratepayers are still captive customers of investor-owned electric utilities and are vulnerable to abuse from utilities with monopoly status over those consumers. In reality, the language in the stand-alone PUHCA repeal legislation is woefully inadequate to protect American consumers from concentrations of market power.

The Tauzin bill and its Senate companion, S. 313, reduce the ability of retail regulators to exercise local regulatory control over complex utility organizations. We believe also that H.R. 2944 introduced by Congressman Barton (R-TX) comes up short in providing meaningful market power provisions or other protections to help consumers in the absence of PUHCA. These measures fail to protect American consumers from the concentrations of market power demonstrated by investor-owned utilities.

Unless and until there is retail competition in all states, PUHCA must remain in place. The electric industry is experiencing tremendous change, but effective competition is not here yet. It is vital that the consumer protections of PUHCA remain in place during this transitional period. The U.S. electric market is a "patchwork quilt" of varying degrees of regulation. Some states are almost fully competitive; other states are semi-competitive; while many states are regulated.

The unprecedented merger activity of utility holding companies also punctuates the need to maintain consumer protections. This consolidation reflects an increase in potential market power over competitors, which leaves consumers vulnerable to anti-competitive behavior. Though most would agree that the modernization of PUHCA is appropriate, PUHCA remains a critical source of key protections for electricity consumers and should not be repealed.

#### *Experience in New Orleans*

Our experience in New Orleans is illustrative of the dangers of PUHCA repeal at this time of rapid market change. The City Council regulates the retail rates of two utility operating companies, Entergy New Orleans, Inc. ("Entergy New Orleans

cent of the electric and gas utilities. When the SEC began its "section 11 work" of simplifying the industry in 1938 (the Act provided for a three-year delay in implementation), there were 214 registered holding companies. By the time the SEC completed its job of simplifying the industry in 1955, the number of registered holding companies was down to 25.

<sup>3</sup>Message from President Roosevelt at 2309-311.

ans”) and Entergy Louisiana, Inc. (“Entergy Louisiana”). Entergy New Orleans and Entergy Louisiana are utility subsidiaries of Entergy, a multi-state utility holding company registered under PUHCA. As shown in Attachment A, Entergy is an extremely complex holding company system. Entergy consists of the parent holding company and 124 direct and indirect subsidiaries.<sup>4</sup> A small number of these facilities represent the domestic regulated utility operations. The remaining companies, Entergy’s “competitive” businesses, are not subject to state or federal authorities—except for the restraints of PUHCA. Entergy’s five domestic retail public utility companies provide electric service to approximately 2.4 million customers in the states of Arkansas, Mississippi, Louisiana, Tennessee and Texas, and retail gas service in portions of Louisiana. Entergy Mississippi, Inc., Entergy Arkansas, Inc., Entergy Gulf States, Inc., Entergy New Orleans and Entergy Louisiana comprise the system operating companies of the Entergy system. The system operating companies and Entergy’s other subsidiaries together form the “Entergy system.”

The organizational structure of Entergy is already difficult to decipher. If Congress were to enact stand-alone PUHCA repeal legislation, the Council would be unable to monitor and track investments made by Entergy. Entergy’s corporate configuration would become unmanageable, thus severely hindering the Council’s efforts to protect ratepayers from RHC abuses. PUHCA requires utility holding companies to separate regulated and unregulated industries so that captive customers in New Orleans do not subsidize business ventures elsewhere in the United States and abroad. The SEC is to enforce PUHCA’s primary goal, which is to make sure that captive ratepayers do not pay unfair prices for the goods and services they receive from affiliates, or otherwise cross-subsidize.

The Council has consistently challenged proposed activities by Entergy which could adversely affect New Orleans’ ratepayers. For example, the Council recently opposed Entergy’s application with the SEC for \$750 million in additional authority to invest in unidentified non-utility projects. As of December 31, 1998, Entergy had invested approximately \$1.2 billion in EWGs and FUCOs. The Council was concerned that the lack of specificity regarding further investments in the amount of \$750 million by Entergy could present serious risks for the Entergy System, including Entergy New Orleans.

However, despite the Council’s objections, the SEC approved Entergy’s application in a June 22, 1999 Order. The request of the Council and the Arkansas Public Service Commission for a full hearing to examine Entergy’s application was denied. With the SEC’s approval, Entergy now has carte blanche to commit to a significant level of undisclosed future investments. Without the continued framework of PUHCA, RHCs like Entergy will be able to make unchecked substantial foreign and non-utility investments that could put its captive ratepayers at risk.

If PUHCA is repealed, state and local regulators will be virtually helpless to prevent or even detect harms to ratepayers from diversification because of the multi-state nature of RHCs and because these regulators have little, if any, authority to oversee transactions of unregulated businesses. In fact, absent PUHCA, state regulators and the public likely will not even find out when registered holding companies take on new, risky investments. Mr. Chairman, electric consumers in New Orleans are tired of being in the dark and they would not welcome further uncertainties in the absence of PUHCA.

#### *Limitations on State Authority*

As our experience in New Orleans demonstrates, even with the protections of PUHCA in place, state and local regulators are hard-pressed to keep up with the activities of registered holding companies. First of all, there are general limitations under the Commerce Clause that prevent state regulation of interstate transactions. Second, even the SEC has admitted that states are limited in their oversight of holding company transactions. In its own report that recommended the repeal of PUHCA, the SEC found that many states cannot address the problems that PUHCA addresses.<sup>5</sup>

The principal obstacle to review of holding company transactions by state regulators, however, is the *Mississippi Power and Light doctrine*.<sup>6</sup> This doctrine was articulated in a 1988 case brought before the U.S. Supreme Court in which Entergy had formed a “nuclear” subsidiary to own and operate a nuclear power plant. Entergy’s “nuclear” subsidiary then hired Mississippi Power and Light, another Entergy subsidiary, to construct and operate the plant. The wholesale transactions

<sup>4</sup> Attachment A consolidates the 125 facilities into Entergy’s material activities.

<sup>5</sup> See *The Regulation of Public Utility Holding Companies*, Appendix A, Securities and Exchange Division of Investment Management, June 1995.

<sup>6</sup> *Mississippi Power and Light v. Mississippi*, 487 U.S. 354 (1988).

between the subsidiaries were covered by a system-wide agreement filed with the Federal Energy Regulatory Commission (“FERC”).

In *Mississippi Power and Light*, the Supreme Court held that because FERC had approved wholesale rates for electric power, the Supremacy Clause of the U.S. Constitution (Article VI, cl 2) prohibited the Mississippi Public Service Commission from second-guessing the FERC in determining whether some or all of the costs associated with the wholesale power sale were or were not prudently incurred. This decision explicitly prevents state utility commissions from exercising their own authority to review the components of a wholesale rate. The practical effect of the doctrine is to preclude state regulators from investigating stranded costs, cross-subsidizations and other components of their citizens’ wholesale rates.

Although the Tauzin bill and its Senate companion, S. 313, give states and federal regulatory authorities additional access to the books and records of registered holding companies, the bills do not give the states any authority to protect consumers. For state regulators, access to books and records will not effectively augment the authority provided under current laws. Consequently, for state regulatory authorities, access to books and records does not fill in the gaps in current regulatory law, nor does it address constitutional restrictions on states regulating commerce among the states.

#### *Effective Market Power Protections Are Needed to Protect Ratepayers*

The purpose of PUHCA is to prevent monopolization, cross-subsidization and other potential market power abuses by large holding companies and their affiliates. Perhaps the greatest threat to consumers in the event of PUHCA repeal is the ability of registered holding companies to diversify into unregulated businesses. If PUHCA is repealed, RHCs will be allowed unrestricted diversification. Because of the multi-state character of RHCs and the lack of state authority to oversee transactions of unregulated businesses, state regulators will be virtually helpless to prevent or even detect harms to ratepayers.

Unbridled diversification could result in a utility’s investments going bad, with the possibility of increased capital costs absorbed by consumers. It also could produce deceptive financing practices, nondisclosure of important corporate accounts, and financial manipulation. Diversification also could lead to improper cost allocation—when unregulated subsidiaries of a utility perform services and undercharge for their services—with the costs being absorbed by ratepayers. The diversification experience of exempt holding companies shows that when companies diversify into businesses in which they have no particular expertise, they fail. Absent PUHCA, state regulators and the public will not even find out when RHCs take on new, risky investments.

Another danger of PUHCA repeal is the potential for cross-subsidization. The current growth in unregulated operations of RHCs, the industry trend toward economies of scale through centralization and growth of shared services, and the sharp increase in merger activity warrant additional, not fewer, safeguards to prevent cross-subsidization. We already are experiencing volatility in the market, but cross-subsidization presents an additional motivation for market volatility that would not otherwise be present.

The elimination of PUHCA without offsetting consumer protections will result in greater monopoly power for RHCs and higher electric rates for consumers. As long as there is the potential for a holding company to retain a major market share, protections should be in place to prevent market power abuses. Such protections should include:

- Repeal of the *Mississippi Power and Light* doctrine
- Effective “codes of conduct”
- Effective audit authority at the state level
- Effective merger authority at the federal level

In addition to these consumer and market power protections, it is critical that any elimination of the requirements in PUHCA be accompanied by comprehensive restructuring of the retail electric market. To that end, the Council commends the approach taken in legislation introduced by Representatives Markey (D-MA) and Largent (R-OK). The Markey-Largent bill would continue to apply PUHCA to utilities operating in two or more states that are closed to competition. Other utilities not operating in two or more closed states would be exempt from PUHCA under the Markey-Largent bill. We believe that this is a reasonable approach to PUHCA repeal.

#### *Monopolies on a Global Scale*

PUHCA is important not only domestically but also from a global perspective. The 1992 PUHCA amendments have resulted in an explosion of foreign investments by

U.S. utilities. As international investments by holding companies continue, Congress must work to ensure that the utilities' ratepayers are protected and that the utilities bear the risks for these investments.

A number of holding companies have already experienced financial setbacks in their foreign investments. For example, CalEnergy Company took a one-time charge of \$87 million in the fourth quarter of last year after its \$500 million investment in three 400-megawatt power projects in Indonesia was suspended due to the Asian financial crisis. Edison International also was adversely affected by Asia's financial problems. Not only did it suffer heavy losses, the company was forced to investigate charges of corruption and excessive electricity tariffs levied against its \$2.5 billion power project in Indonesia.

Despite losses in foreign markets, some U.S. utilities are continuing to expand their global investments. Recently, AES Corp. announced that it will pay \$155 million to acquire a controlling interest in a Brazilian telecommunications group—even though AES reported a cumulative write off of \$146 million on its Brazilian business for the first half of 1999 due to a sudden devaluation of Brazil's currency in late 1998 that resulted in major losses for AES.

Additionally, Southern Company filed a request with the SEC in January for authorization to spend another \$4 billion or up to 175% of retained earnings to invest in foreign and domestic non-regulated businesses over the next five years. Southern seeks this additional authorization despite its acknowledgment that its non-regulated units had shown poor net earnings to date—mostly due to a \$111 million U.K. windfall tax charge in 1997 and a \$200 million write-off on South American assets in 1998. Southern also recently declared bankruptcy for a project in Mobile, Alabama. To date, Southern has spent approximately \$3.5 billion on non-regulated ventures and has used almost 75% of its existing authorization.

Southern has already substantially diversified its portfolio. Some pending Southern projects include:

- \$300 million investment in Thailand;
- a share in a \$500 million project in Shanxi Province, China;
- a bid for up to \$400 million in Cajun Electric Power Cooperative assets in Louisiana;
- a greenfield plant in Australia;
- a new plant in Wisconsin;
- a plant acquisition in Texas; and
- asset purchase deals in New York and California valued at \$1.28 billion.

As more RHCs seek to diversify through foreign and non-utility investments, Congress must ensure that ratepayers do not bear the risks of these ventures. The stand-alone repeal of PUHCA will release RHCs from federal regulation and expose ratepayers to undue risk that is best borne by the utility shareholders.

*PUHCA Repeal at a Time of Uncertainty Could Prevent the Benefits of Competition from Being Realized*

The proponents of stand-alone PUHCA repeal contend that repealing PUHCA is a pro-competitive step that would eliminate barriers to competition and to state restructuring efforts. In reality, stand-alone PUHCA repeal would be a major setback for competition and ultimately would harm rather than benefit customers. Abandoning the protections in PUHCA at the nascent stages of competition would empower large holding companies by allowing them to consolidate a firm share of the market. If industry consolidates in this manner, it is questionable whether competition would be possible at all.

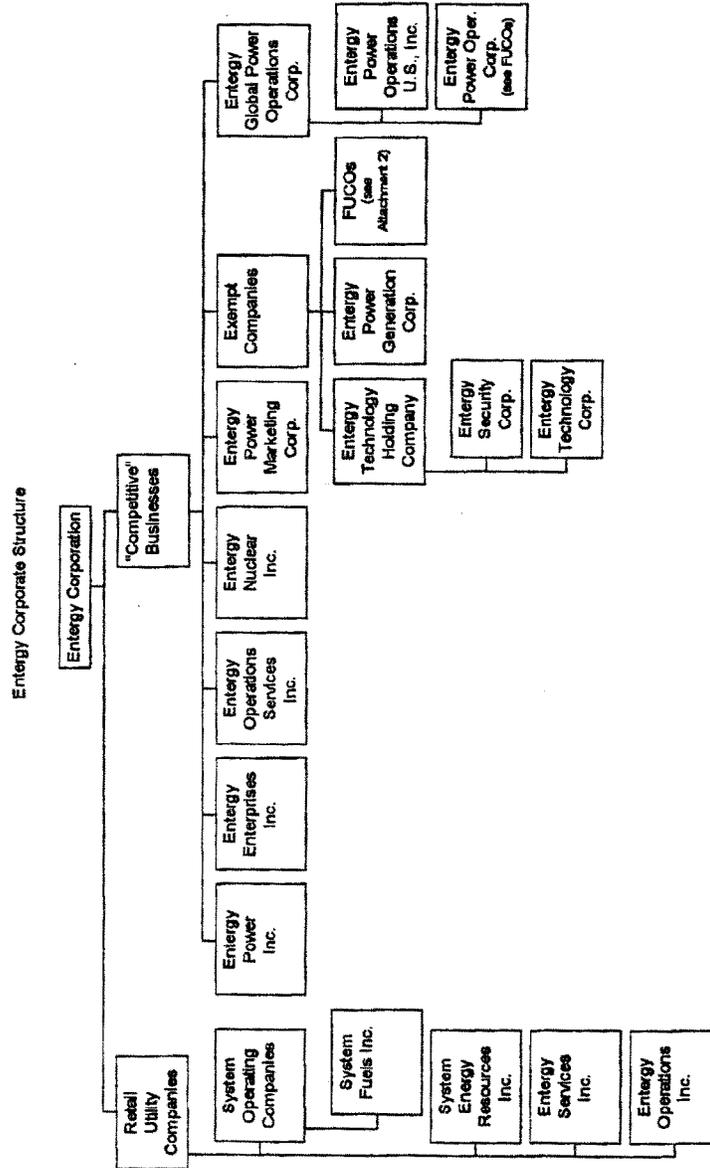
While not perfect, the significant costs to consumers from the repeal of PUHCA would far outweigh the regulatory benefits of abandoning PUHCA. Stand-alone PUHCA repeal would be detrimental to electricity consumers nationwide. Attachment B is a comparison chart of the benefits for consumers versus registered holding companies if PUHCA is repealed on a stand-alone basis. As the chart shows, consumers will lose if PUHCA's requirements are eliminated.

The Council opposes stand-alone repeal of PUHCA. While we agree that some of the requirements in PUHCA need reform, we believe that PUHCA's core protections are necessary unless and until we have a fully competitive electricity market.

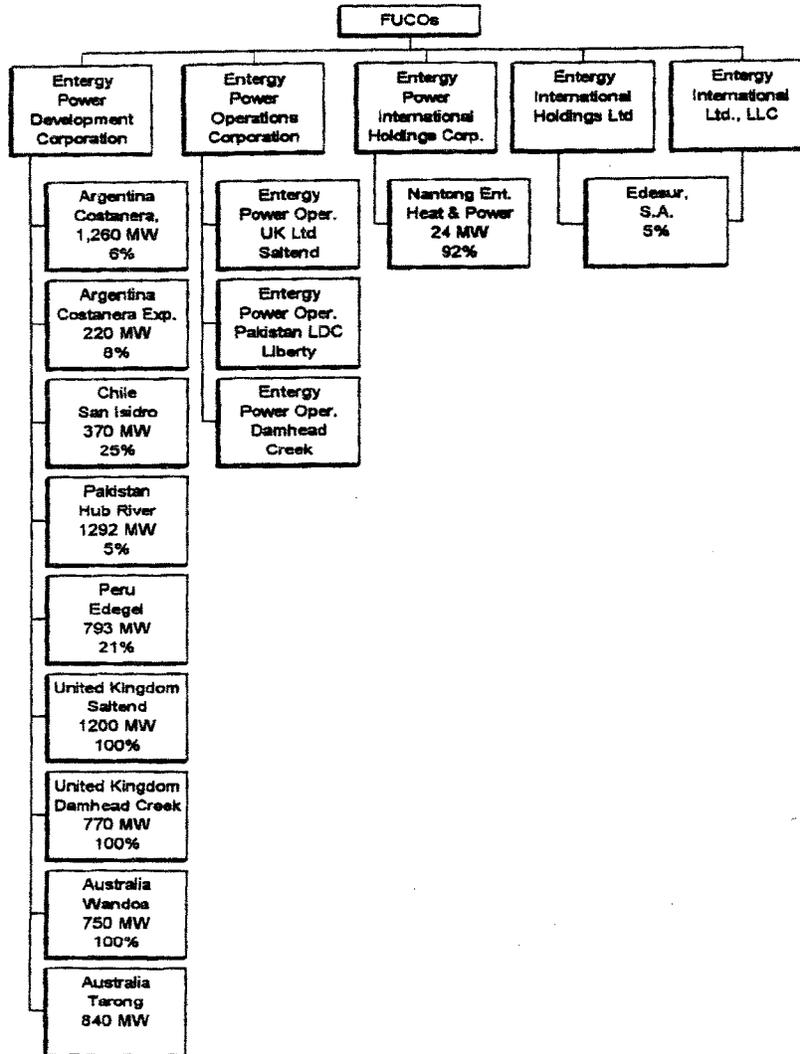
Thank you, and I would be happy to answer any questions at this time.

# ATTACHMENT A

## Attachment 1



Entergy Foreign Utility Companies  
Corporate Structure



## ATTACHMENT B

### A Comparison of the Benefits for Consumers v. Registered Holding Companies if PUHCA is Repealed on a Stand-Alone Basis

While representatives for registered holding companies claim that the Public Utility Holding Company Act of 1935 ("PUHCA" or "Act") imposes duplicative regulation, the stand alone repeal of PUHCA would relieve registered holding companies of significant obligations. From the perspective of consumers, regulation by state public utility commissions and the Federal Energy Regulatory Commission will fail to compensate for the regulatory gap created by the repeal of PUHCA.

In exchange for the regulatory relief provided by the repeal of PUHCA, the registered holding companies have promised nothing to consumers and, in fact, many continue to oppose competition for retail consumers. If Congress is willing to provide such a benefit to the registered holding companies, should not Congress make sure that consumers benefit as well? As reviewed below, consumers will fare poorly if PUHCA is repealed on a stand-alone basis.

#### Benefit to Registered Holding Companies

#### Benefit to Consumers?

Eliminating restrictions on diversified investments.	None. Captive customers of utility subsidiaries will be exposed to risky investments outside the traditional realm of the utility industry. In the absence of PUHCA's restrictions, such transactions can be structured to avoid the scrutiny of state regulators.
Eliminating bookkeeping requirements under the Act.	None. In fact, provisions providing access to books and records provide hollow authority for state and federal regulators in light of the repeal of this authority.
Eliminating the restriction on holding companies charging subsidiaries for services performed by other affiliate.	None. In fact, the sophisticated holding company will structure transactions between affiliated companies to remain outside the jurisdiction of retail regulators.
Elimination of the integration requirements.	None. Registered holding companies will venture into other retail markets to compete while making sure that a base of captive customers is secure. Removing the integration requirement will also facilitate concentration of the industry, undermining the emergence of retail competition.

Mr. OXLEY. Thank you, Ms. Quirk.

Let me begin. It has been my observation that a lot of the folks who oppose PUHCA repeal are many of the same folks who opposed natural gas deregulation and predicted that the world would come to an end, that prices would be controlled by monopolies and oligopolies, and that people would pay more for natural gas, and it has been the opposite.

Where were you on that debate, Ms. Quirk and Mr. Kanner?

Ms. QUIRK. I was in law school at the time.

Mr. OXLEY. Did you have an opinion on same?

Ms. QUIRK. I was probably thinking more toward exams than deregulation.

Mr. OXLEY. Mr. Kanner?

Mr. KANNER. The members of Consumers for Fair Competition are strong proponents of competition. We want to see electric restructuring legislation passed. We just want to make sure that it meets its ideals of creating competition.

Mr. OXLEY. Were you in law school?

Mr. KANNER. I was not active in the natural gas deregulation debate, but I would note that on the natural gas side, pipelines, the equivalent of electric transmission lines, are open for all uses under the same comparable tariff. We don't have that today on the electric side. This knot accomplished in the Barton bill, that is one of the things that we need.

Mr. OXLEY. Let me ask Ms. Heaton, do you believe FERC and the State regulators are currently denied access to necessary books and records?

Ms. HEATON. Mr. Chairman, I think they can get access to whatever they deem appropriate to fill their jurisdictional responsibilities.

Mr. OXLEY. That has been your experience with Columbia?

Ms. HEATON. Yes.

Mr. OXLEY. Mr. Lhota?

Mr. LHOTA. Yes.

Mr. OXLEY. Ms. Heaton, why do you prefer an objective rather than a subjective "deems relevant" standard for access to books and records? Setting aside the issue of sunseting, what would you see as preferable language on books and records?

Ms. HEATON. I would be interested in submitting specific legislative language to you on that issue.

The reason for objective as opposed to subjective is that at Columbia, as well as most other companies, we view our relationships with our regulators as one of our primary assets and take very seriously maintaining a positive relationship.

When there are subjective standards, you are more likely to have disagreements. We view it as a losing situation to have to be, A, arguing with the regulators, or, worse case yet, suing them. So we prefer to have a clear understanding set by Congress as to what books and records could be obtained and would be off the table so we could go forward and deal with those regulatory constraints appropriately.

Mr. OXLEY. Mr. Lhota, do you have an opinion on that?

Mr. LHOTA. We would support their position, but we are not locked into the objective standard.

Mr. OXLEY. Let me ask you, does NARUC support stand-alone PUHCA repeal?

Mr. LHOTA. I would not hazard to speak for NARUC.

Mr. OXLEY. In 1992, Congress amended PUHCA to allow foreign investments and exempt wholesale generators. In 1996, Congress exempted telecommunications companies in the Telecommunications Act.

In both cases Congress created—by the way, both from this committee, in both cases Congress created certain conditions on those exceptions intended to protect consumers. Are those provisions contained or repealed in the legislation that you are advancing, Mr. Lhota?

Mr. LHOTA. Yes. It repeals the—PUHCA as it now exists and replaces it with the books and records. So the answer is yes.

Mr. OXLEY. In your testimony you represent PUHCA as a non-utility or rate regulation statute, which I agree with. Do you mean to assert that PUHCA plays no role in mitigating market power, preempting abusive practice directed against the captive retail market or generally facilitating effective regulation? Does stand-alone PUHCA repeal strip consumers and competitors of structural protections?

Mr. LHOTA. Since that was a long question, let me reply to what I think I heard, Mr. Chairman.

One point I would make is that what PUHCA does is that it is not a rate-making statute. It has an integration standard, a books and records provision, a lines of business provision in issuance of securities. That is the issues that PUHCA deals with.

Relative to market power, that is an issue that FERC would address, and in some regards I would argue that PUHCA could actually enhance market power by encouraging mergers and acquisitions in contiguous geographical areas instead of permitting diverse mergers or acquisitions in remote geographical areas.

Now, I am not sure that I answered your question, but I think that is what I heard.

Mr. OXLEY. The Chair's time has expired. I recognize the gentleman from New York.

Mr. TOWNS. Let me ask you, Ms. Heaton, your testimony calls for a sunset date for both the FERC and State access to books and records provisions. At the bottom of page 4 of your statement, you say that if PUHCA is repealed through comprehensive legislation designed to encourage utility competition, the affiliate oversight and access to books and records provisions now contained in 2944 are simply unnecessary. The competitive forces unleashed through such measures should be more than adequate to substitute for additional regulation to guard against abuses.

Please explain why you believe that affiliate oversight would be necessary, and please be as specific as possible.

Ms. HEATON. Yes, sir.

The Roundtable Group believes that the best consumer protection that could ever exist is vigorous competition. Comprehensive restructuring legislation would unleash competitive forces that at this point are still bound up through a myriad of regulatory schemes. The Roundtable Group could go either way on the issue of comprehensive legislation versus stand-alone PUHCA repeal.

There is a general consensus that PUHCA ought to be repealed, and our view is that it ought to happen sooner rather than later. If that would be part of a comprehensive bill, that would be terrific, but if it could only be done through a stand-alone, that is fine.

In terms of protection for affiliate abuses, again FERC and the States will continue to have jurisdiction over their appropriate scope of authority, primarily on the retail side for the States and the wholesale side for the FERC. They can get access to whatever books and records in that scope that they need as well as transactions that they deem to be relevant to setting either the rates or the protecting of the consumers. To that extent additional books and records authority would not be necessary.

Mr. TOWNS. Mr. Lhota, do you agree with that, and if so, why?

Mr. LHOTA. We fully support competition because I think competition is a great market discipliner, and the examples that I use in my speeches are restaurants in large communities. If they are not competitive and top quality, they go out of business.

We are not proposing the sunseting from our coalition. We would not oppose it, but we are not—we would not oppose it if it were in. We are not proposing that it be included.

Mr. TOWNS. Say that again.

Mr. LHOTA. In our repeal provisions for PUHCA, we are not proposing a sunset provision on the books and records part.

Mr. TOWNS. So—

Mr. LHOTA. We would not oppose it if it were in there, but we are not proposing it.

Mr. TOWNS. As my son would say, any way that the wind blows is cool with you?

Mr. LHOTA. No, I wouldn't go quite that far.

Mr. TOWNS. Thank you very much.

Mr. Kanner.

Mr. KANNER. Mr. Towns, let me emphasize the need for continued access to books and records. It is the fact that the utility would remain in a monopoly enterprise, not subject to the winds of competition. If Office Depot wants to have a loss leader and subsidize the cost of staples and make up the revenues on staplers, they are free to do that, but you as a consumer can say, I am going to buy that loss leader from Office Depot, but I am going somewhere else to buy the other office supplies because I can get a better deal.

In the electric industry, you have to get the distribution function from your local monopoly utility. So if they are subsidizing their competitive ventures with captive customer revenues, that customer doesn't have the choice of going elsewhere. That is why we need the ability for regulators to review all of the relevant information, to be able to audit their activities, to have codes of conduct, to make sure that utilities don't subsidize their competitive ventures with their monopoly functions.

Mr. TOWNS. Thank you very much.

Ms. Quirk.

Ms. QUIRK. If I can just add to Mr. Kanner's statement. One other relevant fact when you talk about affiliate abuses and State regulatory authority is that most States are like New Orleans in that their access to books and records only extends to the boundaries of New Orleans. So in the absence of the books and records

authority currently in Mr. Tauzin's bill and Mr. Barton's bill, there is no extension of the authority of the State regulators beyond the boundaries of their jurisdiction, and that is a huge problem because the overwhelming likelihood is that affiliate transactions will take place beyond the boundaries of that jurisdiction.

Mr. TOWNS. Thank you very much, Mr. Chairman. I yield back the balance of my time.

Mr. OXLEY. In a perfect world—let me ask you this. In a perfect world, if we were to deal with PUHCA reform and PUHCA repeal, would it not be in the best interests of everybody to do it in the context of a restructuring bill? Let me begin with Ms. Heaton.

Ms. HEATON. I have not checked these views with the Roundtable Group, but I will give you a personal opinion, which is no. I think there are so many open questions on the question of what should be in a comprehensive bill, yet it is so clear that PUHCA is continuing to have negative effects today, that consumers would be better off if PUHCA were to be repealed immediately with comprehensive legislation to follow.

Mr. OXLEY. Mr. Lhota?

Mr. LHOTA. Our answer would be no as well, Mr. Chairman. I have been with American Electric Power for 35 years. I have lived under the PUHCA act for 35 years, and I think the constraints that it imposes on our company is a detriment to the consumers and the ratepayers. We would propose that it be done immediately.

Mr. OXLEY. Mr. Kanner?

Mr. KANNER. My answer is absolutely yes, Mr. Chairman. Let me give you an example of why. In 1992, when Congress passed Energy Policy Act, EPACT, and had the limited exemption from PUHCA for exempt wholesale generators, it allowed utilities to convert what are regulated cost-of-service-rate-based generating plants to competitive wholesale generators provided that all of the relevant State commissions approved that conversion. That provision would be repealed by stand-alone PUHCA repeal. So that State commission would no longer have authority over whether that rate-based plant is suddenly taken away from the customers it was intended to serve and is now a competitive plant.

If we don't have other provisions in a comprehensive bill that looks at the generation market and whether it is a competitive market or not, that is a double whammy on consumers and something that I don't think we should stand for.

Mr. Chairman, I would agree with your question. It should only be done in the context of a comprehensive bill and a comprehensive bill that creates a competitive market structure.

Mr. OXLEY. Before I go to Ms. Quirk, let me ask both of the industry folks to respond to Mr. Kanner.

Ms. HEATON. I am puzzled by Mr. Kanner's example. In that circumstance, I have not heard any change about the obligation to serve that the utility would continue to have. Moreover, nothing that Congress is talking about would change the State's rate-making ability for setting the rates for consumers.

So you would have a utility that moved a cost-of-service plant into a competitive plant. It continues to have to serve its captive ratepayers at a cost that has already been set by the State with a mandatory obligation to serve. Consumers have the same rates,

and possibly over time declining rates, while the utility could use that plant in a more efficient manner. I am not seeing the downside to that example.

Mr. KANNER. If it was a low-cost plant that was on average the lowest-cost resource that that utility has, and it is converted into competitive market, the difference between its costs and its market are captured by the utility. Yes, the utility has the obligation to serve. Let's say that it now buys at the market. It is paying the market rate, and under cost of service regulation, the utility's customers would be paying the cost which is now that market rate rather than the cost of production from that low-cost plant.

Ms. HEATON. The rates for the consumers wouldn't change unless the State allowed those rates to change.

Mr. KANNER. They would have to change if the costs changed.

Ms. HEATON. That is not true. There are lots of costs incurred by utilities that the State regulators don't allow to be passed on to consumers because there is a prudence review. If there were to be a concern along the lines Mr. Kanner is suggesting, then the State could simply say, we are not going to allow you to raise your rates.

Certainly a utility going into this would have to recognize the likelihood that if they were to convert a plant from a cost-of-service to a competitive system, that the likelihood of them getting an increase in rates is about nil.

Mr. LHOTA. I would agree. There is an obligation to serve, and there is rate regulation at the State level. I would agree with Ms. Heaton that the regulators would certainly look at this, in my view.

Mr. KANNER. If the regulators would look at it, then I don't think that there is any problem with having the regulators continue to look at it before the asset is sold.

Mr. OXLEY. Ms. Quirk, do you want to get into this mud wrestling match?

Ms. QUIRK. I will jump in because I feel a little left out and lonely.

Mr. OXLEY. It is a tag team.

Ms. QUIRK. I am going to weigh in on Marty's side on this.

I think there is some question about the authority of State regulators to conduct such things as prudence reviews when it comes to something like flow-through of purchase power expenses. Remember in the example that Marty gave, what we are talking about is a purchase power expense in the context of a jurisdiction that has not gone to retail choice, so it is a cost-based rate.

Under the Mississippi Power & Light case, which I discussed, there have been limitations placed on the extent to which a State can look at the prudence of acquisitions of power supplies. So in that instance I think there are some real questions about whether State regulators would have the authority to address this abuse.

Mr. OXLEY. Well, we have had a lively discussion and excellent testimony from all of you. We most appreciate it for all of you to come to the subcommittee with your presence and your testimony. The subcommittee stands adjourned.

[Whereupon, at 12:03 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

October 20, 1999

The Honorable MIKE OXLEY  
 Chairman  
 Subcommittee on Finance and Hazardous Materials  
 2233 Rayburn House Office Building  
 Washington, DC 20515

DEAR MR. CHAIRMAN, I want to commend you for holding a hearing on repeal of the Public Utilities Holding Company Act (PUHCA) on Thursday, October 7.

The Interstate Natural Gas Association of America (INGAA) has long supported repeal of PUHCA. INGAA believes that PUHCA is a barrier to competition. Some natural gas pipelines are registered under PUHCA, some are currently exempt and others currently do not fall under the authority of PUHCA. But our industry has been and continues to change and evolve. All of our members are seeking new business opportunities. As each of our member companies seeks opportunities to grow, they are examining the impact of PUHCA on their businesses. No business except the natural gas and electric utilities industries has to be concerned about this act affecting their business plans.

PUHCA does not give authority over rates. It was not established to protect the consumer. It was enacted to protect investors. Other laws have been passed to meet this need. These laws have enabled the SEC to enhance its regulation of all issuers of securities, including public utility holding companies. State regulation has expanded and strengthened since 1935. Also, institutional investors such as pension funds have become more sophisticated and are continuously demanding more detailed information from all issuers of securities.

INGAA strongly supports early and direct repeal of PUHCA. However, we do not support the request for authority for FERC and states to obtain additional access to books and records of PUHCA companies such as that found in S. 313 and H.R. 2363. INGAA agrees that FERC and the states should have access to the books and records relating to any transactions between a public utility or a natural gas company and its affiliates. However, FERC and the states already have this authority. We are not aware of any instance where either FERC or the states failed to obtain necessary books and records.

I am enclosing a paper explaining our concerns about unfair competition when the books and records of regulated companies are opened to competitors. INGAA is concerned that the language in the PUHCA bills introduced to date can handicap these U.S. companies for competitive purposes. I would appreciate having this letter and attachment included in your record of October 7.

Sincerely,

JERALD V. HALVORSEN

Enc.

NEW INVESTIGATIVE POWERS OVER BOOKS AND RECORDS OF UTILITY HOLDING COMPANIES ARE NOT NEEDED IN THE PUHCA REPEAL TITLE OF A COMPREHENSIVE ELECTRIC RESTRUCTURING BILL

The Interstate Natural Gas Association of America (INGAA) strongly believes that any electric restructuring legislation must include repeal of the Public Utility Holding Company Act of 1935 (PUHCA). Both S. 313 and H.R. 2363 were originally drafted three years ago as "stand-alone" legislation repealing PUHCA. Since then, support for this stand-alone approach seems to have waned, despite wide support for the concept of PUHCA repeal, and its routine inclusion in new comprehensive bills. It now seems clear that Congress wants to repeal PUHCA as part of a comprehensive electricity restructuring measure.

In the same three years, 23 states representing over half the U.S. population have enacted detailed new gas and electric utility competition laws. Even more states—after lengthy proceedings—have approved a number of significant utility restructurings as well as rate cuts, and presided over a wave of electric generation divestitures that have reshaped the U.S. utility industries.

These changed circumstances require a fresh look at the broad, permanent, federally created investigative authority S. 313 and H.R. 2363 grants to the Federal Energy Regulatory Commission (FERC) and the states, to examine the books and records of **some but not all** competitors in the new gas and electric industries. In fact, LNGAA believes that the books and records language set forth in Sections 5 and 6 is both unnecessary and inappropriate for the following reasons:

- (1) the FERC and states already have sufficient jurisdiction to reach all of the relevant books and records of a utility and its *affiliates*;

- (2) the repeal of PUHCA, in and of itself, will expand FERC and state regulatory authority by removing the preemption barrier;
- (3) the lack of either a meaningful standard of relevance or even modest procedural safeguards give rise to the possibility that Section 5 or 6 may result in “fishing expeditions” or the unwarranted disclosure of confidential information;
- (4) these sections may force the anticompetitive disclosure of some firms’ private business strategies to their competitors who may have intervened in rate cases simply to obtain access to this information;
- (5) Sections 5 and 6 contradict one of the main purposes of PUHCA repeal—increasing competition through the creation of a level playing field in the utility industry—by catching only some competitors, and are, therefore, discriminatory;
- (6) Section 6 wrongly assumes the states “need help” from the U.S. Congress, because they cannot actively legislate “on their own,” or effectively investigate the books and records of multi-state utilities.

(1a) FERC can already reach all books relevant to the utility and does not need any new “books and records” authority under Section 5 of S. 313 and H.R. 2363. FERC’s existing powers have been effective enough to completely restructure the U.S. gas industry in the 1980s and 1990s and the U.S. electric wholesale industry in the 1990s. Many sections of the Natural Gas Act (NGA) give FERC power to collect data, but the broadest is Section 14(c) and (d). Under it, FERC can force “any person” to produce, from “any place” in the U.S., “any books, papers, correspondence, memoranda, contracts, agreements, or other records which the Commission finds relevant or material” to “any investigation or other proceeding” under the NGA. Language almost identical to this, requiring the production “from any place” in the U.S., of “any books,” papers, correspondence, etc., of “any person,” is also set forth in section 30 1(b) and (c) of the Federal Power Act (FPA). FERC can reach any cost at issue in a gas or power rate case before it. More is unnecessary.

**(1b) All states already can reach all relevant utility and affiliate books under state law, and do not need any new “books and records” authority under Section 6 of S. 313 and H.R. 2363:** Ever since its landmark 1945 *International Shoe* ruling, the Supreme Court has interpreted the U.S. Constitution to give all states jurisdiction over both in-state utilities, and their out-of-state affiliates that even “minimally” affect in-state utility rates. In the last 55 years, states repeatedly have enacted such “long arm” laws to catch out-of-state firms. Maryland’s utility law, for example, reaches “to the full extent” allowed by the U.S. Constitution. The Massachusetts law covers “all relations, transactions, and dealings, direct or indirect,” between a utility and its affiliates, and is now reaching even documents in England relevant to the National Grid Group’s (NGG) merger with the New England Electric System (NEES). The investigative long arms of the Oregon PUC and the Utah PSC, also intercontinental, have collected thousands of documents from Scotland, that are relevant to the PacifiCorp merger. And the Florida PSC can “exercise all judicial powers and “do all things” to effect its jurisdiction over utilities.

**(1c) The Federal Power Act, in Section §201(g),** also gives states “books and records” power over utilities and affiliates with whom they transact business: With this clear, federally granted investigative control over the in-state utility, a state PUC already can reach all the utility’s direct transactions and dealings with its out-of-state affiliates. As FERC recognizes in its affiliate rules, these direct utility-affiliate transactions are the only ones that can unfairly hike costs to captive in-state consumers; these transactions are already caught by §201(g); and no showing of this provision’s inadequacy has been made.

**(2) Simple PUHCA repeal—by itself, without any extra new state investigative powers—would enlarge current FERC and state authority over affiliate transactions of registered holding companies:** Under the 1992 *Ohio Power* case, both the FERC and the states are preempted from reviewing and disallowing costly transactions among the different affiliates of a registered holding company, if the SEC already has approved these deals under PUHCA. Thus, in the *Ohio Power* case, the SEC approved a “cost-of-service” rate for the utility’s long-term coal contract with its affiliate; and when FERC later tried to set a lower “market rate” for the same deal, it couldn’t. Simple repeal of PUHCA would end this FERC and state preemptive effect, and thus expand FERC and state authority over affiliate transactions of these registered companies—back to the point where it was in 1992, before the *Ohio Power* case. In sum, the simple repeal of PUHCA by itself significantly boosts FERC and state authority over utility affiliates.

**(3) No express protections for recipients of unreasonable state data requests:** Other federally created investigative powers—like those used by the Justice Department in antitrust investigations, under 15 USC § 1311 et seq.—give affected companies the right to raise, in advance, a variety of objections to unwarranted, un-

reasonable, or irrelevant demands that may violate the Fourth or Fifth Amendments. Sections 5 and 6 of S. 313 and H.R. 2363 do not.

**(4) Anticompetitive disclosure of business strategies may result from federal or state “fishing expeditions:”** A company’s confidential customer data and business plans—gained by the FERC or a state PUC under Sections 5 or 6—can be subject to intervenor disclosure, and in some states to public disclosure, in rate and certificate cases that use the data. For the company 5 competitors, who often intervene in these cases, this means an illicit windfall of data on their opponent’s future plans. This hurts competition, and ultimately hurts consumer choice by stifling competition.

**(5) New books and records powers in S. 313 discriminatorily cover only some competitors:** Sections 5 and 6 of S. 313 and H.R. 2363 subject only gas and electric “utility holding companies” to the new federal and state investigative tools. Thus registered and exempt holding companies, such as Columbia and Enron, are covered by it; but multi-state utilities with different corporate structures, such as PacifiCorp and Utilicorp, aren’t. Many other kinds of companies are also exempted—such as Qualified Facilities (QFs), Electric Wholesale Generators (EWGs), Foreign Utility Companies (FUCOs), munis and coops—even though they may be full-fledged competitors in the new gas and power industries. Other exempted entities include the PMAs, Salt River, and TVA—despite their huge market power in many states. This discrimination imposes costs upon affiliates of “utility holding companies” that their competitors do not have to bear. Many of these affiliates already face tight margins, and, therefore, such additional costs may eliminate a significant number of affiliate businesses.

**(6) The massive restructuring of electric utilities in 24 states since 1996 reflects strong state fact-finding powers:** The sophisticated, detailed rewriting of utility laws and rules in these states, beginning with New Hampshire’s law in May, 1996, is part of the biggest change in the utility industry in decades. It could not have been successfully led by uninformed PUCs with inadequate fact-finding powers. Many of these 24 new state laws exceed 100 pages in length. Such detailed drafting makes it difficult to believe that the PUCs and state legislators who drafted these laws failed to provide regulators with sufficient investigative powers to assure that these laws are carried out.

**Conclusion:** Congress must repeal the 1935 Act soon. It should end this impediment to competition, to let the nation’s 100-plus holding companies enter new markets and compete on a level playing field with new entrants as well as companies not now subject to PUHCA. Congress does need to clarify the states’ powers in the new unbundled energy markets. But states do not need to and, therefore, Congress should not prescribe the new “books and records” powers for FERC and the states as is currently proposed in Sections 5 and 6 of S. 313 and H.R. 2363. FERC and the states already have sufficiently broad authority to obtain all relevant books from both natural gas companies and electric utilities.

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#### PREPARED STATEMENT OF NATIONAL ALLIANCE FOR FAIR COMPETITION

The National Alliance For Fair Competition (NAFC) is a coalition of ten national trade associations representing over 35,000 small businesses throughout the United States.

These organizations consist of small, private sector businesses engaged in the design, supply, rental, sale, design, installation and servicing of electrical and mechanical products, equipment, and systems, as well as providing energy fuels. These firms operate in residential, commercial and industrial markets. While a few larger firms are included within this group, the majority of business are small by any standard of measurement and many are family owned and operated. The organizations themselves are independent entities but share common goals and, in some cases, individual members.

The 35,000 firms encompassed within NAFC are only a fraction of the overall number of businesses which make up the affected industry. The Department of Commerce puts the approximate size of the contractor groups alone at 144,000 individual firms. These firms employ over 1.3 million workers, with an annual payroll of \$31 billion. NAFC’s construction member firms add a total value to domestic GNP of over \$100 billion on an annual basis, according to the US Commerce Department.

#### *Introduction*

Proponents of the repeal of the Public Utility Holding Company Act (PUHCA) have frequently portrayed their effort as one which of concern only to the few registered companies to which the Act directly applies; that repeal is needed to allow

them to compete more efficiently; and, that they are unduly restrained in their ability to enter new lines of business or to compete in states outside their home territory.

NAFC and the thousands of small businesses which are being impacted today by the expansion of utility-owned affiliates, many of which exist in holding company settings, believe otherwise.

The existence of the protections contained in PUHCA, including restrictions on cross-subsidization, the requirement of separation of regulated and unregulated businesses, the restrictions on intrasystem loans and financing, the requirement of prior approval for diversification and the restrictions on type of diversification are as necessary now as when the Act was created.

As was the case in the early decades of this century, the electric utility industry is undergoing enormous change. Mergers and consolidation in the industry have reached and now exceed any previous recorded pace. Once again, the very situations which gave rise to the necessity of creating PUHCA, especially the problems of cross-subsidization and affiliate abuses, are threatening substantial harm to consumers and, in the present instance, competition as well.

The climate of deregulation, if not its actual occurrence, has prompted utilities to form unregulated affiliates and subsidiaries seeking to capture markets which have not traditionally been served by utilities and which lie, generally, outside the scope of their core functions. Increasingly, utilities have settled on entry into the energy services and related markets as a means of holding on to customers and establishing profit centers. Thus, utilities now seek to dominate the related energy services markets, such as those for electrical, HVAC/R and air conditioning markets.

This diversification by utilities into areas outside of their publicly regulated role as producers and suppliers of energy has occasioned significant and continuing harm to small, private sector firms engaged in the related energy service fields. Utilities (typically through unregulated affiliates or subsidiaries) now routinely sell appliances, provide plumbing, heating, and cooling equipment and service contracts, engage in insulation work and sales of storm windows and doors, provide outdoor lighting and interior lighting fixtures. Utilities have also begun to enter into security and alarm monitoring markets, telecommunications, and related energy markets such as energy management and energy monitoring.

Most importantly, utilities are unfairly subsidizing their market entry from their utility rate base and using their powers as an incumbent monopoly to discriminate against non-affiliated competitors. There is considerable potential for small businesses to be harmed in their traditional markets and to be denied access to newly emerging markets which are the key to future expansion, job growth, and profitability as deregulation progresses.

#### *PUHCA and Small Business*

Despite the fact that the Public Utility Holding Company Act (PUHCA) directly applies only 16 utility holding companies and may, therefor, be viewed as only of minimal importance to small businesses; PUHCA repeal does have considerable significance for these small businesses.

First, it's a mistake to believe that PUHCA impacts only a few, large multi-state utility operations. By its very existence, PUHCA impacts far more utilities which must operate and structure themselves in a fashion so as not to become subject to the Act's provisions. Indeed, this is one of the major safeguards of the 1935 Act: it serves as a brake on the unrestricted expansion and diversification of other utilities. If PUHCA were repealed, not only the 16 registered holding companies but every other utility would be free to acquire widely dispersed utility affiliate operations and engage in multistate activities which give rise to the very kind of abuses which PUHCA was designed to prevent.

Second, without the restraints imposed by PUHCA, public utility holding companies would have the potential to expand further and to develop and exploit monopoly markets beyond the control of any one state. Indeed, without the restraint imposed by the Act, a multiplicity of mergers and acquisitions, already taking place, will result in even more multi-state utility operations which, but for repeal, would have been subject to SEC jurisdiction and scrutiny. If PUHCA were repealed, the presently exempt holding companies would no longer have to confine their operations primarily to a single state. State commissions could then lose control over the out of state operations of utility holding companies (both the presently registered ones as well as those presently exempt which choose to expand) which would then be free to engage in unconditional interstate commerce and foreign acquisitions.

Third, and more importantly for small business competitors, repeal of PUHCA will bring with it the ability of public utility holding companies to further diversify into unregulated further eroding those markets traditionally served by small busi-

ness and creating barriers to entry in new markets. State regulators will be powerless to prevent harm to these firms because of the multistate character of public utility holding companies and because state regulators have little authority to oversee the transactions of the unregulated business. More specifically, both ratepayers and small business competitors suffer from the performance of services by utility subsidiaries for the unregulated subsidiaries (such as ESCOs) without charging properly, if at all, which results in the costs of the unregulated business being borne by ratepayers and conferring an unfair competitive advantage upon the unregulated subsidiary.

*Specific PUHCA Protections And Pending Legislation*

**Intrasystem Financing.** The Security and Exchange Commission's (SEC) Rule 45(a), promulgated pursuant to the authority of section 12(b) of PUHCA, provides that a company in a registered holding company system must file a declaration and receive an order from the SEC before it may lend or extend credit to, indemnify, or make any donation or capital contribution to any company in the system. This extends coverage to public utility companies which may disadvantage competition by the using the credit of the utility to borrow money on behalf of affiliate operations competing directly against small businesses for customers and markets. Such favorable borrowing not only can impair the future rating of the utility, but amounts to a cross-subsidy to the unregulated affiliate.

Regulators may encounter significant difficulty in distinguishing whether the borrowing was done to benefit the utility operation and its consumers or was done to benefit the unregulated operation competing against non-affiliated private sector firms. The holding company may be able to use its utility operations to raise funds for unregulated ventures in other markets by borrowing against the assets of its regulated utility operations. If the risks inherent in the regulated market are lower than those in the unregulated, competitive market (as can be anticipated) cross-subsidies result in the form of lower cost debt for the competitive venture than would otherwise be the case. Consumers will suffer, as well, since the regulated utility operation now bears some of the risks associated with the capital supplied for the unregulated business. The prevention of this expanded risk, the commensurate higher rates to be paid by consumers to defray such loans, and the adverse impact on competition in unregulated markets are the very reasons why PUHCA protections must be continued.

Unfortunately, the present legislation regarding PUHCA repeal does not require holding companies to exclusively use non-recourse debt, preclude inter-affiliate loans, or otherwise insulate captive consumers from risky financial transactions.

**Affiliate Transactions.** Section 13 of the Holding Company Act governs service, sales and construction contracts among affiliates. In general, section 13(a) prohibits registered holding companies from entering into or performing any such contract with an associate utility or mutual service company, except in limited circumstances to be exempted by rule. Section 13(b) permits registered holding company subsidiaries and mutual service companies to enter into or perform a service, sales or construction contract with an associate company only in accordance with SEC rules and only if such contract is performed "economically and efficiently", for the benefit of the companies serviced, at cost, fairly and equitably allocated among such companies.

One of the more pernicious aspects of unfair competition is the shifting of costs from the unregulated affiliate to the regulated utility operations. This harms both ratepayers and competition in the affected competitive market. One of the major purposes of PUHCA was to prevent this cost shifting.

In connection with monitoring operations of service companies, the SEC has identified and corrected such abuses. The SEC has been particularly concerned with the practice of shifting holding company expenses to operating utilities through the medium of a service company. This shifting was accomplished, for example, by sharing officers and employees between the holding company and the service company and charging some portion of their compensation to the utility customers of the service company. In a series of proceedings, the SEC established the principle that the compensation and expenses of holding company personnel must be borne by the holding company and not shared with an associated service company and passed on to utilities.

Unfortunately, this precise situation—the sharing of officers and employees—is again becoming an issue as utilities expand into unregulated markets. At the instance of public utilities, a number of states now permit such sharing despite the recognized potential for consumer and competitive abuse. For example, New Jersey has passed a statute which specifically permits its utilities to share administrative personnel, employees, administrative services, and facilities with unregulated, non-

utility ventures. The statute specifically allows a utility company's unregulated businesses to use utility employees to service non-residential accounts. Other states have similar provisions, including Illinois, and Massachusetts while some states, such as Nevada, expressly prohibit the practice. If PUHCA should be repealed without establishing new provisions which, at a minimum, continue the protections contained in the statute now, the practice of sharing employees can be expected to expand greatly with attendant increases in cost shifting and cross subsidization.

In addition, the SEC has recognized that even the present language of PUHCA may be inadequate to deal with an increasingly common situation where the utility itself is the provider of non-tariffed services or goods to its affiliates or non-associated entities. In its 1995 Report to the Congress, the SEC's Division of Investment Management stated:

"[increased diversification may raise new and different affiliate concerns.]. A new standard of review for transactions between utility and nonutility associate companies may also be appropriate where the utility is the seller of goods or the service provider. . . Finally, the "cost" standard of section 13 may not be the correct standard for reviewing affiliate transactions; it may make more sense to use market value, or some combination of cost and market value, in reviewing such transactions." (Emphasis added.)

NAFC agrees with the Division in its recommendation. Regardless of what action Congress ultimately takes with respect to PUHCA, federal legislation is needed to address the consumer and competitive abuses now arising from situations where the public utility transfers assets and personal to unregulated, non-utility operations which seek to displace existing firms through cost shifting and cross-subsidization.

**Again, present PUHCA repeal legislation, such as S. 313, does not affirmatively prohibit cross-subsidization, and state regulation is inadequate to prevent siphoning of ratepayer dollars in a holding company structure.**

This is especially true with regard to situations where assets are transferred from the utility itself to an associate company engaged in unregulated, non-utility operations. Increasingly, as noted by the SEC report, utilities are resorting to this new means of conferring a competitive advantage upon their non-regulated subsidiary or affiliate which is not normally recognized by state regulators as falling under the traditional definition of cross-subsidization. This more modern subsidy is the transfer of tangible and intangible assets at very little or no cost to the non-utility subsidiary or associate company. Typically, this would be in the form of marketing data either in the aggregate or with reference to specific customer sites, or would concern the transfer of generating assets, or the laying of fiber optic cable. For example, a holding company could transfer a formerly rate-based, low-cost generating plant to an unregulated marketing affiliate—without pre-approval by all the relevant state commissions—for the embedded cost of the facility thereby denying captive retail customers of the economic benefit of the facility and potentially exacerbating stranded cost exposure. Alternately, a holding company could build a fiber optic system, with a small portion used for core utility operations (such as load control), and the remaining capacity operated as or leased to a competitive telecommunications provider. Given the economies of scale in fiber optic cable, captive utility customers could pay the majority of the underlying costs and not receive the economic benefits of the use of the remaining facilities.

The advent of fiber optic cable and advanced energy monitoring capability now make it possible for utilities to know in advance of even the customer when residential or commercial equipment may fail. Such information may be turned over to the utility's service affiliate without any opportunity for private sector competitors to service even existing accounts. It is no surprise that investor owned utilities have invested billions of dollars into telecommunications in order to capture this market.

Once again, because of its nature as a utility, the local energy provider is in a position to acquire specific information regarding a customer's energy usage. This can include more than just total or average consumption, but also the type of equipment being used, its load profile, the customer's frequency and type of repairs, equipment age and model, customer credit and billing history. Such information is possessed by the utility by virtue of its monopoly status and can be easily transferred to its non-utility affiliate or subsidiary for use in providing a significant competitive advantage against private sector competitors which are unable to obtain such information no matter what the cost.

**Pending PUHCA repeal legislation, such as S. 313, does not require holding companies to provide competitors with comparable access to information obtained from monopoly affiliates.**

Another asset of substantial value which is conferred upon non-regulated affiliates and subsidiaries is the ability to trade upon the utility's goodwill (name and logo). Having been conferred a monopoly franchise for decades during which their

existing captive customer base became acquainted with a utility's name and trade marks, utilities now routinely provide their non-utility subsidiaries and affiliates with all the good will previously acquired. Although, the owners of the utility have a right to permit usage of their identifying marks to those they deem fit, they should not be permitted to do so without recovering the fair market value of such an asset since failure to do so represents a subsidy from the utility side of operations to the non-utility side.

While ratepayers may not be entitled to ownership rights in the asset, they have a beneficial interest in it and have certainly contributed to its value. Failure to compensate them not only unduly drives up rates by foregoing revenues which could otherwise accrue to the utility but also conveys a substantial unfair competitive advantage over private sector competitors.

**Unfortunately, pending legislation limits state commission review of the transfer of assets and fails to require fair compensation to ratepayers for the transfer of ratepayer financed assets.**

**Access to Books and Records.** Another reason for heightened concern regarding affiliate abuses in all holding company systems, both registered and exempt, is the large number of holding company subsidiaries that engage in non-utility businesses. With increasing speed, utilities are expanding their acquisition of contracting firms in the HVAC/R, electrical, telecommunications, and security and alarm monitoring fields. The sheer number of non-utility business activities brings greater potential for improper allocation of centralized service company costs to the non-utility businesses (*i.e.*, electric ratepayers subsidizing the non-utilities' fair share of the costs). It also increases the opportunities for affiliate contracting abuses.

To protect against affiliate abuse and cross-subsidization, federal and state regulators must have access to the books, records and accounts of all companies in a holding company system that are relevant to costs incurred by an affiliated utility or to the transfer of assets, personnel, employees, or the sharing of facilities and employees between a utility and its affiliated or associate companies. This is equally true with respect to both registered and exempt holding company systems. If Congress modifies or repeals PUHCA, it should ensure that ratepayers are protected from affiliate abuse. In addition, NAFC recommends that states should also be given clear authority to review affiliate contracts—up-front—to assure that all anti-competitive issues are adequately addressed before they become a problem.

Finally, NAFC believes that any effort to revise the Public Utility Holding Company Act should take place in the context of overall, comprehensive revision of those key statutes which form the basis of public utility law, including the federal Power Act, the Public Utility Regulatory Policies Act, and other relevant statutes.

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PREPARED STATEMENT OF PLUMBING-HEATING-COOLING CONTRACTORS—NATIONAL ASSOCIATION

The Plumbing-Heating-Cooling Contractors—National Association would like to submit the following testimony to the Subcommittee on Finance and Hazardous Materials on the importance of the 1935 Public Utility Holding Company Act (PUHCA) in today's competitive energy market.

*PHCC—National Association*

The Plumbing-Heating-Cooling Contractors—National Association, founded in 1883, is the oldest trade organization in the construction industry, and the largest in the plumbing-heating-cooling industry. The PHCC-National Association membership is composed of more than 5,000 contracting firms nationwide, including both union and open shops, performing all types of work from residential and commercial to industrial and institutional. Whether serving as a subcontractor or a general contractor, PHCC-National Association members engage in maintenance, remodeling, service and repair, and new construction in the following fields: air-conditioning, backflow prevention, heating (warm air and hydronics), plumbing, process piping, refrigeration, fire sprinklers, sheet metal, and ventilation.

The PHCC—National Association is a member of the National Alliance for Fair Competition (NAFC) and endorses NAFC's positions on PUCHA repeal and on comprehensive electric utility restructuring.

The PHCC—National Association is also a member of the Consumers for Fair Competition (CFC) and endorses its policies on PUHCA repeal and on the mitigation of market power in a deregulated energy market.

*Introduction: PUHCA is Still Relevant Today*

Some have argued that PUHCA is an impediment to electric competition. Others have argued that PUHCA helps competition by preventing electric monopolies from competing unfairly. Both are right.

PUHCA is simultaneously an impediment to and a protector of free and open competition. While PUHCA's regulatory structure may restrict utility holding companies from competing as much as they wish, at the same time it ensures that what competition does occur is open and fair. As Congress considers PUHCA repeal, and electric restructuring in general, the trick will be to remove the barriers restricting competition without removing those barriers that prevent unfair competition and prohibit anti-competitive practices.

The PHCC—National Association believes the market power provisions of PUHCA are still necessary today in order to ensure truly fair and open competition occurs. PUHCA should only be repealed if it is done in the context of comprehensive utility restructuring, and if such comprehensive legislation contains adequate safeguards against market power abuses.

While current proposals to repeal PUHCA retain important bookkeeping and financial reporting requirements, these proposals fail to retain the current cost allocation rules that govern affiliate transactions. Current proposals also fail to require the same level of operational separation that exists today, which prevents a utility from inappropriately supporting its unregulated affiliates with ratepayer assets.

The primary reason for establishing PUHCA in the first place was to prevent utilities from using assets gained from the ratebase to support the utility holding company's competitive affiliates. Utility holding companies had been abusing the market power derived from their captive customers (rate-payers) to support a range of subsidiary companies that used this market power to gain an unfair and anti-competitive edge over their competitors. Such actions harmed both ratepayers, because their energy rates were unnecessarily increased, and competitors, because they were competing against a company supplied with the limitless assets of a monopoly. PUHCA reined in the monopolies and established the financial and operational separation necessary to ensure that unregulated utility holding company affiliates operated in the same manner as every other business in America—without the benefit of a captive ratebase to finance its operations.

As utilities and their affiliate companies begin to compete in different economic sectors and at an ever-increasing rate, the original justification for PUHCA's market power provisions become more evident. In many instances, the first competitive affiliates a utility establishes operate in the energy services market.

*Utilities Compete Against Small Businesses in the Energy Market*

Small businesses, especially contracting firms, are not just consumers of electricity. They are also competitors in the energy market. Professional contracting firms have been the traditional source for providing, installing, servicing and maintaining energy efficient products and services. A dynamic, deregulated energy market will bring even more business opportunities in energy efficiency and load management for small businesses.

Congress must keep in mind when considering electric utility restructuring that utilities and their affiliates will not just be competing against other utilities. They will also be competing against family-owned small businesses found in every community. There is nothing wrong with competition, so long as the utilities do not compete unfairly by using their rate-base to support their private-market ventures.

Every day, PHCC members face a wide range of competitors, from other professional contractors, fly-by-night repairmen, national service centers like Sears and Home Depot, and affiliated subsidiaries of utilities. PHCC members are not opposed to competition and do not seek to limit the number of competitors in their field through any means of legislation or regulation.

PHCC members are, however, fiercely opposed to utilities' unfair and anti-competitive behavior. Increasingly, over the past decade, contractors have seen unfair competition from utilities and their affiliated service companies.

*Description of Unfair Utility Competition*

Unfair utility competition occurs when a utility uses the unique advantages of its situation as a government-sanctioned monopoly to support the competitive business operations of its subsidiaries. This is often referred to as cross-subsidization, because the regulated rate-base is subsidizing the unregulated affiliates. PHCC members have been subjected to unfair utility competition since the 1960's. But with deregulation of the natural gas industry in 1992, and the current momentum of electricity deregulation at the state level, instances of unfair and anti-competitive behavior are increasing to dangerous levels.

Cross-subsidization comes in many forms and sizes. It is not just the transferring of money from the parent utility to the affiliated subsidiary. Any service, product, tool, or even goodwill that is passed to the affiliate without compensating the ratepayers with the fair market value of that product or service is unfair and anti-competitive. Any time a utility refers a consumer to its affiliate, or denies or delays utility service to a competitor of its affiliate, is an instance of unfair utility competition.

Some examples of cross-subsidization that create unfair competitive advantages are:

- **Equipment Transfer:** A utility transfers equipment that has been paid for through the utility rate-base (i.e., the electric bill) to the affiliated service company. Such equipment could be service vans or computers.
- **Customer Data:** The utility provides, at little or no cost, utility-developed ratepayer profiles for the affiliated service company's marketing efforts. These ratepayer profiles become sales leads for the affiliate.
- **Personnel Transfer:** The affiliated service company uses the utility's personnel for service calls. The service company then has a workforce whose salary, health care, employment taxes, and retirement plans are paid for by the ratepayers.
- **Customer Steering:** The utility steers consumers—through toll-free customer service lines, a website, direct marketing in bill-stuffers and via other means of advertising—to the utility's affiliate and recommends the affiliate's products and services.
- **Overhead Transfer:** The utility pays for the affiliate's overhead, such as providing accounting and legal services, purchasing office supplies, or providing free office space in the utility's buildings.
- **Joint Marketing:** The utility allows only the affiliate to add bill stuffers advertising the subsidiary's services in the utility's monthly rate-bills, for free.
- **Name Recognition:** The affiliated service company uses utility's name and logo. Consumers tend to go with what they know, and most everyone knows who their utility is. Consumers may then incorrectly assume that the affiliate's quality control and financial stability are also regulated and approved by the state public service commission.

One must ask: How much would a family-owned construction company have to pay for these services, products, and benefits? Did the utility affiliate pay the fair market value? Were the ratepayers compensated for the use of these assets and benefits they paid for through their bills, or have their rates been lowered by that amount?

#### *How PUHCA Prevents Unfair Competition and Cross-subsidization*

PUHCA contains three provisions that combine to prevent utility holding companies from using ratepayer assets to compete unfairly:

- **Financial Bookkeeping and Reporting:** Registered utility holding companies must file detailed financial reports for the utility and its affiliates, which are then made public.
- **Operational Separation:** The subsidiary companies must be both financially and physically separate from the parent utility. The affiliated subsidiary may not use the same equipment, personnel, office space, vehicles, etc.
- **Affiliate Cost Allocation Rules:** Strict guidelines govern the transfer of assets between the regulated utility and its affiliates to ensure no unnecessary costs are passed to the ratepayers.

Current proposals to overhaul or repeal PUHCA only carry over the financial bookkeeping and reporting requirements. These proposals do not replace the other two provisions and leave a gaping hole in the fair competition coverage.

Separation between a utility and an affiliate is not "protectionist." Separation is a statement that tells an affiliated company that it must operate in the same manner as every other business in America: it must build its own name, develop its own customers, hire its own employees, and fund its operations independently. The general public did not finance the creation of any contractor or small business. Why should the general public, through their monthly utility bill, finance a utility's for-profit affiliates?

While strict financial bookkeeping and reporting is important to prevent unfair competition, it is not enough. With just the reporting requirements, we are left to simply witness the crime without the ability to prevent it or punish it. If Congress expects a truly open and fair competitive energy market to develop, it cannot repeal or reform PUHCA without replacing all three fair competition requirements: proper affiliate transaction cost allocation, operational separation between affiliates and the utility, and strict financial bookkeeping and reporting.

The PHCC—National Association urges Congress to include NAFC’s fair competition language in any electric utility restructuring legislation. This legislative language is included in Appendix A.

The fact that Congress used provisions similar to PUHCA’s in the 1996 Telecommunications Deregulation Act is a testament to the need for strong market power provisions in today’s competitive markets. Congress should not set a lower standard of fair competition in the energy market than it did in the telecommunications market.

#### *States Cannot Do It Alone*

Repealing PUHCA and expecting state utility commissions to have the ability and authority to police a multi-state utility holding company is counter intuitive. The entire reason why Congress created PUHCA in the first place was because the state utility commissions did not have the ability and authority to stop multi-state utility holding companies from competing unfairly.

States, either through legislation or through their public service commissions, cannot promote and police fair competition by themselves. Their jurisdiction is limited to ensuring fair competition for those utilities that solely compete in their own state. State public service commissions need federal guidance to help deal with situations where the competing utility crosses state boundaries. This is often the case with those utility holding companies PUHCA applies to.

Repealing or reforming PUHCA in the context of comprehensive restructuring will prevent utility holding companies from gaining an unfair competitive advantage by competing across state lines.

#### *Conclusion*

The PHCC—National Association believes that in America everyone should be allowed to compete, no matter who they are. However, no one should be allowed to cheat and no one should be forced to compete against a monopoly. Utility holding companies should not be allowed to use any advantage they may have (or had) from being a government-sanctioned monopoly to compete unfair against another company.

PUHCA should only be repealed or reformed in the context of comprehensive restructuring and only if sufficient safeguards are in place to prevent utility holding companies from cross-subsidizing. Any legislation repealing or reforming PUHCA must require operational separation between the utility and its affiliates; provide a clear grant of authority to both the states and FERC for the prohibition of anti-competitive actions; permit access to any and all books and records, wherever located, when necessary for investigation; prohibit the cross-subsidization of non-regulated businesses by regulated utilities; restrict self-dealing and discrimination between utilities and their affiliates; and prevent the transfer of a utility’s non-tangible assets to its affiliate (i.e. customer profiles and corporate name, and logo).

### APPENDIX A

#### PROPOSED FAIR COMPETITION LANGUAGE FOR STAND ALONE PUHCA REPEAL

##### PARTICIPATION BY PUBLIC UTILITIES IN PROVIDING CERTAIN NON-UTILITY SERVICES.

###### (a) **In General**

(1) Notwithstanding any law to the contrary, any public utility company, subsidiary company, affiliate, or associate company of a public utility company, may engage in, directly or indirectly, any activity whatsoever, wherever located, necessary or appropriate to the provision of non-utility services as described herein, subject to the provisions of this Act and the jurisdiction of the State Commission and the Federal Energy Regulatory Commission.

(2) **Non-Utility Services**—No public utility company shall engage in the design, sale, distribution, lease, rental, installation, construction, modernization, retrofit, maintenance or repair of systems, products or equipment, including household appliances, except as permitted under this section.

(A) **Exceptions.** The provisions of this section shall not be applicable in instances of emergency or to protect the life, health, or safety of any customer or property; or where the utility is the sole source of such systems, products, equipment or services.

###### (b) **Prohibition of Cross-Subsidization.—**

The state commissions shall exercise their jurisdiction pursuant to this Act and to the extent otherwise authorized under applicable law with respect to prohibiting the cross subsidization of the activities described in subsection (a) by a public utility company in its rates for electric or gas services, and (2) to make appropriate rate

adjustments, disallow any cost recovery, or make any determination regarding the allocation of charges, to eliminate the effects of any cross-subsidization or to prohibit any unjust, unreasonable, preferential or discriminatory rate.

(c) **Structural and Transactional Requirements.—**

Any activity authorized under subsection (a) shall only be conducted under a subsidiary company, affiliate, or associate company which is separate from any public utility company engaged in the generation, transmission, or distribution of electric power or gas.

(A) Such separate company, affiliate, or associate company—

(1) shall maintain books, records, and accounts in the manner prescribed by the state public utility commission which shall be separate from the books, records, and accounts maintained by the public utility company of which it is an associate company and any other subsidiary or affiliate of such public utility company, shall maintain proper internal cost-allocation procedures as prescribed by the state commission;

(2) shall have separate officers, directors, and employees from the public utility company;

(3) may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of a public utility company; and

(4) shall conduct all transactions with the public utility company of which it is an associate on an arm's length basis with any such transactions reduced to writing and available for public inspection.

(d) **Independent Audit Authority for State Commissions.—**

Any state commission with jurisdiction over a public utility company that is an associate company of a registered holding company and which company transacts business with a subsidiary company, affiliate, or associate company of such holding company engaging in any activities described in subsection (a) may request that the company engaging in such activities have performed, no more frequently than on an annual basis, an independent audit of transactions between such jurisdictional public utility company, its affiliates, subsidiaries, or associate companies and such company engaging in such activities. If such an audit is ordered, the State Commission shall select and supervise an independent management or other accounting firm to perform the audit. The company shall bear the costs of performing such an audit. The audit report shall be provided to the State commission within 6 months of the audit request.

(e) **Fair Competition.—**

In its dealings with its subsidiary or affiliate as described in subsection (a) a public utility company

(1) may not unfairly discriminate in favor of its subsidiaries or affiliates, and any other entity in the provision or procurement of, or access to, goods, services, facilities, and information, or in the establishment of standards or referral of customers;

(2) may not provide information, including marketing leads, to such company, its subsidiaries or affiliates, unless such information is made available to other persons on reasonable and non-discriminatory terms and conditions; nor shall any utility provide, transfer, or permit the use of, or access to, tangible or intangible assets of the utility which were acquired with ratepayer funds unless such transfer, provision, or other use of such assets is fully compensated by the subsidiary, associate, or affiliated company;

(3) shall account for all transactions with a subsidiary described in subsection (a) in accordance with generally accepted accounting principles and shall value any assets that are transferred directly or indirectly from the public utility company to its affiliates, subsidiaries or associate companies, and shall record such transactions, in accordance with such regulations as may be prescribed by the State commission to prevent improper cross subsidies.

(4) the name, logo, service mark, trademark, or trade name of the separate subsidiary or affiliate of a public utility company shall not resemble the name, logo, service mark, trademark or trade name of the public utility company and neither the public utility company nor the separate subsidiary or affiliate may trade upon, promote, or advertise their affiliate or related status.

(f) **Proprietary Information.—**

(1) In complying with the requirements of this section, each public utility company and any subsidiary, affiliate, or associate company of such public utility company shall have a duty to protect the confidentiality of proprietary information of competitors and customers. A public utility may not share customer proprietary information in aggregate form with its subsidiaries, affiliates or associate companies unless such aggregate information is available to other competitors or persons under the same

terms and conditions. Individually identifiable customer proprietary information and other proprietary information may be

(A) shared only with the written consent of the person to which such information relates or from which it was obtained; or

(B) disclosed to appropriate authorities pursuant to court order.

(2) **Exceptions.**—Paragraph (1) does not limit the disclosure of individually identifiable customer proprietary information by each public utility as necessary

(A) to initiate, render, bill, and collect for the service or products requested by a customer; or

(B) to protect the rights or property of the public utility, or to protect users of any of those services from fraudulent, abusive, or unlawful use of any such service.

(h) **Implementation—**

Each State commission, for each public utility company under its jurisdiction which is not a registered holding company, shall:

(A) Hold a hearing and make a determination based on evidence presented in the record as to what rules, procedures, or other actions are necessary to implement the safeguards set forth in subsections (a)-(f) of this Section; and

(B) promulgate any regulations necessary to implement those sections within one year from the date of enactment of this Act.