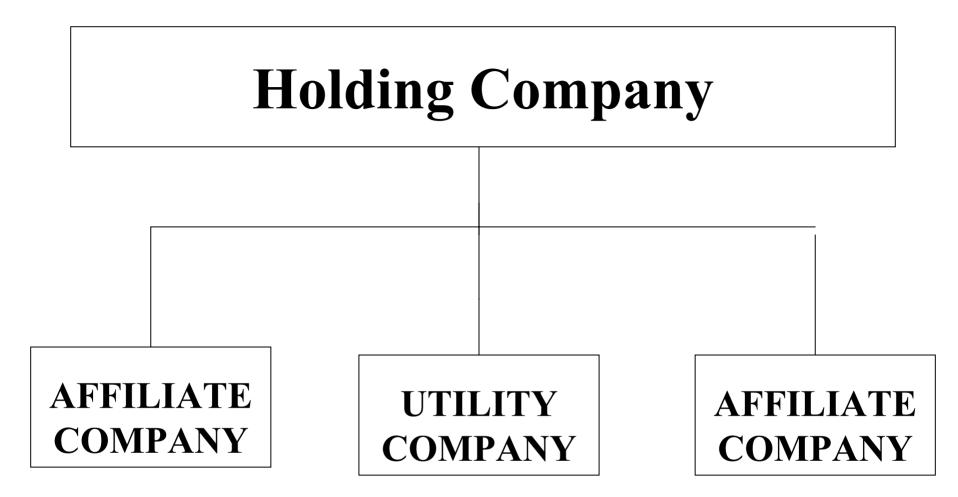
# Regulated Utilities and Unregulated Losses

Roy Hemmingway, Chair Oregon Public Utility Commission

Harvard Electricity Policy Group Palm Springs, CA January 31, 2003

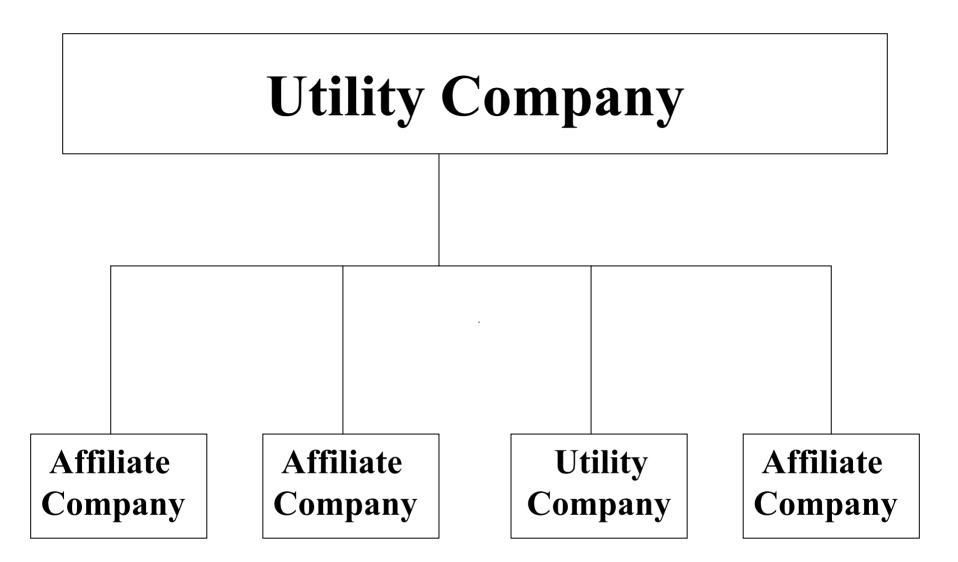
### **Conclusions**

- Activities of affiliate companies can affect the financial health of utilities.
- Regulatory commissions can take actions to reduce, not eliminate, problems stemming from affiliate companies.
- Problems with affiliates are likely to become more common, as holding company structures get more complex, particularly if PUHCA is repealed.

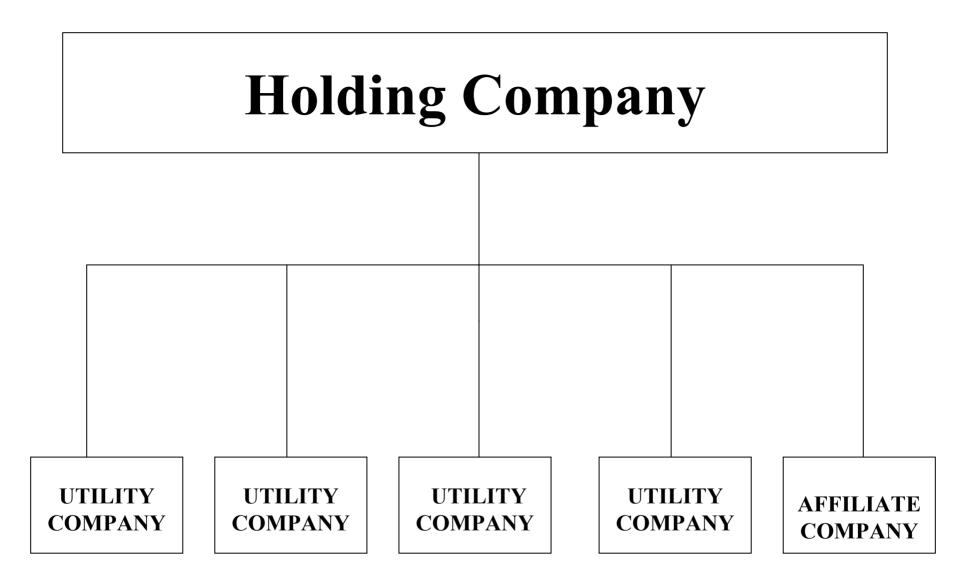


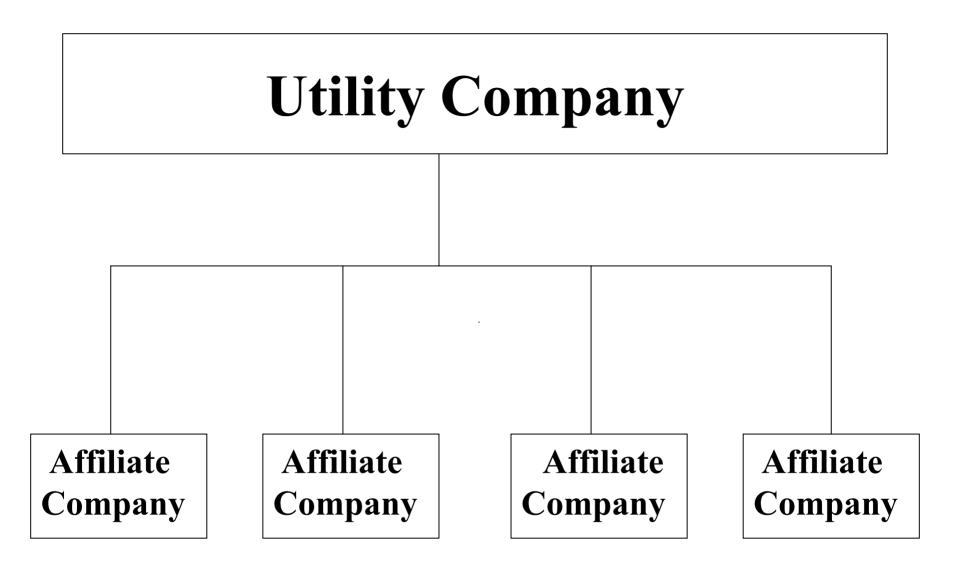
**Simplest Holding Company Structure** 

Sec. 3 (a) (1) Exemption



Sec. 3 (a) (2) Exemption





Non-Jurisdictional

# Oregon's Experience – Enron/Portland General Electric Co.

- In 1997, Enron bought Portland General Electric (PGE)
- FERC approved purchase without structural conditions
- SEC approved sale with minor changes to meet PUHCA
- Oregon PUC approved sale with "ringfencing" conditions

### PGE/Enron Ringfencing - 1997

- > PGE must maintain common equity portion of its capital structure at 48% or higher
- > PGE must maintain its own long-term debt ratings and preferred stock ratings
- Enron must notify Oregon PUC before any extraordinary dividend or raid on retained earnings
- > PUC access to books and records
- > More frequent reporting of affiliated interest transactions
- > Prohibition on charges from Enron to PGE without Oregon PUC authorization

# Other Oregon Ringfencing Actions

PacifiCorp was acquired by Scottish Power in 1999

- **✓** PacifiCorp must operate as stand-alone company
- ✓ Access to books and records in Portland, Oregon
- ✓ PacifiCorp must maintain a common equity ratio of 35% or higher
- ✓ Notice required of distributions from PacifiCorp to Scottish Power

#### Other Oregon Ringfencing Actions (continued)

- ✓ Separate debt and preferred stock ratings required for PacifiCorp
- ✓ No higher cost of capital allowed than without merger
- ✓ 1983 limit on loans from PacifiCorp to affiliates is retained
- ✓ PacifiCorp waived any preemption by PUHCA or *Ohio v. FERC*

# Post Hoc Ringfencing In Oregon

- > September, 2002, PGE got authority to issue one share of \$1.00 par value Junior Preferred Stock
- > PGE transferred share to third party holder
- ➤ "Golden Share" vote required for entrance into voluntary bankruptcy that might be sought by Enron creditors
- > S & P sought Golden Share mechanism to provide additional insulation from Enron bankruptcy

# Effect of Enron Bankruptcy on PGE

- Lenders sought additional security for debt that would otherwise be unsecured
- Higher interest rates
- ❖ PGE customers do not (at this time) pay any higher costs as result of Enron bankruptcy

# Other Affiliated Interest Strategies

- ➤ Prohibition of encumbrance of utility property (Minnesota Xcel/NRG)
- Prohibition on utility loans to affiliates (Minnesota Xcel/NRG)
- > Service quality standards for utility (Minnesota Xcel/NRG)
- ➤ Reassignment of improperly allocated debt from utility to unregulated affiliate (Kansas Westar)

#### Other Affiliated Interest Strategies (continued)

- ➤ Loan from utility to parent to keep line of credit open (Arizona Pinnacle West/APS)
- ➤ Audit and reallocation of expenses (North & South Carolina Duke)

# Financial Markets View on Affiliate Regulation

### **Standard & Poor's**

"Any action that state regulators take that provides support (whether legal, regulatory, financial or operational) to the utility and/or isolates the utility (most importantly financial obligations) from its parent company will be positive for credit."

"... credit ratings of regulated utility companies are affected by the parent company's nonregulated businesses.

Financial Markets View on Affiliate Regulation (continued)

"Only when sufficient regulatory insulation exists will the corporate credit rating (risk of default) of an operating company be separated from that of the holding company."

"The two strongest means of insulation are through either regulatory or legal barriers, which prevent excessive dividend upstreaming, intercompany loans, or any 'non-arm's length' transactions."

### **Conclusions**

- Activities of affiliate companies can affect the financial health of utilities.
- Regulatory commissions can take actions to reduce, not eliminate, problems stemming from affiliate companies.
- Problems with affiliates are likely to become more common, as holding company structures get more complex, particularly if PUHCA is repealed.