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SPECIAL SESSION: THE FUTURE OF PUHCA

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MEETING SUMMARY

For sixty years the industry structure has been dominated by the Public Utilities Holding Companies Act of 1935. With increasing competition, repeal of PUHCA, or at least substantial change in it, is being advocated. What happens if the Act is repealed? How do different interests view such change? What is the public interest? Is there a role for a federal statute structuring the electricity industry?

First Speaker:

The reasons supporting repeal of PUHCA have been well articulated already. One of the real issues is the question of why electric and gas utility holding companies continue to be regulated by this kind of statute when the telephone, water, gas production, transmission, generation, insurance and industrial companies are not so regulated?

The primary voices against repeal are public power and NARUC, some populist members of Congress, and some of the ILUs. The argument of public power is to say that regulation is a substitute for competition in a monopoly situation. Therefore, they say, since we don't yet have full deregulation, the Act should be left in place. But it's really regulation of services and rates that's a substitute for competition, and the '35 Act doesn't regulate rates or services. There's a good case in which the SEC said just that as recently as 1988. NARUC and the Congressmen seem to be worried that PUHCA is a consumer protection statute and that therefore we ought not to repeal it. But what kind of protection is it offering to consumers if it has nothing to do with rates and services? The PUHCA is not without cost to the industry in terms of not allowing the markets to function.

I'm not necessarily convinced that PUHCA will be repealed this time around. But the time is riper now than at any point since it was passed. I can foresee a great deal of change in the interpretation of PUHCA, as well as changes in implementation that grow out of various SEC rulings, but I don't see Congress taking the time to make changes to the real fundamentals of the Act. It's just not a priority right now. And the proposed

moratorium on new regulation would slow down the process of change even further. In my opinion, the thing to keep an eye on is not Congressional repeal of PUHCA, but rather the various SEC rulings that change the effect ofPUHCA.

A couple of recent SEC rulings have proved of interest in terms of their effect on PUHCA, and I understand there are more in the pipeline. There was one case in which the commission reaffirmed a 50% limit on a certain conservation company, a registered holding company. The limit was then overturned a year later. Another case marked the first time that the commission has consciously allowed the acquisition of a U.S. utility by a foreign utility. This was a gas company in Vermont that could only get gas from a Canadian pipeline. These kinds of actions reflect a "re-deal" way of looking at the act, which has certainly been the case in informal communications and discussions by the SEC staff The odds just don't favor repeal of PUHCA. Rulemaking could take many months, while re-deal is already going on through rulings and interpretation. Obviously there are risks to this process. There may be court challenges to the policy of refashioning the Act; there may be Congressional changes or staffing or commission changes in another year. But to quote that recent holding company case, the Act creates a system of pervasive and continuing economic regulation that must, in some measure at least, be refashioned from time to time to keep pace with changing economic and regulatory climates.

: You list all these changes that are ongoing. Does the effectiveness of competition or the efficiency of allocation of resources or any public policy objective make any difference?

First Speaker:

I believe that what matters is that the industry ought to be allowed to shape itself without regard to the Act. The Act's purposes have really been taken over by accounting and rating agencies and improved regulation by states and the FERC. And therefore the Act is an anachronism and, I'm afraid, a hindrance to the restructuring effort. I think we will see enough economic pressures on the companies that they should be allowed to restructure themselves without worrying about whether they're incorporated and doing business in Delaware or New York.

Second Speaker:

That was as good an encapsulation of the reasons for repealing the Holding Company Act as any I've heard. I'd like to add that I realize the folks at the SEC are doing their best to work with a difficult statute. As the last speaker pointed out, there is a great deal of flexibility of language in the Holding Company Act which has only just begun to be tested. Yet I think as this process unfolds we will discover that there are limits to the statutory language and that therefore reasons for repeal do remain.

First and foremost among those reasons is simply the daily grind, the red tape if you will, involved in complying with the Act. Those of you who are in business or who are academics or regulators have probably never experienced the joys of having to get permission from the SEC for the most simple and ordinary business activities, such as security issues or the transfer of assets, that in any other regulatory context are not matters that

require the permission of regulators. Recently, the company I represent did a study of the legal costs of compliance with the Act. The actual number was relatively small, something like 150 million dollars. But I think that number understates conceptually what goes on. It doesn't recognize the number of discouraging situations the registered holding companies face daily, in which they often simply choose not to undertake whatever action they might have considered in dealing with business partners had they not been faced with the discouragement that exists under the Act.

The second reason that registered holding companies seek repeal of the Act is for purposes of diversification. Most corporations like to be able to put their capital in the places where it seems most likely to produce earnings that will benefit shareholders. Registered holding companies, like utilities, are subject to increasingly competitive pressures, explicit and implicit. Now, even the most well-run company is going to have problems competing ITom time to time. Any other company always has the options of competing or not competing, of withdrawing its capital ITom the traditional utility business. Registered holding companies, even under some of the mentioned SEC allowances, are for the most part constrained to placing their capital into traditional utilities. In some respects the desire to engage in diversification is all about exit strategy. The time is long past when we had to worry about reliability and therefore require registered holding companies to be in the utility business.

The third argument for repealing the Act is in the area of integration. Right now, the Act effectively requires those in the utility business to operate geographically integrated systems. Keeps utility companies, both registered and unregistered, confined to one geographic area. Historically, this was based on the belief that the utility business as a whole and generation in particular were natural monopolies. We now know that that isn't the case for generation. It may still be so for distribution and transmission. But why shouldn't we have utility holding companies that own utilities dispersed widely throughout the country? Companies such as Utilicorps and Citizens Utilities already operate widely disbursed systems.

There's little question that certain modifications to PUHCA would make it easier to administer and to live by. The big debate centers around diversification. There was a famous article in Public Utilities Fortnightly in 1992 that claimed that utility diversification had been disastrous for most utilities. A more recent and comprehensive study by the Coba Group shows that utilities that have diversified have in fact done better than those that didn't, based on such measures as return on equity and a host of other financial considerations. So diversification is not the disaster that it is popularly thought to be. And the marketplace is a much more effective force than the regulators for channeling negative experience with diversification in positive directions. On the policy side, some would suggest that diversification will have a negative effect on the protection of captive electric or gas repairs.

The argument against diversification on the grounds that the failure of a subsidiary could be passed through to the operating utility is easily refuted. It is

abundantly clear that both FERC and the state commissions can refuse to pass the costs of field diversification through to utility rates. Compared to the relatively benign record of diversified holding companies, more than 25% of the registered holding companies in this business have either gone into bankruptcy or been in severe financial distress within the last 15 years or so. In comparing the world of diversification with the world within the centered utility business under the holding company, it's just not possible to say that one is inherently more dangerous than the other.

One of the greatest breaks in the integration requirement of PUHCA was, of course, the passage of the Energy Policy Act. The Act can no longer restrict entry into the wholesale generation business on a geographical basis. Lurking in the background is still a kind of fear of big companies resulting from this, but we have to keep in mind that mergers and acquisitions do not take place without regulatory oversight. Some utilities may fear being taken over, but there are economies to be reaped from geographically dispersed acquisition. We have not even begun to approach the sort of concentration we already have in, say, the telephone business, where there are only a handful of regional Bell operating companies. FERC and the state commissions stand ready to oversee the competitive considerations. There is no gap in consumer protection.

Third Speaker:

Is there a role for a federal statute in shaping this industry? The answer is a qualified yes. Yes, there is a role for a federal statute; no, that statute should not be PUHCA in its present form

PUHCA is fundamentally about market power, although some see it as a consumer protection or security statute. As it stands today, it has two fundamental features. One is the integration requirement, the complete prohibition on the acquisition of geographically distant retail companies or transmission assets through the holding company form. The other feature is the special conditions on the financing transactions related to registered holding companies. The second point needs less attention since we are already moving toward compromise through SEC case law. It is the first point that really represents the fundamental change in structure that would result from the repeal of PUHCA.

In 1978, we overcame a market power externality problem by allowing the acquisition of distant wholesale companies outside of the Holding Company Act. In 1992, we said that competition is possible in generation, so let's allow the acquisition of generation facilities regardless of location. It was not hard to reach a compromise on that point once we solved the problem of market power in the area of transmission. Now in 1995 we're proposing that we allow the distant acquisition of monopoly businesses like retail sales franchise control and transmission ownership. It's a qualitatively different change. At stake is our response to the problem of market power.

Effective competition in electricity has not yet come into being as market power continues to pervade the industry. In many areas of the country, utilities and courts still present a significant barrier to entry in wholesale generation. Some would argue,

based on the number of EWG applications filed at the FERC, that effective competition is here. But the filing of an application does not indicate a viable entrant into the generation market. There remains a barrier to entry into transmission until we establish independent transmission companies or a regional tariff that allocates transmission costs fairly among all users.

Given that effective competition is *not* here, it follows that elimination of the integration ban is not necessarily good for the ratepayer. It may be true that maintenance of the integration requirement is no more consumer-protective than its elimination would be; but without a strong argument for repeal it hardly seems reasonable to eliminate the statute first and worry about the consequences later.

In addition, we should decide just what it means to have effective regulation as a substitute for competition, and whether or not we have that today. The other premise for repeal of PUHCA is the idea that if we have effective regulation then anything can be done in the industry. Yes, regulation has been developing since 1935, but it's been developing to deal with the vertically integrated utility company. The de-integration of those companies will present us with a whole range of new regulatory situations for which we're not necessarily prepared despite sixty years of regulatory history.

In the absence of a statute like PUHCA, we could conceivably set up a regulatory structure at the state level. Is it really an effective solution to replace one federal structural statute with fifty separate sets of consumer protection statutes? If we want this industry to shape itself, we need to make market power irrelevant in every sector of the industry. Then the industry can shape itself.

There are some significant problems in the way FERC deals with mergers and acquisitions. If we could clean those up, much of my concern about changing the Act would disappear, because then mergers would be held to the test of the market rather than to the test of regulatory will. First, FERC tends to compare the benefits of the merger to implementation costs alone, leaving out the cost of the acquisition itself. Second, it weighs any improvement in the status quo of a company -- technological improvements, increased efficiency and the like -- against the cost of the merger. This does not penalize inefficiency but rather rewards it. Those who presided over the inefficient technology can demand higher premiums because of all the improvements that will be made as a result of the merger. Mergers must be held to the test of the market, subject to a traditional prudence test against all the lower-cost alternatives. Without a clear merger policy, the two chief conditions for letting the industry shape itself do not exist.

You can permit anybody to acquire anybody else if no one has market power -- that is, if the industry chose to divest itself. It hasn't been shown, however, that there is any benefit to anyone in, say, SoCal Edison acquiring a distribution company in New Jersey. If someone were to show that there were economies of scope or scale involved in such an acquisition, I'd be interested in seeing it happen. I am not sure that just leaving the states to fight over whether that acquisition should take place is the right approach. There is an element of neutrality in the existence of Federal regulators to

mediate between states that would be more appropriate to the creation of efficient multi-state acquisitions.

: One of the answers to your objection is that executive salaries are more closely correlated with gross sales than with net profits. You want to manage mergers in some way to assure yourself that there won't be market power. Some of the proponents of the pooling model want to manage it to be sure it fits into the model. And some of us just want to let it happen, subject to the usual anti-trust restraints. As for diversification, one has to be skeptical of whether or not markets can correct unsuccessful diversification, because of the obligation to serve. How can you maintain the same rate structures after a failed diversification? And as far as market power is concerned, there's no reason why SoCal Edison should have to identify economies of scale to you in order to acquire a company in New Jersey. It's the shareholders whose money is being gambled on such an acquisition, and to whom the company is ultimately responsible in this respect. AT&T used to demonstrate economies of scale and scope all the time, and when it was disintegrated, they proved to be nothing more than a myth. I would rather rely on the market to sort out competition.

There is always going to be imperfection in regulation. Look at the debacle of nuclear investment in utilities. That's a responsibility that has to be shared societally, and not just by the utilities. You're right, I can't give you a model in which ratepayers are protected in absolutely every instance. But let's not let the perfect be the enemy of the good. The same faults of the utility industry back in the '80s were shared by American business as a whole. Like American business as a whole, diversification strategies are now increasingly oriented toward the "do what you know" strategy, which is a constantly evolving concept. I submit that the marketplace does a far better job of disciplining corporate management and punishing bad diversification efforts than regulators ever could.

: When I refer to economies of scope or scale, I am not saying that that is something they should have to prove to me or to regulators. I would suggest that those are the things which should be motivating the acquisition -- the creation of efficiencies. The question then becomes how to get to that point given that the asset that is going to be acquired probably has market power?

The only way they can pay for such acquisitions is to capitalize the anticipated efficiencies that will result.

: And that is why the assurance that the acquisition will be an efficient one depends on having a regulatory rule at the retail level, where the rate is set and where the customer isn't shopping around. The industry still wants market power at the retail level, and if that is combined with separate sets of state regulators, we'll have battles between the New Jersey and California regulators over the benefits of that merger. We'd be forced to reinstate some sort of Federal arbitrator to resolve the conflict.

: Acquisitions occur when the acquiring company thinks it can make more money owning the acquired company than the present owners. Without monopoly power, the only way they can do it is by lowering costs, and that's to everyone's advantage. As

long as we don't let them charge the acquisition premium to the ratepayer, the result is to capture more savings in the long run than the regulator can wring out of the system.

Let me remind you that regulators' reluctance to endorse repeal of PUHCA is hardly an abstract fear of the unknown. The misuse of mergers and acquisitions that regulators see in the water and telephone industries are paler versions of what Congress saw in the utilities industry. At some point in time in most holding companies' history, they function fundamentally to misallocate resources, to take money out of monopoly subsidiaries and use it in other respects. In Maine we saw ways in which the general utility holding company took excess costs out of its Maine subsidiaries and routed them through its own corporate structure to its holding company owner, a French water company which distributed them among banana plantations in the Dominican Republic and shipbuilding companies around the world. AT&T's economies of scale were largely disproven upon disintegration. And in New York, the NYNEX holding company structure, through its material enterprises subsidiary, overcharged New York Telephone millions of dollars for work done through the '80s which could have been done more cheaply by others. There are a lot of real concerns about the way these holding companies have operated when they have monopoly subsidiaries that they can milk, and most of them have nothing to do with diversifications gone wrong.

I agree that the best possible cure for this is full competition rather than regulatory structures. State regulators are being referred to as the Herculean barrier against these sorts of abuses, often by the same entities which, when they want to preempt inconvenient state regulation, go to the Congress and assure them that state regulators are the gang that couldn't shoot straight. FERC is justifiably busy with a number of other undertakings and is not likely to be an effective police force here. They cannot be expected to take on the responsibility of preventing the kinds of holding company abuses that led to the Act in the first place. To quote a previous speaker, what positive benefits are to be expected from repeal of the Act before we are sufficiently confident that real competition exists to prevent these sorts of abuse, especially given the history of the way holding companies with monopoly utility subsidiaries have functioned throughout the regulated sector, with only occasional sanctions, for the last fifty years?

: I think that's an important point to bear in mind. The Act is an artificial constraint on restructuring, but it's only when we have restructuring that we can rid ourselves of that constraint. On the other hand, we don't want to fall into the trap of assuming that changing ownership patterns is the only way to achieve competition or to remove market power. There is also the movement to separate use and control facilities, some of which might be considered monopoly facilities, from ownership. It is entirely possible to have ownership patterns stay roughly similar but have changes in the way you regulate their use. Separation of ownership from control through access to and use of essential facilities is a very important option.

: When the speaker suggested that the FERC was unable to deal with merger issues, he effectively suggested that we need

to create a new Federal body with jurisdiction over registered holding companies. He also suggested that because utilities own transmission systems and have a responsibility to serve customers at the retail level, that effective competition cannot exist unless you sever, to some degree, property rights from responsibilities to serve. What does he consider to be the effective structure that would engender this efficient competition that he perceives necessary to create an efficient market? Also, to the person who suggested that holding companies foster the misuse of monopoly benefits, I think you should note that something like 75% of the electricity industry is now configured in holding companies that were vetted by the state PUCs to attest to the benefits they afforded, not only to shareholders, but also to ratepayers at the retail level.

If you have effective separation of ownership from control over a monopoly facility, you have achieved the same thing as complete disaggregation. So we ought to be talking about understanding those regulatory conditions under which the continued combined ownership of monopoly and competitive businesses can take place, rather than complaining that we should be trying to remove regulators from the process entirely.

When I criticized FERC's merger policy, I wasn't suggesting that we should replace the agency, but rather that we correct the merger policy. As long as there is a Federal role in regulation, it should be at the FERC, where long-term expertise is concentrated. Perhaps the most experienced individuals at the SEC should move over to FERC as well and we could do away with the SEC. The key is in the quality of the design of the regulation. After all, the problem isn't holding companies *per se.* The problem is the mixture of competitive and monopoly businesses in one corporate form. We need to make sure that people bear the costs of their own risks.

: What about the issue of redundancy? What is it that the Federal government would add to this hypothetical California-New Jersey merger that the two states can't, for themselves, determine? Why should FERC have to examine the same matters that the state PUCs have already reviewed?

Because the combined interests of California and New Jersey are not equal to the public interest. One of them could stop a merger that is a good deal because they didn't like the allocation of the benefits they were getting.

: But states can already veto this kind of deal.

: And that's not a good thing. That is why I stressed the problem of merger policies over the question of repeal of the Act, because what we have now is not conducive to efficient competition.

Correcting FERC's merger policies should not be tied to whether or not we keep the Act around.

: To me the Act is merely a set of rules on corporate structure. It does not go into what competition should be in the electric and gas industries. That was left to the wisdom of Congress and the FERC when the Act was passed in 1935. Given the sixty years that have passed, and the continuing evolution of regulation, what is the continuing role of a Federal arbiter? State commissioners have made it clear that we

certainly don't need the SEC to take care of our concerns about whether or not costs are being inappropriately passed on to us. If we don't like it, we can eat the cost ourselves.

Well, I've talked to some state regulators who don't feel that way. And a statute that precludes people from going into a market is a statute that affects competition, and the repeal of that statute is about competition.

: It's true that you can't say categorically that the Holding Company Act had nothing to do with competition. But it does mostly overlook the transactional regulation issues, the regulation of the sale of electricity and natural gas, that we're concerned with. If there were no captive customers anywhere, then the Act would cease to function. But competitive issues fall mostly under the Federal Power Act and State Utility Law. That is why most holding companies are taking summary positions that repealing PUHCA is not ultimately about competition.

If we had competition, we wouldn't need the Act. That doesn't mean that without the Act, we'd automatically have competition. If we are going to leave some residual of PUHCA, we should take the SEC out of it; it's a long time since the SEC has had any real relevance to competition in this industry.

: It's really very simple. What we want is the merger which is efficient, and not the one which is inefficient. One way to do that is to disallow an acquisition premium at the retail level. I don't think that's necessarily the best solution, because an acquisition is like any other investment; you have to recover the costs somehow. How about FERC deciding that a given acquisition is the best pairing of all that are available? I'd like to look at a market standard of some sort. When regulators have the ability to impose the consequences of a bad merger on a given company, then the situation is ripe for politics to enter the scene. I'd rather see a set of FERC rules that says you have to show that this merger is a better use of resources than other options. That doesn't seem different from most ways we regulate monopolies.

: I'm not convinced that political issues are as important as you imply, that regulators would be so hesitant to put a company in bankruptcy. Furthermore, the history of successful acquisition is that the money is made by buying companies and making them more efficient, not by raising prices. In a competitive marketplace, you can't afford to raise prices, and in a regulated marketplace, it's not allowed. The huge gains in productivity that we are now seeing had a lot to do with the acquisition wave of the 1980s. The savings are in driving the inefficiencies out of the system.

In the history of the utility industry, some great efficiencies have been achieved through judicious mergers. Today mergers are far rarer than they once were, and I think it's because regulators are effectively taking all of the savings away from the stockholders and giving them to the ratepayers. If companies do agree to merge, they run into the second barrier, which is that, given the current state of regulation, most investors have no faith whatsoever in the value of the regulatory assets the companies hold. So the companies themselves can't come to any conclusion about what the value of those assets is. The third barrier is that of corporate culture and

governance, which is not something we can really deal with here.

One of the reasons why I favor competitive bidding over the sort of FERC determination of the value of a merger we've been talking about is that most of the administrative determinations of what was the best option were all hypothetical and based on engineering costs rather than on actual projects. I don't know how we can possibly look at what is the best and the least-cost merger. I shudder to think of the administration it would involve.

: Yes, but when I bring up the possibility of competitive bidding for the retail franchise, people break out laughing. No one wants to talk about it, so you have to treat this investment as you would a nuclear plant, asking "Is it for the best?" Now unfortunately, regulation is not a search for the best, but rather a search for the practicable. It's true that you would get a market working by putting the franchise up for option to the most efficient bidder; but the political resistance to this is so strong that I wonder if it's possible in any real sense.

: When someone is competing to buy a retail franchise, then you do have bidding for that franchise.

: But the regulator still has to ask the question of how much of that acquisition cost can be let into rates.

Second session: Perspectives of the relevant interests

Moderator:

Having hopefully defined somewhat the policy issues that are at stake, it's clear that we all have different takes on what ought to happen with the holding company, including some of us whose very corporate structure has been dictated by this statute. The larger question is, what ought to happen to the holding company in order to create or at least allow the evolution of a more competitive industry. The next panel consists of a group of people who have worked with the Act over the years and who will try to define how the statute looks from their perspective. Our first panelist is a Washington lawyer who has spent most of his professional life dealing with the Public Utility Holding Company Act from the point of view of the registered holding companies.

First Speaker:

I am the chairman of the Registered Counsel Group, which meets with all the holding companies. They all come out in favor of repeal of the Act for two basic reasons. One is the massive changes in the industry and in regulation; the other is the Ohio Power Company decision. Let me give you an example. Take Entergy and go back to 1971 when it acquired Arkansas Power Co. It went for approval to the Missouri Public Service Commission and to the SEC. Twenty-two years later, in 1993, when Entergy took over Gulf States, it went to a series of state commissions, the FERC and the SEC. Now if we are talking about achieving efficiencies, it doesn't make much sense to have to spend so much time before so many regulatory bodies. And the SEC is not dealing with operational issues. It defers to the FERC, which results in still more appeals that have nothing to do with PUHCA.

PUHCA was enacted at a time when public utilities were exempt from federal anti-trust legislation. It was designed to fill a gap in the anti-trust laws, a gap which no longer exists. Now the FERC and the SEC are examining the same aspects of proposed mergers. The last thing we need is another federal regulatory body. PUHCA is full of unnecessary and redundant regulations that stand in the way of industry restructuring. For example, FERC is considering allowing the setup of Gencos and Transcos; but if a company owns more than 10% of one of those entities, it is probably a holding company and subject to the impediments of the Act. That doesn't make any sense. The same thing is true with power brokers and marketers.

There's been some argument that the Holding Company Act cannot be repealed unless you have retail wheeling. As a corporate lawyer with thirty years' experience in the field, I'd like to say that the Act has nothing to do with retail wheeling. It is a structural issue, and retail wheeling can occur, or not occur, regardless of the presence or absence of the Act. The fact that roughly one quarter of registered holding companies have been in severe financial difficulties has nothing to do with diversification, but rather with the condition of the utility business.

The idea of cross-subsidization, on the other hand, is worth talking about. PUHCA doesn't deal with it at all, so repeal would have no effect. The FCC has always

treated affiliate transactions as an at-cost requirement. Now the FCC is considering going to the lower of market standard or cost. So if a utility in state A wants to sell goods or services to a utility in state B, and market is lower than cost, the regulators in state A are going to be unhappy. They'll feel that there is cross-subsidization because state B is getting a lower cost. The same thing is true with registered companies. What happens when a non-utility company purchases goods from a utility company at the lower of market or cost when market is lower? It's hard for me to understand how PUHCA operates against cross-subsidization under these situations. But under the Ohio Power Company case, rate commissions may lose the authority to change rates based on perceived cross-subsidization. Therefore, PUHCA may turn out to be an impediment, not a benefit, to dealing with these issues, which is what the states and the FCC are working on right now.

Second Speaker *(representing an exempt New York State holding company):*

The New York commission has historically exhibited great concern that New York ratepayers not subsidize to any degree a utility's participation in non-utility activities and also great concern that diversification by utilities not be permitted because it might weaken the financial condition and thereby cause the cost of capital to the utilities to be increased. Under state law, the commission has imposed a royalty owed to retail ratepayers equal to 2% of any revenues invested in a non-utility business. So while we are an exempt company under PUHCA, we don't have a strong position either way on the benefits or burdens of eliminating PUHCA.

There are five exemptions under PUHCA, but only two of those five are really most important. One is holding companies whose utility business and subsidiaries are predominantly trustee in nature and are substantially limited to the state in which the utility is organized. The other one is the predominantly public utility exemption where the public utility companies operate within one state or contiguous states. The exemptions are subject to the SEC's approval. So long as it does not find the exemption to be detrimental to the public interest or the interest of investors or consumers, then the SEC shall exempt, under its rules, utilities that qualify under these criteria from all provisions of PUHCA except section 982, which requires the approval of the SEC for acquisition of any interest in a public utility. This exemption then imposes certain restrictions on exempt companies, principally that the company and its public utility subsidiaries must be predominantly intrastate in nature. An exempt company is precluded from organizing under a non-utility parent company. So the effect of PUHCA repeal would be that these restrictions on maintaining the exemption would be lifted, affording us a great deal more structural flexibility. Of course, the current registered holding companies would then have the same flexibility, and the question remains as to whether the exempt company would then be advantaged or disadvantaged once other companies could move into its territory and compete for retail business.

In addition, under PUHCA the registered holding companies are precluded from owning gas distribution companies, and so with the repeal of the Act, outside companies could purchase local gas

distribution companies. State regulation would be the only remaining deterrent to the expansion of retail competition. But it still depends mostly on the competitive position of the exempt company whether or not the company is disadvantaged by PUHCA repeal. Given that state regulation in New York continues as it has been, I don't believe that my company will experience any very significant difference in our business opportunities.

Third speaker *(IPP perspective):*

From the perspective of the IPPs, PUHCA has far less significance to the majority of business than PURPA. Nonetheless, there are matters of philosophy that do produce what might be considered an "IPP perspective" on the continued relevance of the Act. Generally, we favor the elimination of regulation that interferes with a competitive market, and to the extent that PUHCA is part of that regulation, we would be in favor of repeal. Much of the IPP position on reform of the Act depends on the response of the registered companies. PUHCA reform may allow current registered holding companies to increase their earnings through new lines of business like telecommunications. Of course, reducing the financial stress of narrowed activities on the registereds might be good for the independents because it might reduce the pressure to reopen existing contracts with IPPs. And registereds may be more willing to buy rather than build, if they see opportunities to invest their capital in other lines of business. This would leave opportunities open to IPPs to build more generation, if the registereds are focusing their energies elsewhere. In fact, registered companies may even experience an incentive to start divesting existing generation assets, because the utilities may have a real or perceived conflict that causes the states to increase their regulatory scrutiny.

Interestingly enough, under current law, qualified facilities and EWGs are exempt trom the restrictions of the Act. If PUHCA were repealed, you could be a non-QF, non-EWG, but still be exempt trom PUHCA and avoid being subject to the SEC as well. This could lead to an increase in retail sales activity, and we should consider how that would affect the market. In any event, the independents are of the view that there is not yet sufficient competition to justify the repeal of PUHCA. The Act is still needed to fill in the regulatory gaps until we have full competition.

Fourth Speaker *(CFA and the small consumer's perspective):*

Let me talk about what happens when you don't have a holding company act. Let's look at the telephones. Contrary to what you might have heard, over the past ten years I've seen a pattern of abysmal performance and abuse in the telecommunications holding companies. Bell Atlantic, with over 150 subsidiary companies, has never earned one penny of profit in those non-TELCO entities, and yet the asset base has risen trom about 5 billion to close to 40 billion. All the money has come trom the telephone ratepayer in declared profits and so it is at the disposal of the shareholders of the parent holding company. We think those profits have been excessive. In other industries, you couldn't squirrel those profits away. They would pile up in the bank and regulators would be so

embarrassed that they would have to lower rates.

I thought about going through the whole list of things that happened in the twenties that gave rise to PUHCA. But they can just as well be seen in the telephone industry of the 1980s. One of the Baby Bells in Denver played havoc with the real estate market by transferring assets out of their subsidiaries at ratepayers' expense. The transfer of services and the leveraging of debt are two other interesting abuses of the system. Another company expanded into cellular services as part of their holding company and then spun it off to the tune of about a billion dollars' worth of value. I could go on and on about cases I've dealt with in Virginia and Georgia, real cases that have been litigated and decided, but the point is that the potential for abuse in the telecommunications holding companies, where there is no "TUHCA," is limited only by human creativity. Do such things happen in the electricity industry? Occasionally they do; witness the OPCO case as an example. But that is small change compared with something like Pinnacle West. Some of the Bells have gotten into information services as well, so even the FCC is involved. The electricity industry doesn't have these extreme cases, and I think it is due to the absolute penalties provided by PUHCA. Unless you can convince me that the alternatives for consumer protection will come even close to approximating the barrier now provided by PUHCA, we are not particularly interested in giving up the protection of the Act.

Fifth Speaker *(large consumer's perspective):*

Our comments before the SEC In support of PUHCA were based on the assumption that the current regulatory regime is going to continue in the short run, and that therefore the Act really is probably the best thing we have going for us right now. I am convinced that the Act is a very arcane piece of legislation that in a more perfect world would have been repealed long ago. Financial accounting standards and the regulation of the securities industry have advanced substantially since 1935. However, assuming that old-fashioned regulation of a vertically integrated industry will continue, then the Act represents a valuable piece of consumer protection. I don't think that state PUCs have done a very good job with supervising the non-utility investments of the exempt companies, and I've seen no reason to suspect that they might do better with the registereds if given the opportunity.

What most utilities and most regulators call competition is really rather a kind of rivalry. Business under the traditional regulatory umbrella is not a natural breeding ground for competitive behavior. Some utilities claim they have no position on PUHCA or PURPA 210 because they are not directly affected. They should be thinking about whether or not those laws give them some sort of competitive advantage by harming their competitors.

The motivation for the registered holding companies to expand their investments is twofold. One is the classic monopoly power grab. The other is the misconception that the utilities are capable of making prudent investments. This from an industry that, by their own estimate, is already saddled with over $200 billion of stranded assets. Why should we allow them to add to that? There is a possibility in the

short run that the registereds, the exempts, and the consumers might explore, which is the concept of reciprocal competition. If an electric utility wants to enter another industry, then it should be prepared to let third parties enter their industry and go after their own customers.

Yes, we support the repeal of PUHCA, preferably sooner rather than later. Just think of the electric industry in 1981. One very large domestic manufacturer was so irate at the electricity rates it was forced to pay that it seriously considered buying a controlling interest in the seven primary utility suppliers to that corporation. Elimination of PUHCA would let an industrial basically remove itself trom the retail market and operate solely on the wholesale level, to build its own distribution or transmission grid to serve its own needs.

(N.B.: The sixth speaker's presentation, representing the perspectives of the financial community, was missing from the tape. The following is some of the discussion that arose from his talk)

The problem with trying to audit a company like AT&T is that it would take you five or six years. How long will it take to audit the 200 or so utilities that are likely to end up as multi-state holding companies? True, PUHCA is a blunt instrument, but it works to our advantage, especially in a situation like this where audits are not an effective approach.

: There has been relatively limited debt issuance over the past couple of years, but if you look at the debt that is being issued, more and more there's an inclination to begin to issue unsecured debt, and to try to get out trom under the restrictions that exist under utility mortgages. This trend is still in its early stages; certain companies have come to the conclusion that it was substantially cheaper to issue unsecured debt than to pay the mortgage recording tax, at least until they lost investment-grade credit ratings. If you've got a dollar's worth of real assets for every sixty cents' worth of first mortgage bonds, you can consider yourself fairly well protected as an unsecured creditor. However, the less regulated the environment becomes, the more important regulatory assets become in terms of that asset protection, and the more concerned these creditors should be over the value of stranded assets like nuclear plants and so on.

There are a lot of utilities that are clearly wondering whether or not in a changing industry they ought to consider changes to the structure of the company, and if so, what restrictions their mortgage covenants impose on them in terms of being able to realize those changes. This is another reason for the rise in issuance of unsecured debt. A few utilities have effectively eliminated their mortgages at this point, and they do have considerably greater flexibility.

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Moderator:

This morning we looked at the issue of PUHCA trom, to quote one of our members, the architect's rather than the carpenter's viewpoint. Some of the key questions we've raised include: Do we need some sort of check on diversification by utilities, and if so, what agency should be responsible for it? Do we need a federal review of mergers? Again, if so, by whom?
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What are the roles of the various regulatory agencies in this new environment? Does the market provide sufficient discipline to rein in corporate abuse? Meanwhile, has the integration requirement outlived its usefulness?

Does the integration requirement work to constrain a competitive power purchaser in a way that's useful? Or does it really work to sustain market power rather than constrain it? Grand Gulf and Ohio Power are two cases in which that question is not at all clear. Should states' powers be restricted in some way, or will the states' self-interest balance out in the long run without mediation? Should we repeal PUHCA in its entirety, or should there be section-by-section changes? And, what I think is the fundamental question we're facing here, should the law conform to the corporate structure of the utilities or should the utilities' structure be reflective of public policy dimensions? This morning we heard from the holding companies and from various consumer groups. This afternoon we'll be hearing from regulators who deal with PUHCA in their everyday work. Let's start with a representative from the SEC.

First Speaker:

Thank you. Please be aware that my views are not necessarily those of the Commission or of my colleagues. As you are all aware, the SEC is nearing the end of a yearlong study of the regulation of public utility holding companies. Unfortunately, I can't tell you any more than anyone else what the future of the Act will be. But I think I can say with certainty that in a year or so, holding company regulation is going to be a very different thing from what we know today.

Although PUHCA has been a pervasive influence on the structure of the electricity and gas industries, it was never intended to be the centerpiece of energy policy, just as the SEC never intends to dictate energy policy. We focus on corporate and capital structure, to ensure that companies abide by the rules of fair play with respect to their investors and their consumers. If we are doing our job properly, this should make things easier for the federal and state regulators whose job it is to establish energy policy.

The Commission does not currently have a position on repeal or reform of PUHCA, but it has advocated repeal of the Act since the early 1980s. Unfortunately, there have been too many unanswered questions standing in the way of past reform efforts. This past year's study of the Act has been an effort to answer some of those questions and try to represent the need for reform or repeal in an empirical way and focus on ways of bringing it up to date. We began last year with a round-table discussion in which industry representatives, consumer groups, trade associations, economists, federal, state, and local regulators were represented. Everyone agreed that the status quo with regard to PUHCA had to be changed; and everyone agreed that the industry was facing fundamental challenges with the advent of competition. Of course, there was less agreement over what should be done. Recommendations ranged from repeal to reform to total industry restructuring.

Supporters of repeal argued that the Act is outmoded and redundant. Opponents are concerned that repeal would invite a recurrence of the abuses that led to passage of the Act in the first place. Many of the

round-table participants emphasized the need for an ongoing federal presence, at the very least to mediate disputes that could not be resolved at the state level. Some of those now believe the states can solve their own conflicts and there is no need for federal arbitration.

As of late last fall, we had arrived at two fundamental questions. First, what regulation of the public utility holding companies is needed, if any? Second, who would provide such regulation? As you can well imagine, we've received thousands of pages of comments. The staff is reviewing them, and when we're done, we'll have a set of legislative and administrative recommendations that we'll present to the Commission. Meanwhile, we've been working with NARUC to come up with a questionnaire that's been sent to all state and local PUCs. It's intended to give the staff a better understanding of what powers the states have vis-a-vis holding companies, and what additional protections may be needed to enable state regulators to cope with the operations of a multi-state holding company in the absence of PUHCA. It's clear that reform of the Act will occur, and it will occur sooner rather than later. How quickly competition and disaggregation come about is a matter for the FERC and the states to decide.

<u>Second Speaker</u> *(US. FERC)*

For people who have an interest in the history and theory of the electric utility industry, PUHCA is really the point of origin of the model that we have of the single integrated utility system, at least from a legal perspective. I respect the previous speaker's views as to what the SEC intends for its role and what Congress had in mind when it enacted PUHCA. But the Act has had every bit as big a role in the guidance of utility structure as the FERC has over the years. This has to do with the fact that it makes being a registered holding company such a big bother. I think that a lot of companies over the years just decided not to move to become registered systems because of the existence of the Act. This has obviously contributed to the current structure of the industry.

Over the years, the SEC has been tremendously flexible in administering the Holding Company Act. This flexibility in adjusting to the circumstances of the industry, while maintaining a command-and-control model for corporate regulation, would allow most of the current restructuring proposals to go through without serious impediment. So we should analyze PUHCA more in terms of whether or not it continues to be a good idea rather than as an impediment to restructuring. Basic competition can be accomplished without change in the Holding Company Act. I can assure you that when and if the Commission applies open access tariffs, we will not discriminate on the basis of membership in registered systems. I'm less than convinced by the utilities' arguments about needing PUHCA reform to survive in a competitive environment.

From FERC's point of view, the greatest concern in our minds with respect to the Act is the Ohio Power decision. Obviously, repeal of PUHCA would eliminate any conflict between FERC and the SEC. In terms of FERC's ratemaking functions, that means that we would get to

go about doing things the way we prefer to. If we are able to use our ratemaking authority to solve the problems of cost allocation and transfer pricing, we are comfortable that registered companies can be properly regulated. This is because historically, ratemaking regulation at both the state and federal levels has emerged as the preeminent device by which all utility companies, regardless of corporate structure, are regulated. Our authority under Title 3 of the Federal Power Act has worked pretty effectively.

This questionnaire for the state commissions will be helpful to all of us in understanding what really goes on at the state level. The basic ratemaking issues of cost allocation and transfer prices are similar at the federal and state levels, but the states have a very different outlook on the diversification issues, especially in a registered system that is bigger than the state that's trying to regulate it. This is the kind of thing the questionnaire might be able to shed some light on.

Finally, even though PUHCA may not have much direct influence on the implementation of competitive power markets, I do think it's important to understand that people are trying to find different ways of doing business in a rapidly changing world. Diversification is an option for non-registered companies as well, and it is probably going to be a more and more attractive option. It does involve very significant problems of the deployment of assets and the continued management of the utility business. We at the FERC have concluded that we can do our job with the ratemaking side of it. The states are grappling with similar issues and the utilities have a legitimate business mission that they're trying to pursue as well. I think this is beyond the individual or cumulative control of all of us as regulators, and it's very appropriate that Congress will be looking at this.

Third Speaker *(state regulatory commission):*

I, too, should state up front that I speak only on my own behalf and not on that of my Commission or the state, or NARUC, or anyone else. I recently saw an article in Electric Utility Week that was attempting to characterize the recent resolution that NARUC put out on PUHCA reform. I was concerned because the headline implied that NARUC was rejecting efforts to link PUHCA legislation to increased competition. I don't think that's an accurate characterization. NARUC originally produced a draft resolution that, among other things, would have asked Congress in deciding the direction of PUHCA to reaffirm states' rights to make decisions on competition at the wholesale and retail level. Some, however, felt that stipulation was an unnecessary distraction from the more pressing issue of states preserving their jurisdiction to monitor holding company activities. I do know that some members of the committee didn't want any mention of competition in the resolution. But NARUC as a whole is not trying to assert that there is no relationship between competition and the desire of the registered holding companies to be released from the strictures of the Act.

Central and South West has filed a very comprehensive plea advancing their best case on PUHCA repeal. Some of the statements in it are remarkably sweeping in their nature and they make me worry that

the holding companies may be completely missing the point. For example, there's a line saying that the Federal Power Act authorizes FERC to defer to state views and refer matters to joint boards to resolve federal-state conflicts. That's possible under the Act, but it's not the usual practice at the FERC as I understand it. Somehow there's an air of unreality that pervades this document. They argue that diversification restrictions are no longer necessary because, now that wholesale competition is here and retail competition visible on the horizon, they feel that the industry is no longer stable, secure, or profitable. Their point is that this lessens the difference in risk between them as a traditional utility business and the non-utility businesses they want to invest more heavily in.

While there is some wholesale competition in the generation sector, competition can hardly be said to have fully arrived in any sense. To the extent that there's a degree of increased risk, it's mostly an inevitable outgrowth of this transitional phase and not a permanent thing. Even if we were to acknowledge that the risk gap were narrowed between utility operations and non-utility entities, it still would fail to confirm the prudence of diversifying into other utility ventures, especially ones that may be more competitive and even more speculative than utility investments. One of the examples of such a venture that Central and South West mentioned was telecommunications; but I recently attended hearings on a state bill that, if made into law, would make entry into that market very, very risky for any new players, including utility companies.

A number of holding companies seem to be under the impression that states have ample authority to secure access to books and records to guard against potential cross-subsidization of non-utility activities by jurisdictional companies. Again, recent hearings in my state at least have been moving toward narrowing that authority on the part of the states. The point is not to focus on Central and South West or on my state in particular, but rather to indicate that the holding companies seem to me to be relying far too heavily on the ability of state jurisdictional authority to fill in the regulatory gaps left by the repeal of PUHCA, when the direction of recent state legislation is not necessarily to reinforce that authority.

Another area of concern is the confusion, in some of these pleadings, of administrative reform with structural reform. If the holding companies have had problems dealing with the SEC in implementing certain operating efficiencies, the answer to their problems is available short of amending the Act. That's not to say that we mightn't look at the need to update or modernize the Act. In that regard, things such as the integration requirement ought to be looked at seriously to see if it is a general obstacle to necessary structural reform. We might also eliminate redundancies between PUHCA and the SEC's general financial disclosure requirements.

Our state was recently involved in completing a joint audit along with four other states that are all served by the same regional Bell operating company, together with the FCC, to insure against cross-subsidization of utility and non-utility activities, and to prevent the shifting of costs from one jurisdiction to another. While most of the audit authority was generated at the state level, the federal presence was

crucial to help the states coordinate their monitoring activity. I think that at the very least when we talk about PUHCA reform that in order to maintain consumer safeguards and to allow the states to discharge their statutory responsibilities, there will still need to be some federal presence to provide that coordinating function.

: On the subject of FERC and its deference toward the states, my impression has always been that FERC in fact was quite deferential. Of course, if there is division among the states FERC is going to have to follow its own direction, but if the states are together, I don't think FERC would go against them. As for joint boards, to my knowledge FERC has never exercised that option, but that hasn't meant that they don't work with the states. On the subject of competition, I suspect that the registered companies collectively have not done a very good job articulating this. It's not that we believe that full competition is here, it's just that we feel that the utility business, which once was a safe preserve, is no longer safe and can only grow less so as time goes on. Every other participant in the electric utility business has the choice of competing where they feel most able. Registered holding companies are for all practical purposes uniquely unable to choose alternatives. There is the easy way out of returning everything to your shareholders and letting them go their separate ways, but of course corporate management would like to preserve itself. Is it not appropriate in a fundamentally capitalist economy to allow capital to be deployed where it makes the most sense by corporate management, with the oversight of a board of directors? As for books and records, I think that the holding companies recognize the need for an appropriate information flow. Your point about audit functions is well taken and if there is an absence of information there, then it's an important issue that needs to be addressed.

: I would agree that FERC has been deferential to states and that states can agree. The important point is that one should not expect states to agree. We should expect them to be parochial. We should also expect the federal government to take a broader view, and there is a role for both of them in that process. As for solving the problems of cross-subsidies and transfer pricing and so on, those problems have no solution, as anyone who's been involved in the telecommunications settlement process can tell you. Regulators in that environment end up with fundamentally problematic cost allocations.

The key point on which we should focus is that we're here to try to preserve the U.S. common market, not to preserve fifty different state markets. We must recognize that there is a federal role here. There is no way states could possibly acquire and coordinate the kind of information needed to manage a national economy, and they have no interest in doing so. Utilities will tell the regulators and legislators that the state commission can get all the information it needs and then, two weeks later, tell a court that it doesn't need that same information because it has no jurisdiction over that transaction. In effect this makes it impossible for states to protect themselves in this national economy. We must have a federal government that makes the pieces fit together.

PUHCA has been one of the pieces of federal legislation that has made the

system fit together reasonably well. Clearly, if we change the structure of the industry, PUHCA can be revised. But I'm not hearing any suggestions about what we'll use to replace PUHCA other than more vigorous state regulation, and that's just not going to work. What about the situation we had in the 1920s, just before PUHCA? What happens when the court says Texas is not permitted to regulate the price of a transaction that occurs in Arkansas?

The question to concentrate on is, what kind of industry structure are we heading for? Then we can decide on the role of the states and the federal government. For instance, I think that the states could oversee regulated distribution companies while the federal government could handle regulated transmission companies. Some of these divisions of labor may in some sense make PUHCA almost irrelevant. I think we should decide to what extent we're trying to carve out a role for the nation to hold the fifty states together and what constraints we should impose on them in order to accomplish that result.

: Assuming for the moment that the state commission can indeed get all the information they need, where is the great danger if states are able to decide whether costs get passed on to ratepayers, particularly if the states can also control the disposition of the operating company's assets. I can see where sometimes that might be burdensome for the multi-state holding companies because there could be inconsistent state determinations. There would likely be some common ground for uniform allocation formulas of affiliate. Nonetheless, if the state commission is protecting retail ratepayers and FERC is protecting wholesale ratepayers and they both have adequate access to information and control of the activities of the operating utility, I don't see where the problem lies.

If we're talking about allocating common costs, what's to keep two states from allocating only 10% of the costs apiece to themselves and letting the 80% fall in the gap?

: I think that's a risk that the holding companies recognize they'd have to undertake in repeal. It's an inevitable consequence.

: An interesting question here: What is the legitimate national issue, and what are legitimately parochial issues? When is parochialism acceptable, and when is it something that has to be checked? I'm not sure I agree that the holding companies are all willing to take the kind of risks that were just mentioned, but I don't think that that situation necessarily requires a federal bailout.

: But we made the decision a long time ago that it was in the interest of efficient financial markets in this country not to let Texas and Arkansas, or any group of states, do that.

: That's an interesting conflict. On the one hand the supposed national interest is in competition. On the other hand, the registered companies are supposed to be coddled and protected monopolies that the federal government ensures won't be hit with competition.

: It stems from the proposition that states, acting alone, can't necessarily protect their ratepayers from the upstream effects of interstate holding companies. And that for

whatever reasons, most of the potential holding company abuses can't be detected or prevented by either the state or the federal entities.

: Isn't that saying that more regulation is better regulation? We're always assuming that we'll have perfection in regulation. We don't have it now, and we won't have it in the future. And the costs of regulation, perfect or imperfect, must be factored into any decision. Now we're starting to see vigorous market competition that's getting more vigorous by the day. In this current situation, the costs of increased regulation simply don't justify the benefits you get.

: It's even simpler than that. The holding company structure that mixes competitive energies with captive utilities is fundamentally predatory. At some point in time they will all find ways or imperatives that will incline them to try to take money out of the monopoly structure. To me, you've got to show very substantial benefits before you encourage that kind of structure, and I just haven't heard it in the presentations today.

: We shouldn't allow the expansion of those structures into any new areas until there's a lot more active real competition in that marketplace. Competition discourages affiliate abuses because you pass the resulting overcharge on to the customers.

: That's where the Grand Gulf case fails to support your argument. That case could never have arisen outside of a holding company.

: From a legal standpoint, Grand Gulf was a problem of wholesale transactions. The error was in authorizing full recovery of costs of a plant that was way over budget. It was also the case that the four states involved couldn't decide how much of the costs should be allocated to whom. FERC had to handle both these problems, but it should be understood that neither can be blamed on the Holding Company Act. It was not the structure of the holding company that led to the states bearing too much of the cost in that case. It was a problem of imprudence and a failure of the regulators to disallow it.

: But FERC's jurisdiction in that case came from the fact that there were agreements between entities in different states, so that FERC treats those, for legal purposes, as if they were arm's-length transactions.

: No, FERC's job was to determine whether the costs of the nuclear plant were too high. It's too bad the FERC didn't do a prudence review on its own in that case, but it's not a failure of PUHCA. Just now someone asked the question, "What is the national interest?" And someone else answered, "The states can protect themselves," That was a perfect non sequitur. We're suggesting that there are opportunities for efficiencies here, and that distant acquisitions should be encouraged where they're efficient. And that perhaps in that situation the states are not going to be able to agree on the allocation of costs and benefits, and that they may need an arbiter at the federal level to work that out. I don't see why the presence of adequately empowered regulators at a single level, be it the state or the federal level, is not sufficient. If you say it isn't sufficient, you're ultimately making an argument about the nature of government and not this particular regulatory issue.

: But it's not sufficient. Do we think it's good public policy to institute a system where states or state commissions are continually at odds with one another? I think that will be the inevitable outcome of the absence of some central overarching authority to resolve these questions of cost allocation and responsibility. And I don't think it's in the national interest to have states behaving in this way toward one another.

Finally, to respond to the comment someone made earlier about the prospects of utilities going before their legislatures to seek sufficient enabling authority to fill the gap in the absence of PUHCA, I am very cynical about that. Most knowledgeable state commissioners fundamentally do not trust the utilities to behave in a way which is at odds with their own self-interest before the state legislature. That's not how they perceive their mission.

: I'm advancing a model where a state utility commission would have more or less comprehensive authority over an operating utility. If you have total authority over the operating company within your state, you need to know about inputs and outputs but you needn't concern yourself with the business of a utility company elsewhere.

: It's important to realize, as someone said, that Grand Gulf and the question of allocation are not Holding Company issues. I talked earlier about the Holding Company Act as a point of origin of the single-state integrated utility system. I think the reason Congress set it up that way had to do with a real lack of confidence in the constitutional ability of states at that point to have any effect on interstate systems, and no confidence in the effectiveness of federal regulation. That led to a statute that created enormous disincentives to the creation of holding companies, which is why there are so few. I'm expecting this to end up with a very basic debate in tront of Congress over whether or not we should have holding companies at all.

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: We've heard a lot of argument that the registereds are handicapped in a competitive market because of PUHCA's regulatory checks. Couldn't one make the argument that the registereds could simply restructure themselves in a way to be tree of that handicap, and wouldn't that contribute even further to the robustness of a competitive market?

: I think some would like to. The practical problem is that to deregister winds up being a very difficult process because so many financial instruments are dependent on the registered holding company structure. I know Central and South West were considering it recently.

: Is it possible to make the deregistration process easier?

: I don't think it can be much simplified beyond the present form, because of the number of interests that are involved.

: But should public policy really be governed by the individual corporate problems of ten or fifteen companies?

: PUHCA affects hundreds of holding companies. It's not just the ten or fifteen registereds. Also, I don't think it's inevitable that states will find themselves unable to settle multi-state cost allocations.
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: Yes. Any company that tries to unbundle its assets will face the same problems as the registereds.

: Are we tackling the wrong issue, changing the Holding Company Act? Should we be looking at some sort of generic approach to allowing easier restructuring for all the utilities?

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: Let me change direction a bit and make a quick point. We've talked about FERC and joint boards. The current Federal Power Act statute on joint boards does not, in my judgement, allow FERC to be a member of a joint decisionmaking process.

: The issue is going to come down to allocation of regulatory authority between FERC and the states, separately or jointly; it's not clear that the SEC needs to be involved. And there well may be an argument for a continued federal role. There's also a notion out there that if utilities wanted to, they could just divest themselves of their generation assets and get out of the market. But that notion misses the point that there's no one out there who wants to buy those generation assets.

: Were you saying just now that the only real effect of PUHCA repeal is to take the SEC out of the game and just make it a FERC-state commission situation?

: Yes.

: But there are areas covered by PUHCA that are outside the scope of the Federal Power Act. So there's a question of the allocation of that jurisdiction. We need to decide which type of transactions should be handled by which level of regulator.

: There seems to be a sort of balance of powers question here, one in which bigger is not necessarily better. Nor can you say out of hand that smaller is better, either. You can imagine if we had neighborhood regulatory commissions and multi-state utilities, you'd have as much trouble handling regulatory issues as you would if we had neighborhood utilities being regulated by FERC. The general principle seems to be that some kind of balance is needed between the scope of regulation and the scope of regulated industries. I have heard some folks at the state level saying they don't feel they have the capability to deal with this problem themselves when they are confronted with multi-state entities. I think that's a pretty powerful point of view that we should reflect on as we're thinking about what to do next.

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: There's another aspect of Grand Gulf that responds to this question of allocation. Several people have suggested that the states were at fault for not requesting a prudence review in the face of a billion dollars in cost overruns. I'd suggest that FERC shouldn't have needed the states to suggest such a review. But FERC doesn't have the resources for prudence reviews. PUHCA provides a fundamental safeguard against these types of abuses; but if it's repealed, FERC may need to expand its staff and do prudence reviews in cases where allocations of this sort have occurred.

: The judge at the time asked the parties if prudence was an issue, and the lawyers said no. The reason they said that only came out later; it was because they thought the states

could handle the prudence issue. But once it was subsumed within a case at the federal level, the issue of prudence should have been raised by FERC as well.

: The Ohio Power decision arose out of a prudence review, and the FERC's desire to have that restored is articulated in the fact that it established standards for the recovery of transition costs that specifically incorporated standards for prudence reviews of those costs.

: Yes, there were hundreds of requests for prudence reviews. Maybe fifty or seventy-five actual cases.

: Well, no nuclear costs were disallowed by the FERC that I'm aware of. I do think this is beside the point in that we are going to have both FERC and the states, and people who don't like the FERC decisions can take it to the Court of Appeals. The answer is to make sure that the structure of the industry is such that the costs are minimized up front.

: A good point is that the FERC hasn't really viewed its role in the past as that of dictating the structure of the industry, although PUHCA has had a tremendous effect on the industry's structure.

: I'm hearing this notion that the minute you repeal the statute there's going to be this free-for-all where everybody runs in and the registereds start buying up businesses and spinning off assets. I think the fear about that has been way overblown.

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