THE URGE TO MERGE: A LOOK AT THE REPEAL OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

by
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On February 8, 2006, the repeal of the Public Utility Holding Company Act of 1935 (PUHCA) went into effect. The repeal of this Depression-era law was part of a larger package of new regulations enacted under the Energy Policy Act of 2005, signed into law by President George W. Bush. At the time of its inception, PUHCA provided essential protections for consumers and investors against the questionable business practices of unregulated utility holding companies. Critics of the PUHCA repeal have repeatedly asserted that removal of these regulations will result in a return to holding company abuses such as defrauding investors, loose accounting practices, and carrying excessive debt. Proponents of the repeal believe it signals a new era of growth within the utility sector and carries with it the strong possibility of restructuring in the electric and gas industries. This Comment examines the effects of the PUHCA repeal by analyzing two mega-mergers proposed shortly after the enactment of the Energy Policy Act of 2005. Ultimately, the author concludes that the repeal of PUHCA will result in increased merger and acquisitions activity in the electric and gas industry, but the pace and degree of future mergers and acquisitions will be tempered by the role state public utility commissions play in merger review.

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I. INTRODUCTION

After more than seventy years in effect, Congress repealed the Public Utility Holding Company Act of 1935 (PUHCA) on February 8, 2006. The repeal of this Depression-era law was part of a larger package of new regulations enacted under the Energy Policy Act of 2005 (EPAct 2005), which was signed into law by President Bush on August 8, 2005.[1] President Franklin Roosevelt enacted PUHCA in response to the many holding company abuses of the 1920s and 1930s that subsequently resulted in the great Wall Street Crash of 1929. These abuses included defrauding investors, loose accounting practices, and carrying excessive debt. The Great Depression, coupled with lack of regulatory oversight over public utilities and concentrated power, prompted the need for federal regulation. At the time of its inception, PUHCA represented essential protections for consumers and investors against the questionable business practices of unregulated utility holding companies. Under PUHCA, the Securities Exchange Commission (SEC) was charged with ensuring that complex interstate holding company systems were

[1] The Energy Policy Act of 2005 (EPAct 2005) passed the U.S. House of Representatives by a margin of 249-183 on April 21, 2005. H.R. 6, 109th Cong., 151 Cong. Rec. H2397, H2449-50 (2005). The U.S. Senate followed suit by a margin of 85-12 on June 28, 2005. *Id.* at S7451, S7477. The 1,700 page document is the first piece of comprehensive energy legislation enacted in over a decade. EPAct was passed in response to America's increasing dependence on foreign oil and need for energy security. The comprehensive legislation enacted over 100 provisions addressing energy production, conservation, distribution, storage, efficiency, and research. *See* MARK HOLT & CAROL GLOVER, CONG. RES. SERV., ORDER CODE RL33302, ENERGY POLICY ACT OF 2005: SUMMARY AND ANALYSIS OF ENACTED PROVISIONS 1 (2006), *available at* http://www.ncseonline.org/NLE/CRSreports/06Apr/RL33302.pdf. Specifically, the legislation covers renewable energy; oil and gas; coal; Indian energy; nuclear energy and security; vehicle and motor fuels, including ethanol, hydrogen and electricity; energy tax incentives; hydropower; geothermal energy; and climate-change technology. Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005) (codified at 42 U.S.C. §§ 15801 et. seq. (2006)) [hereinafter EPAct 2005]. The conference report excluded controversial provisions, including the opening up of the Arctic National Wildlife Refuge (ANWR) for oil production, increased corporate average fuel economy (CAFE) standards, and efforts to reduce greenhouse gases. HOLT & GLOVER, *supra*, at 1.

reduced to integrated holding company systems that served a limited region of the country.[2]

The repeal of PUHCA eliminates numerous obstacles to consolidation of the electric and gas industry. The first significant change is that utilities are no longer required to be confined to a single integrated system. This allows for the merging of geographically diverse companies, for example, an electric company on the East Coast acquiring a combination gas distribution and electric company on the West Coast. Additionally, non-utility-related enterprises are now free to invest in public utilities without first having to divest unrelated holdings. This change will lead to greater diversification of utility investments as well as future restructuring of utilities.[3]

Despite these changes in the law, EPAct 2005 still provides regulatory oversight over mergers and sales of utility companies. In place of the SEC, the Federal Energy Regulatory Commission (FERC or Commission) will retain jurisdiction over these companies and any resulting mergers. Additionally, state utility regulators and FERC will also retain access to the books and records of holding companies.[4] In an effort to ensure consumer protection, EPAct 2005 specifically directs FERC to undertake any necessary rulemaking to determine the extent of access to the books and records of holding companies.[5]

Critics of PUHCA repeal have repeatedly asserted that repeal of the law will lead to another "Enron" scenario. However, even without PUHCA, utility companies will still have to answer to state regulators and federal oversight. The controversial repeal of PUHCA signals a new era of holding company regulation and carries with it the strong possibility of restructuring in the electric and gas industries. Reducing regulation over holding companies will bring with it the opportunity for holding companies to grow and diversify, as well as commingle and join in the most efficient manner possible. Further, by encouraging investment by both traditional and non-traditional investors, growth within the utility sector that was restricted by PUHCA will now be feasible. With these changes comes the heavy burden of identifying regulatory gaps that could potentially harm consumers and investors, or compromise the financial integrity of utilities. In light of these concerns, FERC and state public utility commissions will have to step up to the plate to exercise both long-held and newly enacted authority to fill in regulatory gaps.

This Comment recounts the historical events leading up to the passage of the Public Utility Holding Company Act of 1935, as well as post-enactment efforts to reform the legislation. Partial repeal of PUHCA is briefly addressed, followed by a more in-depth look at the provisions

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[2] *See infra* Part II.

[3] *See* Stephen Angle & Jim Hoecker, Vinson & Elkins LLP, *Energy Currents: The End of the Public Utility Holding Company Act of 1935—Now What?*, Aug. 8, 2005.

[4] *Id.*

[5] EPAct 2005 § 1264.

included in EPAct 2005 repealing PUHCA, also known as the Public Utility Holding Company Act of 2005 (PUHCA 2005). The effects of PUHCA 2005 are best illustrated by examining two mega-mergers—the merger of PSEG-Exelon and Constellation-FPL—proposed shortly after the enactment of PUHCA 2005. Finally, the Comment closes with an analysis of potential changes that may occur as a result of PUHCA repeal and their effect on future mergers in the industry.

II. THE NEED FOR HOLDING COMPANY REGULATION

The history of commercial electricity in America can be traced back to 1879 when Charles Brush built the first central power station in San Francisco. Due to the high cost of copper wire at the time, it was only economical to deliver electricity the length of eight city blocks—or half a mile.[6] Thomas Alva Edison, the inventor of the light bulb and phonograph, expanded on the central-station concept[7] by building the nation's first commercial power plant in 1882, the Pearl Street generating station.[8] Serving just one square mile of lower Manhattan,[9] the Pearl Street generating station delivered electricity to the Wall Street offices of New York City.[10] Although Thomas Edison was a pioneer of electrical generation and distribution, it would take the genius of Samuel Insull to survive the economies of scale. Insull developed the vertically integrated public utility, which later proved to be an instrumental management model for utilities.[11]

Additionally, Samuel Insull was the private secretary of Thomas Edison and proved indispensable to the inventor. In 1886 when Edison moved two of his companies, the Electric Tube Company and Edison Machine Works, to New York, he instructed Insull to manage the entire operation.[12] Edison directed Insull to "[d]o it big, Sammy. Make it either a big success or a big failure."[13] In 1892, with the financial underwriting of J.P. Morgan, Insull formed a $50 million dollar corporation known as General Electric Company.[14] Over the next two decades, Insull continued to work his way up the corporate ladder, managing Commonwealth Edison, Public Service Company of Northern Illinois, and Peoples Gas

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[6] FRED BOSSELMAN, ET AL., ENERGY, ECONOMICS, AND THE ENVIRONMENT 737 (Robert C. Clark ed., Foundation Press 2d ed. 2006).

[7] *Id.* at 738. The "central station" concept refers to the generation of electricity at a central power plant that is distributed to consumers via wires. *Id.*

[8] Markian M.W. Melnyk & William S. Lamb, *PUHCA's Gone: What is Next for Holding Companies?*, 27 ENERGY L.J. 1, 3 (2006).

[9] *Id.*

[10] BOSSELMAN ET AL., *supra* note 6, at 738.

[11] *Id.*

[12] Robert Grant & Joseph Katz, *The Case of Samuel Insull*, *in* THE GREAT TRIALS OF THE TWENTIES 222, 224 (1998).

[13] *Id.*

[14] *Id.*

Light & Coke. Finally, in 1912, Insull created the Middle West Utilities Company—the first of many holding companies he would acquire in his time.[15]

The holding company is thought to have been:

> [T]he most effective device that has ever been invented for combining under single control and management the properties of two or more hitherto independent corporations. It has, therefore, made possible the development of giant systems of business enterprise at a pace far more rapid than would have been feasible by any other method of concentration.[16]

The holding company is also considered an unrivaled device of American enterprise. "During the stock-market boom of the 1920s, the utility holding company became an instrument of high finance that . . . has no parallel in the entire history of American business—not even in the earlier history of the railroads."[17] Holding companies were established through a process of pyramiding, with an operating utility at the bottom.[18] The pyramid was formed by a holding company purchasing an operating utility, which would then be bought by another holding company, and so forth until many "tiers" of holding companies were

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[15] ENERGY INFO. ADMIN., U.S. DEP'T OF ENERGY, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935: 1935–1992 6 (1993). Middle West Utility Company grew by acquiring smaller utilities and consolidating them into larger ones—creating a subholding company between Middle West and its operating utilities. At one point, Middle West Utilities was built as a pyramidal holding company with subsidiaries operating in thirty states and serving 5,300 communities. The operating companies were held by Middle West Utilities for little cost, because the subholding companies would issue preferred stock and bonds for an amount almost equivalent to the cost of purchasing the operating utilities. Insull manipulated the debt of Middle West Utilities, and in 1932, when the company went into receivership, its books showed a surplus of $2.9 million, which was in actuality a deficit of $177.7 million. *Id.* The merger of Commonwealth Electric and Chicago Edison resulted in the creation of Commonwealth Edison, valued at $400 million. Insull transformed Public Service Company of Northern Illinois into a $200 million enterprise and Peoples Gas Light & Coke into a $175 million utility. Grantz & Katz, *supra* note 12, at 225.

[16] JAMES C. BONBRIGHT & GARDINER C. MEANS, THE HOLDING COMPANY: ITS PUBLIC SIGNIFICANCE AND ITS REGULATION 4 (Augustus M. Kelley 1969) (1932). Holding companies were responsible for the creation of the multi-billion dollar enterprises of American Telephone and Telegraph Company, the Insull system of electric light and power properties, the U.S. Steel Corporation, and the Pennsylvania Railroad System. *Id.* at 4–5.

[17] Richard D. Cudahy & William D. Henderson, *From Insull to Enron: Corporate (Re)Regulation After the Rise and Fall of Two Energy Icons*, 26 ENERGY L.J. 35, 57 (2005) (citing James C. Bonbright). "In 1926 alone, there were more than 1,000 mergers, most of which involved sales of public utilities to private companies the stock of which was controlled by large holding companies." Michael C. Blumm, *The Northwest's Hydroelectric Heritage: A Prologue to the Pacific Northwest Electric Power Planning and Conservation Act*, 58 WASH. L. REV. 175, 191 (1983).

[18] ENERGY INFO. ADMIN., *supra* note 15, at 2.

added to the pyramid.[19] This structure allowed holding companies to earn large gains on small increases in operating company profits,[20] because the masterminds of holding company pyramids often inflated their values and arbitrarily "wrote up" the assets of operating utilities and their holding companies.[21]

Insull continued to expand his empire in the 1920s and 1930s, acquiring holding companies at inflated prices. Due to the highly leveraged capital structure of the pyramidal holding companies, it was possible for Insull to control over half a billion dollars worth of capital by employing less than $30 million worth of equity.[22] At its peak in 1926, Insull's empire had combined assets totaling approximately $3 billion.[23] The empire became so complicated that "no one, even the boss himself, could completely disentangle it."[24] By 1932, three holding companies controlled almost half of the energy generated in the United States. Along with Insull's utility empire, J.P. Morgan's United Corporation and the Electric Bond and Share Company were responsible for 45% of the electricity generated in the United States.[25] Sixteen holding companies also held ownership interests in utilities producing close to 92% of the available electrical output from the nations' privately owned companies.[26] A mere four holding companies controlled over 56% of the total mileage of the country's natural gas transportation system.[27] Despite Insull's belief that a disastrous "slump or calamity" of leveraged holding companies was "practically inconceivable," during the Great Depression the unbelievable happened.[28] From 1929 to 1935, fifty-three holding companies went bankrupt, including thirty-six utilities with publicly held securities.[29] The

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[19] *Id.* The SEC noted that five to six tiers of holding companies typically existed above an operating company. *Id.*

[20] *Id.*

[21] THOMAS LEE HAZEN, 2 TREATISE ON THE LAW OF SECURITIES REGULATION 268 (1990). Pyramiding was beneficial for two reasons: reducing the amount of funds initially needed to gain control of operating companies and increasing the amount of income available at the "apex" of the pyramid. *Id.* Additionally, because the holding company was separate from its subsidiary, it was not legally liable for its debts. Union of Concerned Scientists, Backgrounder: The Public Utility Holding Company Act (PUHCA), http://www.ucsusa.org/clean_energy/clean_energy_policies/public-utility-holding-company-act-puhca.html.

[22] Cudahy & Henderson, *supra* note 17, at 59.

[23] Grant & Katz, *supra* note 12, at 225.

[24] *Id.*

[25] JOE SELIGMAN, THE TRANSFORMATION OF WALL STREET 127 (rev. ed. 1995).

[26] *Id.* "In 1924, 74.6 percent of all electricity generated in the United States was produced by operating companies which were parts of holding companies; by 1930, 90 percent of all operating companies were controlled by 19 holding companies." ENERGY INFO. ADMIN., *supra* note 15, at 6.

[27] SELIGMAN, *supra* note 25, at 127. Control over natural and manufactured gas production was similarly concentrated in a handful of dominant firms. *Id.*

[28] Cudahy & Henderson, *supra* note 17, at 59.

[29] Melnyk & Lamb, *supra* note 8, at 4. The fifty-three utility holding companies that went into receivership or bankruptcy were valued at a whopping $1.7 billion.

collapse of Insull's holding company empire took with it the holdings of 600,000 shareholders and 500,000 bondholders.[30]

As illustrated by the enormous losses resulting from the bankruptcy of many holding companies, the highly leveraged structure of the holding company, combined with its artificially valued assets, built a house of cards that inevitably came crashing down. Nevertheless, it was the concentrated power in the electric and gas industry, coupled with a lack of oversight by the federal and state governments, that fueled the imminent collapse of utility holding companies during the Great Depression.[31] This prompted the Federal Trade Commission (FTC) to perform what has been labeled as the "most extensive study of an American industry ever conducted."[32] The FTC's study of abusive practices within the nation's electric and gas utilities took seven years to complete,[33] and spanned 101 volumes.[34] The study revealed numerous systematic abuses, which were enumerated in section 1(b)(1) of the Public Utility Holding Company Act of 1935.[35] Many of the abuses included: the issuance of securities to the public based on unsound or fabricated asset values derived from intercompany transactions; the issuance of securities without the approval or consent of state commissions that maintain jurisdiction over their subsidiary companies; and inadequate disclosure to investors of the financial position or earning power of the holding company.[36] The FTC's study concluded with recommendations to Congress that it abolish all top holding companies and sub-holding companies via tax measures and statutory prohibitions.[37]

Twenty-three other utility holding companies, valued at $535 million, defaulted on interest payments and voluntarily offered readjustment plans. SELIGMAN, *supra* note 25, at 127.

[30] Cudahy & Henderson, *supra* note 17, at 36.

[31] "[T]he holding company, perhaps more than any other legal device, is being used by business men as a means of avoiding various forms of social control." BONBRIGHT & MEANS, *supra* note 16, at 6. "Social control" refers to all forms of regulation and publicity that are designed to protect the interests of the investing public against the adverse interests of those controlling a business enterprise. *Id.*

[32] SELIGMAN, *supra* note 25, at 127–128.

[33] Cudahy & Henderson, *supra* note 17, at 61.

[34] Melnyk & Lamb, *supra* note 8, at 4.

[35] Public Utility Holding Company Act of 1935 § 1(b)(1), 15 U.S.C. § 79a(b) (2000) (repealed 2005).

[36] 15 U.S.C. § 79a(b)(1). The FTC study further revealed instances of affiliates subjecting subsidiary utilities to excessive charges for services, construction work, equipment, and materials, as well as the existence of transactions resulting from a lack of arm's-length bargaining or free competition. 15 U.S.C. § 79a(b)(2). Furthermore, the report uncovered that the capital assets of the 151 firms studied, including 18 of the largest holding companies and 91 operating companies, totaled $8.6 billion, but these assets were overvalued by approximately $1.4 billion. SELIGMAN, *supra* note 25, at 128.

[37] SELIGMAN, *supra* note 25, at 129.

III. ROOSEVELT'S SOLUTION: THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

A. *The Public Utility Holding Company Act of 1935*

In the wake of the stock market crash of 1929 and the realization that states could not effectively regulate big business, President Roosevelt proposed a New Deal package that included the Securities Act of 1933, the Securities Exchange Act of 1934, the Federal Power Act of 1935, and the Public Utility Holding Company Act of 1935.[38] The legislative innovations of the New Deal—"a phoenix rising from the ashes of the Insull empire"—were aimed at rectifying the manipulations and misrepresentations revealed by the collapse of numerous holding companies in the securities market.[39] Roosevelt "believed that the centralization of wealth and power in the electric industry amounted to 'private socialism,' resulting in unwarranted corporate control over other people's money."[40] He concluded that holding companies needed to be eliminated from the utility industry framework, so that the average citizen could regain control over his wealth:

> 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. If we could remake our financial history in the light of experience, certainly we would have none of this holding-company business . . . . 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 the public-utility field into what has justly been called a system of private socialism which is inimical to the welfare of a free people.
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> . . . It is time to make an effort to reverse the process of the concentration of power which has made most American citizens, once traditionally independent owners of their own businesses, helplessly dependent for their daily bread upon the favor of a very few, who, by devices such as holding companies, have taken for themselves unwarranted economic power. I am against private socialism of concentrated private power as thoroughly as I am against governmental socialism.[41]

[38] Cudahy & Henderson, *supra* note 17, at 72.

[39] Grant & Katz, *supra* note 12, at 245.

[40] Blumm, *supra* note 17, at 193.

[41] Melnyk & Lamb, *supra* note 8, at 5–6 (quoting 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, H.R. Doc. No. 74-137 (1935)).

Similar to Roosevelt, Senator George W. Norris, a leader for the fight for public power in the Tennessee Valley, also denounced the abusive holding company practices of the 1920s and 1930s.[42]

Under PUHCA, the SEC reconfigured the arrangement and business practices of the entire utility industry.[43] Congress enacted PUHCA "to compel the simplification of public-utility holding company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies."[44] The fundamental purpose of PUHCA was "to free utility operating companies from the absentee control of holding companies, thus allowing them to be more effectively regulated by the states."[45] One way to achieve this was to require financial disclosure and standardization of holding company accounts. PUHCA established two broad categories of utility holding companies: those required to register with the SEC and those that were exempt. Under PUHCA, holding companies required to register with the SEC included: 1) a holding company that owned or controlled ten percent or more of the voting securities of a public utility or other holding company, or 2) any entity that the SEC determined (after opportunity for notice and comment) to have a controlling influence over the management or policies of any public utility or holding company; thus making it necessary to regulate in the interests of consumers, investors, and the public interest in general.[46] This included all holding companies with subsidiaries that engaged in interstate commerce and who also conducted business in the distribution of electricity or natural gas.[47]

Holding companies that were exempt from having to register with the SEC included: 1) companies that were located in the same state as their subsidiaries, from which they derived any material part of their income; 2) companies that operated predominantly intrastate and carried on business with their subsidiaries in the state in which they were organized and contiguous states; 3) holding companies that were only

[42] Blumm, *supra* note 17, at 193–94.

[43] Although at its inception, the electric industry was the main target of PUHCA, the Act applied to holding companies of all public utilities, including the natural and manufactured gas industries. As these industries eventually grew, bringing thousands of gas utility companies into being, the operating ownership and operating requirements of PUHCA became a large determinant to shaping the industry. Energy Info. Admin., U.S. Dep't of Energy, *The Public Utility Holding Company Act of 1935*, Jan. 17, 2005, http://www.eia.doe.gov/oil_gas/natural_gas/analysis_publications/ngmajorleg/pubutility.html.

[44] The Public Utility Holding Company Act of 1935 § 1(c), 15 U.S.C. § 79a(c) (2000) (repealed 2005).

[45] HAZEN, *supra* note 21, at 268.

[46] 15 U.S.C. § 79b(7)(A)–(B).

[47] MICHAEL V. SEITZINGER, CONG. RESEARCH SERV., ORDER CODE RS20952, THE PUBLIC UTILITY HOLDING COMPANY ACT: MAJOR STATUTORY PROVISIONS AND POSSIBLE REFORM EFFORTS 3 (2002).

incidentally a holding company; 4) holding companies that were only temporarily holding companies due to the acquisition of securities for liquidation and distribution; and 5) holding companies that did not derive a material portion of their business from a subsidiary that was a public utility.[48] Companies that qualified for exemption from registration with the SEC were still subject to limitations, as well as state regulation. Exempt companies were bound by the "two-bite rule" in section 9(a)(2) that prohibited any exempt company which owned five percent or more of the voting securities of any public utility from acquiring five percent or more of the voting securities of another public utility without first gaining SEC approval.[49] Furthermore, exempt companies were prohibited from organizing under a non-utility parent company.[50]

The companies required to register under PUHCA faced a myriad of substantive restrictions in addition to disclosure-type requirements.[51] The two main requirements focused on geographic integration and corporate simplification.[52] The most stringent and controversial provision of PUHCA was section 11, known as the "death sentence." This provision dismantled the mega-holding companies by fragmenting them into hundreds of local and regional companies, which made them easier to regulate by state utility commissions.[53] This provision was so controversial that on the day PUHCA was signed into law, Joseph Kennedy, the first chairman of the SEC, submitted his draft resignation letter.[54]

Under section 11(b)(1), the SEC was required to "limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or

[48] 15 U.S.C. § 79c(a).

[49] The Public Utility Holding Company Act of 1935 § 9(a)(2), 15 U.S.C. 79i(a)(2); *see also* R. Richard Geddes, *Time to Repeal the Public Utility Holding Company Act*, 16 CATO J. 63, 64 (1996), *available at* http://www.cato.org/pubs/journal/cj16n1-4.html.

[50] 15 U.S.C. 79i(a)(2); Geddes, *supra* note 49, at 64.

[51] Between 1938 and 1962, 2,419 electric and gas distribution utilities fell under the SEC's jurisdiction as either holding companies or subsidiaries. AMY ABEL, CONG. RESEARCH SERV., ORDER CODE RS20015, ELECTRICITY RESTRUCTURING BACKGROUND: PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 (PUHCA) 3 (1999), *available at* http://www.ncseonline.org/nle/crsreports/energy/eng-47.cfm. "PUHCA regulates a number of registered holding company activities, including financing through the issuance of securities, the acquisition of utility assets, various intercompany transactions, record-keeping and accounts, and contracts between operating and service companies." Geddes, *supra* note 49, at 64.

[52] SEITZINGER, *supra* note 47, at 3. "Corporate simplification" refers to the elimination of corporate structures or companies that unduly complicate the holding company structure or which inequitably distribute voting power among security holders. *Id.* at 4.

[53] Cudahy & Henderson, *supra* note 17, at 73.

[54] *Id.* at 76.

appropriate to the operations of such integrated public utility system."[55] These limitations resulted in holding companies confined to a single area or region of the United States, and required the SEC to examine and monitor the structure of every holding company and its subsidiaries, as well as their relationships. Holding companies that went through this simplification process were said to have been "put through the wringer."[56] The SEC did, however, allow a holding company to continue to control one or more additional public utility systems if it found that: 1) each of the additional systems could not be operated as an independent system without substantial economic loss; 2) the additional systems were located in one state, adjoining states, or a contiguous foreign country; and 3) continued operations of the system did not hinder localized management, efficient operation, or effective regulation of the system.[57] Additionally, the SEC required public holding companies to divest all businesses that did not have a functional relationship to the utility, which limited the ability of non-utility companies to invest in the utility sector.[58] A registered holding company could only retain a non-utility system if it was "reasonably incidental or economically necessary or appropriate to the operations of [an] integrated [public-utility] system[]."[59]

"The restructuring of the public utility industry historically has been the SEC's single most useful accomplishment. It was also by far the most difficult to attain."[60] With the exception of wartime, no federal agency ever assumed the level of total control over an industry—not even in banking, railroad transportation, or communications—as did the SEC when it administered PUHCA.[61] PUHCA's corporate simplification and geographic integration provisions imposed significant restraints on the utility industry. Vigorous enforcement of section 11(b) by the SEC resulted in the elimination of most multi-state holding companies and reversed the wave of consolidations occurring in the years prior to 1935.[62]

B. The Push for PUHCA Repeal

In the early 1980s, the SEC began to push for repeal of PUCHA in its entirety. Based on its findings in a study conducted in 1982, the SEC alleged that by 1952, the legislation had achieved its main goal of

[55] The Public Utility Holding Company Act of 1935, § 11(b)(1), 15 U.S.C. § 79a(c).

[56] Melnyk & Lamb, *supra* note 8, at 7. In a twenty-year period alone, from 1935 to 1955, the SEC reduced 214 holding companies, which controlled 922 utility companies and 1,054 non-utility companies, to 25 registered holding companies with 171 electric and gas subsidiaries and 137 non-utility companies. *Id.*

[57] SEITZINGER, *supra* note 47, at 4.

[58] *Id.*

[59] ABEL, *supra* note 51, at 3.

[60] SELIGMAN, *supra* note 25, at 127.

[61] *Id.* at 131.

[62] Melnyk & Lamb, *supra* note 8, at 8.

dismantling the large holding companies into units that could be effectively regulated by the states,[63] and that "investors in registered public utility holding companies would remain adequately protected" if PUHCA was repealed.[64] Based on its findings, the SEC unanimously urged Congress to repeal the Act, although Congress declined to do so.[65] In 1995, the SEC again recommended that Congress repeal PUHCA, but this time only pushed for conditional repeal of the law, noting that the SEC's access to books and records of multi-state holding companies was still necessary to ensure appropriate regulation.[66] The SEC continued to chalk up problems of growth in the utility industry to the restrictive nature of PUHCA, arguing that after deregulation, the industry was "moving from a monopoly structure into a more competitive energy marketplace with many diverse participants," and "the solutions of the past [PUHCA 1935] have become barriers today." [67] Additionally, the SEC's increasingly lax interpretation of PUHCA's geographic integration provision resulted in the approval of mergers between companies with no physical connection at all and hinted at the imminent repeal of PUHCA.[68]

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[63] DIV. OF INV. MGMT., SEC. & EXCH. COMM'N, THE REGULATION OF PUBLIC UTILITY HOLDING COMPANIES viii–ix (1995).

[64] Melnyk & Lamb, *supra* note 8, at 14–15.

[65] *Id.* at 15.

[66] ABEL, *supra* note 51, at 4. "Certain provisions of the Holding Company Act, however, still serve a useful function. In particular, the SEC's ability to obtain books and records, to audit holding companies and subsidiaries, and to review affiliate transactions, assists states in protecting utility consumers. The Division believes that former efforts to repeal the Act failed largely because they did not address concerns about the continuing importance of these consumer protection provisions." DIV. OF INV. MGMT., *supra* note 63, at 114.

[67] Cudahy & Henderson, *supra* note 17, at 103. In its June 1995 report, the SEC's Division of Investment Management noted that "[a]lthough the SEC has attempted to interpret the Holding Company Act flexibly and responsively, there is an increasing tension between the model of regulation under the Act, and the rapidly evolving structure of the utility industry." DIV. OF INV. MGMT., *supra* note 63, at 113.

[68] For example, the SEC approved a merger between Northern States Power Company, operating in Minnesota and Wisconsin, and New Century Energies, in Colorado, New Mexico and Texas, to form Xcel Energy. The Commission also approved the merger of PECO in Pennsylvania and Unicom Corp. in Illinois, which resulted in Exelon Corp. AM. PUB. POWER ASS'N, THE PUBLIC UTILITY HOLDING COMPANY ACT: ITS PROTECTIONS ARE NEEDED TODAY MORE THAN EVER 5 (2003), *available at* http://www.docstoc.com/docs/DownloadDoc.aspx?doc_id=780795. In June of 2000, the American Public Power Association (APPA) and the National Rural Electric Cooperative challenged the merger between Ohio-based American Electric Power Company and Texas-based Central and South West Corporation. In 2002, on remand, the U.S. Court of Appeals for the D.C. Circuit found that the merger violated PUHCA laws and that the SEC had failed to explain how companies in Ohio and Texas could be part of a "single area or region." Am. Pub. Power Ass'n, *Losing Hold at 70*, PUB. POWER, Sept.–Oct. 2005, http://www.appanet.org/newsletters/ppmagazinedetailarchive.cfm?ItemNumber=13834 [hereinafter *Losing Hold at 70*].

Electric utilities also urged for the repeal of PUHCA, arguing that the law inhibited industry development. Utilities wanted to further diversify their assets in hopes of improving company risk profiles, based on the assumption that the risk of investment in their utility would be diluted by the risk associated with all other investments.[69] Thus, investment in flourishing non-utility ventures would contribute to the overall financial health of the holding company.[70] Utilities also argued that diversifying their assets would be more economical, because it would allow for greater use of underutilized resources due to the seasonal nature of electricity demand.[71]

C. Partial PUHCA Repeal of 1992

After more than a decade of pressure from the SEC, Congress enacted a partial repeal of PUHCA in the Energy Policy Act of 1992 (EPAct 1992).[72] The repeal exempted independent power generation facilities that produced and sold power at wholesale, specifically Exempt Wholesale Generators (EWGs), from the provisions of PUHCA. This exemption applied to EWGs regardless of whether they were owned by operating utilities, utility holding companies, or parties not involved in the electric business.[73] In response, many holding companies took advantage of this immunity from SEC oversight and created independent, unregulated power production subsidiaries.[74] Critics believe this was one of the major causes of the financial troubles electric utilities face today, because it resulted in the downgrading of credit ratings for the entire utility industry, in addition to individual instances of bankruptcy and huge accumulation of debt by utilities.[75]

Standard & Poor's and Fitch, two major credit rating agencies, both blamed the downward trend of utility ratings for merchant generators and power marketers on the partial repeal of PUHCA.[76] In a study conducted in 2004, Standard & Poor's concluded that PUHCA may have provided some level of credit protection for bondholders by restricting

[69] AMY ABEL, CONG. RES. SERV., ORDER CODE RL33248, ENERGY POLICY ACT OF 2005, P.L. 109-58: ELECTRICITY PROVISIONS 10 (2006), *available at* http://ncseonline.org/NLE/CRSreports/06Feb/RL33248.pdf.

[70] *Id.*

[71] *Id.*

[72] Energy Policy Act of 1992, Pub. L. No. 102-58, § 711, 106 Stat. 2776, 2905–2911 (1992).

[73] *Losing Hold at 70*, *supra* note 68.

[74] *Id.*

[75] *Id.*; Public Citizen, *Changes In the Financial Health of the Electric and Natural Gas Utility Industries Since the PUHCA Hearings of 2001* (Mar. 2004), http://www.citizen.org/documents/industryhealth.pdf [hereinafter *Changes in Electric and Natural Gas Industries*].

[76] Lynn Hargis, Public Citizen, *PUHCA FOR DUMMIES: An Electricity Blackout and Energy Bill Primer* (Sept. 2003), http://www.citizen.org/documents/puhcafordummies.pdf [hereinafter PUHCA FOR DUMMIES].

investment in utilities by risky or low-rated non-utility entities that could lower a utility's credit rating.[77] Consumer advocate group Public Citizen also notes that there were numerous bankruptcies of PUHCA-exempt utilities, such as EWGs, and non-utility businesses after partial PUHCA repeal. The downfall of Mirant Energy, Montana Power Company, and Westar Energy are a few examples of bankruptcies that occurred after partial PUHCA repeal.[78] In the case of Montana Power Company and Westar Energy, the utilities suffered significant losses due to bankruptcy of their telecommunication subsidiaries. Public Citizen also partially blames bankruptcy of PUHCA-exempt EWGs and merchant plants on the fact that partial PUHCA repeal in 1992 took a majority of the country's power generators out of the control of state regulators and placed them in the hands of FERC.[79] Foreign utility companies (FUCOs) also found refuge from the stringent provisions of PUHCA under EPAct 1992.[80] The FUCO exemption allowed holding companies to acquire electric and gas utility companies located and conducting business outside of the U.S.[81] The FUCO exemption resulted in a surge in the 1990s of U.S. utilities flocking to Argentina, the United Kingdom, and Australia to invest in foreign utilities as a way to diversify their operations and encourage higher growth rates and returns.[82]

IV. THE ENERGY POLICY ACT OF 2005

Repeal of PUHCA granted FERC new authority and expanded the Commission's jurisdiction over mergers and acquisitions of utility holding companies. Specifically, Subtitle F of Title XII of EPAct 2005, effective February 6, 2006, repealed PUHCA and enacted the Public Utility Holding Company Act of 2005 (PUHCA 2005) in its place.[83] EPAct 2005 also amended section 203 of the Federal Power Act (FPA), which reformed FERC's merger-review authority.[84] Repeal of PUHCA removes corporate simplification restrictions and geographic integration barriers restricting the type of investments holding companies can make. Furthermore, the SEC is no longer tasked with regulating utility holding company systems; and, thus, these holding companies are no longer required to register with the SEC. In its place, FERC now maintains

[77] *Changes in Electric and Natural Gas Industries*, *supra* note 76, at 2 (citing STANDARD & POOR'S, IS PUHCA BENEFICIAL OR DETRIMENTAL TO U.S. UTILITIES' CREDIT? (Feb. 19, 2004)).

[78] *Changes in Electric and Natural Gas Industries*, *supra* note 76, at 2. Public Citizen also cites the bankruptcy of NRG, Northwestern Corp., and National Energy Group (NEG) as other examples of partial PUHCA failures. *Id.* at 2–3.

[79] *Id.* at 2.

[80] Energy Policy Act of 1992, Pub. L. No. 102-486, § 715, 106 Stat. 2912 (1992).

[81] Melnyk & Lamb, *supra* note 8, at 10.

[82] *Id.*

[83] EPAct 2005 §§ 1261–63, 119 Stat. at 972–74.

[84] EPAct 2005 § 1289, 119 Stat. at 982–83.

jurisdiction over these companies and their subsidiaries. When enacting PUHCA 2005, Congress closely followed the SEC's recommendations in 1995 for conditional repeal of PUHCA. In its report, the SEC prescribed that Congress repeal the Act, but also "enact legislation to continue federal protection of energy consumers."[85] The SEC favored the inclusion of a provision that provided for state access to books and records of all companies within a holding company system, and for "federal audit authority and oversight of affiliate transactions."[86] The SEC believed that this was the best means to protect against cross-subsidization.[87] Additionally, the SEC recommended that the conditional repeal take place over a transition period of at least one year.[88]

A. *Repeal of PUHCA 1935*

On December 8, 2005, FERC issued its final rule implementing PUHCA 2005, Order No. 667.[89] PUHCA 2005 is "primarily a 'books and records access' statute and does not give the Commission any new substantive authorities," with the exception of section 1275 of EPAct 2005 which addresses cost allocations for non-power goods and services.[90] This section is discussed in further detail below. Section 1264 protects ratepayers with respect to FERC jurisdictional rates. Under this provision, FERC has access to the books and records of affiliate transactions with holding companies and their associates, affiliates, and subsidiaries that FERC determines are relevant to costs incurred by a public utility or natural gas company within a holding company system.[91] Books and records access will provide FERC oversight to prevent cross-subsidization of utilities by parent companies and to ensure utilities are not used as "cash cows" to funnel money into unregulated investments. Prior to PUHCA 2005, the SEC required registered holding companies, their

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[85] DIV. OF INV. MGMT., *supra* note 63, at 6–7.

[86] *Id.* at 114.

[87] *The Electric Supply and Transmission Act of 2001: Hearings on H.R. 3406 Before the Subcomm. on Energy and Air Quality of the H. Comm. on Energy and Commerce*, 107th Cong. 103 (2001) (statement of Issac C. Hunt, Jr., Commissioner, U.S. Securities Exchange Commission). Cross-subsidization involves the subsidization of an unregulated affiliate by its regulated parent company. ABEL, *supra* note 69, at 10.

[88] DIV. OF INV. MGMT., *supra* note 63, at 7, 114.

[89] Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, 70 Fed. Reg. 75,592 (Dec. 20, 2005), [hereinafter Order No. 667]. The Commission's decisionmaking was guided "by the clear intent of Congress to repeal the regulatory regime established by PUHCA 1935 and to rely on state regulatory authorities and the Commission to protect energy customers, by supplementing the Commission's books and records authority under PUHCA 2005 and by enhancing our [FERC's] already significant authority over public utility mergers, acquisitions and dispositions of jurisdictional facilities." *Id. See also* Public Utility Holding Company Act of 2005, Pub. L. No. 109-58, §§ 1261 et. seq., 119 Stat. 594, 972–78 (2005) (to be codified at 42 U.S.C. §§ 16451 et. seq.).

[90] Order No. 667, 70 Fed. Reg. at 75,592.

[91] EPAct 2005 § 1264.

subsidiaries, and affiliates to preserve "accounts, cost-accounting procedures, correspondence, memoranda, papers, and books that the SEC deemed necessary or appropriate in the public interest or for the protection of investors and consumers."[92] PUHCA 2005 also provides state regulators with jurisdiction over the associates and affiliates of holding companies, as well as access to their books and records.[93] The request for access to books and records must be: 1) in writing; 2) identified in reasonable detail in a proceeding before the state commission; 3) relevant to costs incurred by the utility company; and 4) necessary for the state commission to effectively fulfill its responsibilities in respect to a particular proceeding.[94] States previously had authority under the FPA to examine the books and accounts of a jurisdictional utility company, but were not required to identify in detail the records or books requested. FERC's access to the books and records of holding companies provides the Commission with new-found authority to monitor the costs incurred by traditional utilities with captive customers to ensure that jurisdictional rates are not excessive.[95]

Furthermore, holding company systems regulated under PUHCA 2005 frequently include an associate company organized specifically to provide centralized non-power goods or administrative or management services to the holding company system. Section 1275 provides that FERC will review and authorize the allocation of the associate company's costs for such goods and services.[96] This section does not preclude FERC or state commissions from exercising their authority to review authorization of any costs under other applicable laws.[97]

In light of FERC's decision not to recreate the distinction between "exempt" and "registered" holding companies, the books and records requirements of PUHCA 2005 apply equally to all holding companies. All holding companies are required to notify FERC of their holding company status by a one-time filing.[98] FERC focused its exemptions and waivers on non-traditional holding companies and single-state holding companies.[99] In particular, investors in independent, transmission-only companies, and holding companies owning 100 MW or less of generation that is used primarily for their own load or for sales to affiliated end-users qualify for waiver.[100] Holding companies that own only exempt wholesale

[92] ABEL, *supra* note 69, at 11.

[93] EPAct 2005 § 1265.

[94] *Id.* at § 1265(a)(1)–(3).

[95] Melnyk & Lamb, *supra* note 8, at 18.

[96] EPAct 2005 § 1275.

[97] ABEL, *supra* note 69, at 13.

[98] Order No. 667, 70 Fed. Reg. at 75,593. Every holding company must make a one-time filing of form FERC-65 notifying FERC of its holding company status within 30 days of the statute's effective date (March 10, 2006), or, if after March 10, 2006, within 30 days of becoming a holding company. *Id.* at 75, 593–94.

[99] Melnyk & Lamb, *supra* note 8, at 18.

[100] 18 C.F.R. § 366.3 (2008).

generators (EWGs), foreign utility companies (FUCOs), or qualifying facilities (QFs) are also exempt from federal access to books and records requirements.[101] PUHCA 2005 also exempts any person whose books and records, or class of transactions, are not relevant to jurisdictional rates.[102] Order 667 further exempts: utilities without captive customers that are not affiliated with any jurisdictional utility with captive customers; passive investors, including mutual funds; power and natural gas marketers; local distribution companies that are not regulated as natural gas companies; transactions between affiliates who are independent of and do not include a natural gas company; and electric power cooperatives.[103] Additionally, single-state holding companies are also waived from record-keeping and reporting requirements with the understanding that when a utility operates within a single state, ratepayers are protected by state oversight and federal oversight under the FPA.[104] It should be noted that PUHCA 2005 provides a type of "savings clause," which denies the preemption of state laws aimed at protecting ratepayers.[105]

FERC retains broad authority to determine which entities qualify for an exemption from the books and records requirement under PUHCA 2005. For example, despite Legg Mason Inc.'s ownership of more than ten percent of voting securities in AES Corporation (AES), the Commission determined that Legg Mason was a passive investor, and thus, was exempt from the books and records requirement of PUHCA 2005.[106] The Commission conceded that Legg Mason was the single largest shareholder in AES and could potentially influence shareholder meetings. Regardless, FERC found that Legg Mason was still a passive investor and qualified for an exemption, because "[t]he size of the holdings alone is not determinative of whether an investor is a passive investor for purposes of exemption from PUHCA 2005's requirements." The Commission justified its finding based on Legg Mason's assertions that it:

[101] EPAct 2005 § 1266. A Qualifying Facility (QF) is either a cogeneration or small power production facility that "meets the requirements for QF status under the Public Utility Regulatory Policies Act of 1978 . . . and part 292 of the Commission's Regulations (18 C.F.R. Part 292) and which has obtained certification of its QF status." Fed. Energy Reg. Comm'n, Electric—*What is a Qualifying Facility?*, Apr. 23, 2007, *available at* http://www.ferc.gov/industries/electric/gen-info/qual-fac/what-is.asp.

[102] EPAct 2005 § 1266.

[103] Order No. 667, 70 Fed. Reg. at 75,594.

[104] Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, 71 Fed. Reg. 42,750, 42,753 (Jul. 28, 2006) (codified at 18 C.F.R. pt. 366).

[105] Robert W. Gee, *After PUHCA Repeal: The State Response, Will the Industry Be Able to Meet Capital Investment and Growth Expectations?*, PUB. UTIL. FORT., Jun. 2006, at 44; *See* EPAct 2005 § 1269.

[106] Order on Exemption Notification, Docket No. PH06-48-000, FERC Stats. & Regs. ¶ 61,268 (2006) at ¶ 15.

> [D]oes not (and plans not to) have a role in AES management or operational decisions or in AES transactions to buy or sell electric energy or natural gas, or transmission or distribution, or the operation, buying, or selling of facilities for production, transmission, or distribution; there are no interlocking officers or directors between the AES companies and the Legg Mason companies; that Legg Mason's interests in AES are managed for investment purposes only, and not as part of an integrated energy business; and the voting decisions of Legg Mason's subsidiaries and affiliates are dependent on individual agreements with individual clients whose accounts hold the shares of AES, with Legg Mason having a fiduciary duty to vote in the respective best interests of each such client.[107]

B. FERC's New Jurisdiction—Section 203 Amendments

The Commission's role in merger and acquisition oversight is also significantly expanded under EPAct 2005. Section 1289 of EPAct 2005 amended section 203 of the FPA, granting FERC greater review of public utility mergers, acquisitions, asset dispositions, and holding company mergers and acquisitions.[108] The purpose of section 203 is to examine the market power arising from the transaction and its resulting competitive effects. Amended section 203 of the FPA raises the threshold amount triggering FERC review and authorization for dispositions of public utilities from $50,000 to $10 million.[109] There is also the addition of new language which grants FERC express authority to regulate mergers and acquisitions. According to section 203(a)(2), a holding company, including a transmitting utility or electric utility, must first attain Commission approval if it wishes to either: 1) merge or consolidate with another electric utility, transmitting utility, or holding company in a transaction valued at $10 million or more, or 2) acquire $10 million or more in securities.[110] FERC looks at the market value of transactions between non-affiliates to determine whether the asset transfer requires a section 203 filing.[111] FERC must also find that the transaction (the

[107] *Id.*

[108] EPAct 2005 § 1289. On December 23, 2005 FERC issued its final rule, Order 669, implementing its authority under Section 203 of the Federal Power Act. Transactions Subject to FPA Section 203, 71 Fed. Reg. 1348 (Dec. 23, 2005) [hereinafter Order No. 669].

[109] Order No. 669, 71 Fed. Reg. at 1350.

[110] *Id.* Regulatory scrutiny at FERC will continue to be prevalent in the post-PUHCA era. A review of plant acquisitions in 2004–2005 revealed that the average value of assets sold well exceeded the $10 million threshold, triggering FERC jurisdiction. Almost 50 electric-plant acquisition deals were completed, resulting in a total of 46,384 MW and $13.7 billion in assets changing hands in 2004 and 2005. Romkaew Broehm, *The New Art of Plant Acquisition*, PUB. UTIL. FORT., Jun. 2006, at 68, *available at* http://www.fortnightly.com/display_pdf.cfm?id=06012006_TheNewArt.pdf.

[111] Order No. 669, 71 Fed. Reg. at 1361.

proposed disposition, consolidation, acquisition, or change in control) is "consistent with the public interest" prior to approving it.[112] The Commission gauges this standard by considering three factors: 1) the effect on competition; 2) the effect on rates; and 3) the effect on regulation.[113] Section 203(a)(4) also tasks FERC with the new requirement of ensuring that the transaction does "not result in cross-subsidization of a non-utility associate company or pledge or encumbrance of utility assets for the benefit of an associate company, unless that cross-subsidization, pledge, or encumbrance will be consistent with the public interest."[114]

The Commission further recommended procedures to prevent against cross-subsidization and affiliate abuse within the context of section 203.[115] FERC requires applicants to submit evidentiary support by which it may assess the effect of the transaction on jurisdictional rates. Applicants proposing section 203 transactions bear the burden of proving that ratepayers will be protected, and should employ customer protection mechanisms to assure that captive customers, in particular, are protected from the effects of cross-subsidization.[116] The Commission explained its concern regarding cross-subsidization as being "principally a concern over the effect of a transaction on rates."[117] Thus, the Commission recommends applicants consider options, such as a "general hold harmless provision," in which the applicant commits to protect wholesale customers from any adverse rate effects resulting from the merger for a significant period of time after the transaction, or a "moratorium on increases in base rates," entailing a rate freeze for wholesale customers.[118] FERC intends to review all of these proposals on a case-by-case basis.

The inclusion of section 203 amendments in EPAct 2005 also expedites the approval of smaller and less controversial mergers. Section 203 provides for "blanket authorizations" designed to "ensure that there is no harm to captive customers of franchised public utilities, but [seeks] to accommodate investments in the electric industry and market liquidity."[119] Currently, section 203(a)(2) provides for blanket

[112] Order No. 669, 71 Fed. Reg. at 1350. All determinations are subject to hearing and comment by the Commission. *Id.*

[113] Order No. 669, 71 Fed. Reg. at 1349. The Commission applied this standard to Section 203 transactions prior to EPAct 2005. "The purpose of the Merger Policy Statement was to ensure that mergers are consistent with the public interest and to provide greater certainty and expedition in the Commission's analysis of merger applications." *Id.*

[114] *Id.* at 1350.

[115] *Id.* at 1367.

[116] *Id.* at 1368.

[117] *Id.*

[118] *Id.*

[119] Blanket Authorization Under FPA Section 203, 73 Fed. Reg. 11,003, 11,003 (Feb. 21, 2008) (to be codified at 18 C.F.R. pt. 33) [hereinafter Order No. 708].

authorizations to holding companies to purchase, take or acquire: the security of a transmitting utility or company that owns, operates, or controls facilities used only for the intrastate transmission and sales of electric energy[120] or facilities used solely for local distribution and/or the sales of electric energy at retail rates regulated by a state commission;[121] the security of an electric utility company that owns generating facilities totaling 100 MW or less and fundamentally used for individual load or for sales to affiliated end-users;[122] non-voting security in a transmitting utility, an electric utility company, or a holding company in a holding company system, which includes a transmitting utility or an electric utility company;[123] any voting security in a transmitting or electric utility company, or a holding company in a holding company system that includes a transmitting utility or an electric utility company if the holding company owns less than ten percent of the outstanding voting securities after disposition;[124] and any security of a subsidiary company within the holding company system.[125]

Additionally, the Commission's Final Rule issued on February 21, 2008 addressing blanket waivers under section 203, preauthorizes a public utility to dispose of less than ten percent of its voting securities to a public utility holding company on the condition that after the disposition, the holding company and any associate or affiliate companies *in aggregate* own less than ten percent of the outstanding voting interests of the acquired public utility.[126] Section 203(a)(1) makes this blanket waiver applicable in circumstances where the public utility is transferring its voting securities to any holding company that was already granted blanket authorization under section 203(a)(2) in 18 C.F.R. 33.1(c)(8),[127] 18 C.F.R. 33.1(c)(9),[128] and 18 C.F.R. 33.1(c)(1).[129] Additionally, 203(a)(1) grants a public utility blanket authorization

[120] 18 C.F.R. § 33.1(c)(1)(i) (2008). If the utility has captive customers or provides transmission over jurisdictional transmission facilities, the holding company must report the acquisition to FERC. *Id.*

[121] 18 C.F.R. § 33.1(c)(1)(ii) (2008).

[122] 18 C.F.R. § 33.1(c)(1)(iii) (2008).

[123] 18 C.F.R. § 33.1(c)(2)(i) (2008).

[124] 18 C.F.R. § 33.1(c)(2)(ii) (2008).

[125] 18 C.F.R. § 33.1(c)(2)(iii) (2008).

[126] Order No. 708, 73 Fed. Reg. at 11,005. The Commission imposed the "in aggregate" limitation to prevent a public utility from transferring less than ten percent of its voting securities in successive transfers to affiliate or associate companies to transfer control. *Id.* at 11,006. As noted in the Commission's Supplemental Policy Statement, although there is a presumption that less than ten percent of a utility's shares would not result in a change of control, this presumption is rebuttable. *See* FPA Section 203 Supplemental Policy Statement, 72 Fed. Reg. 42,277, 42,286 (Aug. 2, 2007).

[127] 18 C.F.R. § 33.1(c)(8) (2008) grants a blanket authorization under section 203(a)(2) to a person that is a holding company solely with respect to one or more EWGs, FUCOs, or QFs to acquire the securities of additional EWGs, FUCOs, or QFs.

> for the acquisition or disposition of a jurisdictional contract where neither the acquirer or transferor has captive customers or owns or provides transmission service over jurisdictional facilities, the contract does not convey control over the operation of a generation or transmission facility, the parties to the transaction are neither associate or affiliate companies, and the acquirer is a public utility.[130]

Under amended section 203, FERC is required to act on proposed section 203 transactions within 180 days, but may extend this period for an additional 180 days if "good cause" is shown. This provision provides for the expedited approval of certain section 203 transactions that predominantly meet the Commission's standards. These include transactions that are uncontested, are not mergers, and are consistent with Commission precedent.[131] EPAct 2005 also strengthens FERC's review of utility mergers, which will provide greater scrutiny over complex holding company deals to ensure that they meet the Commission's public interest standard imposed by the FPA.[132] Increased scrutiny of section 203 transactions is necessary, because repeal of PUHCA will likely lead to increased merger activity and consolidation in the industry. This will, in turn, result in greater opportunities for the exercise of market power and undue preference to affiliates.[133]

V. CASE STUDY OF TWO FAILED MEGA-MERGERS

The repeal of PUHCA removed numerous obstacles for utility mergers and made running the regulatory gauntlet easier. This evolution has resulted in a market ripe for mergers between big energy companies. However, thorny state utility commissions are also playing a greater role in reviewing mergers, which means new roadblocks for big energy companies that do not provide ratepayers incentives sought by state regulators.[134] The failure of two recent mergers between the Public Service Enterprise Group and Exelon Corp., and Constellation Energy

[128] 18 C.F.R. § 33.1(c)(9) (2008) grants a conditional blanket authorization under section 203(a)(2) to a holding company, or a subsidiary of that company, that is regulated by the Board of Governors of the Federal Reserve Bank Holding Company Act of 1956 as amended by the Gramm-Leach Biley Act of 1999.

[129] 18 C.F.R. § 33.1(c)(10) (2008) grants a limited blanket authorization under section 203(a)(2) to a holding company, or a subsidiary of that company, for the acquisition of securities of a public utility or a holding company that includes a public utility for purposes of underwriting activities or hedging transactions.

[130] Order No. 708, 73 Fed. Reg. at 11,005.

[131] Order No. 669, 71 Fed. Reg. at 1369.

[132] AM. PUB. POWER ASS'N, THE ELECTRIC UTILITY INDUSTRY AFTER PUHCA REPEAL: WHAT HAPPENS NEXT? 13 (2005).

[133] *Id.*

[134] "State commissions have traditionally conditioned their approval of mergers and asset transfers by requiring that the bulk of operational savings created by a transfer must be passed on to ratepayers." Angle & Hoecker, *supra* note 3.

Group and Florida Power & Light Co. illustrate the hurdles state regulators can present in merger deals. A closer look at these two merger proposals provides a better realization that "utility mergers are still a local game, and removal of PUHCA barriers does not diminish that fact."[135]

A. PSEG-Exelon

On December 20, 2004, Exelon Corporation (Exelon) and Public Service Enterprise Group Incorporated (PSEG) proposed a merger valued at $16 billion. Merging of the two utilities would have created one of the nation's largest utilities, Exelon Electric & Gas, with combined assets totaling approximately $79 billion, including almost $25 billion in annual revenue and $3.2 billion in annual net income.[136] As one of the nation's largest power generators and leading U.S. wholesale power marketers, Exelon Electric & Gas would have maintained a generation portfolio of approximately 52,000 MW of domestic capacity, including 20,000 MW of nuclear generation.[137] Exelon Electric & Gas would have also served seven million electric customers and two million gas customers throughout Illinois, New Jersey, and Pennsylvania.[138] The deal required approval from FERC, the Department of Justice, the Pennsylvania Public Utility Commission, and the New Jersey Board of Public Utilities. Due to the size of the merger, it drew significant opposition from state regulators, consumer and public interest groups, competitors, and environmental groups.

FERC evaluated the transaction's effect on competition, rates, and regulation, and required Exelon and PSEG to divest 4,000 MW of peaking and intermediate generation facilities and "virtually divest" 2,600 MW of nuclear capacity. This allowed Exelon and PSEG to retain ownership of the virtually divested plants, but forced the company to sell or swap its output.[139] Consequently, FERC found the proposed merger to be in the public interest and approved it without a hearing only five

[135] Edward Metz & Michael Tarney, *Big Time Mergers? Not So Fast My Friend . . . Whole-Company Deals May Not Take Off with PUHCA Repeal*, PUB. UTIL. FORT., Oct. 2005, at 25, *available at* http://www.fortnightly.com/result.cfm?i=/4600.cfm.

[136] Press Release, Exelon Corporation, Exelon and PSEG Agree to Merge, Forming the Nation's Premier Utility Company (Dec. 20, 2004), *available at* http://www.exeloncorp.com/NR/exeres/510BE0d7-1A0A-43E0-9073-084D7A3C5224.htm [hereinafter Exelon Merger Press Release].

[137] Richard Stavros, *The Man Who Would Be King*, PUB. UTIL. FORT., May 2005, at 15, *available at* http://www.fortnightly.com/result.cfm?i=/4539.cfm.

[138] Exelon Merger Press Release, *supra* note 136.

[139] Mary O'Driscoll, *Energy Markets: Consumer Groups Hail Collapse of Exelon-PSEG Merger*, GREENWIRE, Sept. 15, 2006, http://www.eenews.net/greenwire/2006/09/15/5.

months after the companies filed their application with the Commission.[140]

The Department of Justice Antitrust Division (DOJ) also required divestiture of electric generation, but ordered the utilities to divest even more generation than required by FERC. DOJ found that the transaction would have caused higher prices for wholesale electricity, in turn increasing electricity rates for consumers in the mid-Atlantic region.[141] Thus, DOJ agreed to approve the merger on the condition that Exelon and PSEG divest 5,600 MW of generating capacity to remedy anticompetitive effects. In order to meet this requirement, the companies were forced to divest six electric generating plants, four in New Jersey and two in Pennsylvania.[142] The companies agreed to DOJ's demands on June 22, 2006.[143]

Exelon and PSEG also faced significant resistance from the Pennsylvania Public Utility Commission (Pennsylvania PUC). Despite a clash with the Pennsylvania PUC, PSEG and Exelon reached an agreement on January 27, 2006 that provided numerous concessions to Pennsylvania ratepayers. This settlement required that Exelon and PSEG give Pennsylvania customers $120 million in rate discounts over the course of four years and called for a cap on PSEG's rates through the end of 2010.[144] PSEG also agreed to pay $19.2 million to fund clean-energy

140 Order Authorizing Merger Under Section 203 of the Federal Power Act, Docket No. EC05-43-00, FERC Stats. & Regs. ¶ 61,011 (2005) at ¶¶ 1, 5.

141 Press Release, U.S. Dep't of Justice, Justice Department Requires Divestitures in $16 Billion Merger of Exelon and Public Service Enterprise Group (June 22, 2006), *available at* http://www.justice.gov/atr/public/press_releases/2006/216780.htm.

142 *Id.*

143 *Exelon-PSEG Merger Still Unsettled After New Jersey Rejects New Offer*, NUCLEONICS WK., Aug. 10, 2006, at 5 [hereinafter *Exelon-PSEG Merger Unsettled*].

144 The settlement agreement also provided for approximately 1.2% off customer bills. Mary Wisniewski, *Exelon Settles PSEG Merger Issues in Pennsylvania*, CHI. SUN-TIMES, Sept. 14, 2005, at 83. PECO's generation rates will remain capped through the end of 2010, at which point the rate caps will expire and PECO will complete its transition to market-based rates. William Mulgrew, *PECO Rates May Increase Twenty Percent in 2011*, THE BULLETIN, July 31, 2008, *available at* http://www.thebulletin.us/site/index.cfm?newsid=19880480&BRD=2737&PAG=461&dept_id=576361&rfi=8. To mitigate drastic rate increases, the Pennsylvania Legislature has introduced HB 2200, which encourages efficient usage of electricity and overall conservation of energy, and HB 2201, which calls for requirements that utilities procure their power through a mix of short- and long-term contracts and spot market purchases. Press Release, Chuck Ardo, Pennsylvania Governor's Office, Governor Rendell to Legislature: Help Consumers Avoid $1.6 Billion Increase In Electricity Rates (Mar. 8, 2008), *available at* http://www.state.pa.us/papower/cwp/view.asp?A=11&Q=473910. For a discussion of PECO's views on the rate caps set to expire in 2010 and proposed legislation, *see* Lisa Crutchfield, Senior V.P., Regulatory and External Affairs, PECO Energy Co., Testimony Before Pa. H. Comm. on Consumer Affairs (Jan. 31, 2008), *available at* http://www.exeloncorp.com/NR/rdonlyres/70F4A83D-BE9B-40FB-9CBC-C851CAF89C47/4260/LCTestimonyforHouseCom13108.pdf.

and energy-conservation programs, maintain its headquarters in Philadelphia through 2010, and increase participation in customer-assistance programs for low-income households.[145]

Unlike the negotiations with the Pennsylvania PUC, Exelon and PSEG were not as fortunate to reach a resolution with the New Jersey Board of Public Utilities (BPU). In turn, the BPU proved to be the downfall of the merger. New Jersey state regulators voiced concerns over the consolidation of large amounts of generating power under one company, which could result in higher increases for electric and gas customers. The Board noted that the proposal lacked "clarity on several issues," including "ensuring against the possibility of increased rates as well as continuing the high standard of safety and reliability currently delivered by PSEG."[146] The BPU also stressed the potential for "possible market dominance and the ability to set power prices which could lead to higher bills."[147] The merger was subject to review under the BPU's "positive benefits" standard, which required the petitioners to prove that positive benefits would flow to customers and the State, and likewise that there were no adverse impacts as a result of the proposed change in control.[148] The BPU also scrutinized the merger pursuant to N.J.S.A. 48:2–51.1, which requires that the Board evaluate "the impact of the acquisition on competition, on the rates of ratepayers affected by the acquisition of control, on the employees of the affected public utility or utilities, and on the provision of safe and adequate utility service at just and reasonable rates."[149] The New Jersey Ratepayer Advocate further echoed concerns of negative impacts stemming from the merger, such as the elimination of almost 950 jobs in the State.[150]

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[145] *PA. Gives OK to Exelon-PSEG Deal*, PHILA. BUS. J., Jan. 27, 2006, *available at* http://www.philadelphia.bizjournals.com/philadelphia/stories/2006/01/23/daily49.html.

[146] *Exelon-PSEG Merger Unsettled*, *supra* note 143, at 5.

[147] *Id.*

[148] Order on Standard of Review at 15, *In re* The Joint Petition of Pub. Serv. & Gas Co. & Exelon Corp. for Approval of a Change in Control of Pub. Serv. & Gas Co. and Related Auths., No. EM05020106 (N.J. Bd. of Pub. Utils. July 9, 2005). The BPU uses two standards to evaluate mergers and acquisitions—the "positive benefits standard" and the "no harm" standard. The "positive benefits standard" imposes a greater burden than the "no harm" standard used by the Board when reviewing mergers and acquisitions. The "no harm" standard requires the petitioner to show, and the Board to be satisfied, that at the very minimum, "there would be no adverse impact on the provision of safe, adequate and proper service at just and reasonable rates and no adverse impact on the other criteria delineated in N.J.S.A. 48:2–51.1 . . . ." *Id.* The BPU determines which standard to use on a case-by-case basis. *Id.*

[149] N.J. Stat. §§ 48:2–51.1 (1984).

[150] Initial Brief of the Div. of the Ratepayer Advocate at 28, *In re* The Joint Petition of Pub. Serv. & Gas Co. & Exelon Corp. for Approval of a Change in Control of Pub. Serv. & Gas Co. and Related Auths., No. EM05020106 (N.J. Bd. of Pub. Utils. April 26, 2006).

Dissatisfied with Exelon and PSEG's initial proposal, the BPU offered a counterproposal consisting of the structural divestiture of additional New Jersey plants, increased rate relief, and stronger consumer protections and reliability. As directed by DOJ, the companies had already agreed to divest 5,600 MW of fossil fuel generation and "virtually divest" 2,600 MW of nuclear power; however, the BPU asked for the divestiture of two additional plants in New Jersey and another $200 million in rate credits for customers.[151] PSEG and Exelon responded to the BPU's request by transmitting their "last and best offer," which consisted of "$600 million in targeted customer and state benefits, $220 million in savings related to pending rate cases and stay-outs, $170 million in increased state cooperation business tax revenues, and $465 million in savings related to improved nuclear facilities."[152] Exelon and PSEG also agreed to locate the headquarters for Exelon Energy Delivery Company, the parent company to PSEG, Commonwealth Edison Co., and PECO Energy, in New Jersey.[153] The total package was valued at $1.46 billion.[154]

Despite the counter-offer, the BPU felt that the benefits of the merger were too small to justify the risks associated with it. On August 4, 2006, amid concerns over market power, market manipulation, and the companies' inability to meet the positive benefits standard imposed by the BPU, the Board voted to reject the merger proposal.[155] In response, after twenty-one months of negotiations, on September 14, 2006, the companies pulled the proposed merger, citing "insurmountable gaps" with the New Jersey BPU.[156] The failed merger resulted in rate increases for New Jersey customers, a condition that PSEG was willing to forego if the merger was approved.[157] PSEG and Exelon are also faced with replacing many company employees who left in anticipation of the merger.[158]

B. Constellation-FPL

On December 19, 2005, Florida Power & Light (FPL) and Constellation Energy Group, Inc. (Constellation) agreed to an $11

151 *Reaction Mixed to Exelon-PSEG Merger Failure*, MEGAWATT DAILY, Sept. 18, 2006, at 1.

152 *Exelon and PSEG Back Off From Their Warning that They May Scrap Merger Plan Unless New Jersey BPU Agrees to Latest Offer*, FOSTER ELECTRIC REP., Aug. 9, 2006, at 10 [hereinafter *Exelon and PSEG Back Off*], *available at* 2006 WLNR 13922148.

153 *Id.*

154 *Reaction Mixed to Exelon-PSEG Merger Failure*, *supra* note 151, at 1.

155 *Exelon and PSEG Back Off*, *supra* note 152, at 10.

156 *Reaction Mixed to Exelon-PSEG Merger Failure*, *supra* note 151, at 1; Ken Silverstein, *Merger Denied*, ENERGY BIZ INSIDER, Sept. 27, 2006, http://www.njcitizenaction.org/news/util074.html.

157 Silverstein, *supra* note 156.

158 *Id.*

billion merger that would have resulted in one of the nation's largest power generators, Constellation Energy.[159] Constellation Energy would have had the capacity to generate 46,432 MW of power, providing energy to consumers from Maine to Florida, specifically serving 5.5 million electric customers in Florida and 625,000 gas customers in Maryland.[160] The merger of FPL and Constellation would have also produced annual revenues upwards of $27 billion, and resulted in Constellation Energy maintaining $57 billion in assets. The combined company would have held the second largest electric-utility portfolio in the U.S., ranked number three in nuclear-power plant operators in the U.S.,[161] and been among the nation's top seventy-five biggest public companies.[162] Under the terms of the proposed merger, FPL and Constellation agreed to maintain headquarters in both Juno Beach, Florida and Baltimore, Maryland.[163]

The merger required approval from FERC, the Nuclear Regulatory Commission, and the Maryland Public Service Commission. However, the Florida Public Service Commission had little involvement in the merger, because Florida remains one of three states that does not give its regulators the authority to approve or deny utility mergers.[164] Consequently, the Florida Public Service Commission intervened in the FERC proceeding to voice its position on the merger.[165] FERC was forced to extend its initial review of the merger for an additional 180 days due to the magnitude of the deal, thus giving the Commission until February 2, 2007 to evaluate if the merger was in the public interest and met necessary requirements imposed by section 203 of the Federal Power Act.[166] The proposed merger sparked concerns of cross-subsidization, and

[159] *Update: FPL Group, Constellation Energy Clinch $11 Bln Deal*, DOW JONES BUS. NEWS, Dec. 19, 2005.

[160] *Id.*

[161] *Id.*

[162] Steven Mufson, *Energy Deregulation Comes Home to Roost*, WASH. POST, Apr. 25, 2006, at D1.

[163] Press Release, Florida Power and Light, FPL Group and Constellation Energy to Merge, Creating Nation's Largest Competitive Energy Supplier and Its Second-largest Electric Utility (Dec. 19, 2005), *available at* http://www.fpl.com/news/2005/contents/05266.shtml.

[164] *Sun Q&A: Bernie Kohn on Constellation-FPL Deal*, BALT. SUN, Dec. 21, 2005, *available at* http://www.baltimoresun.com/business/bal-constellationqa1220,0,749801.story?coll=bal-specials-headlines. Montana and Michigan are the two other states that do not maintain authority to approve or deny utility mergers. *Id.* The Florida Public Utilities Commission does, however, retain authority to regulate and supervise the rates and service of each public utility in its jurisdiction, as well as regulate the issuance of sales and securities of public utilities, among other powers. *See* Fla. Stat. § 366.04 (2007).

[165] *See* Notice of Intervention, Florida Public Service Commission, EC06-77, Apr. 6, 2006, *available at* http://elibrary.ferc.gov/idmws/nvcommon/NVViewer.asp?Doc=10993418:0.

[166] *As One Big Utility Merger Draws Fire, Action on Another is Deferred by FERC*, PLATTS: INSIDE F.E.R.C., July 31, 2006, at 5. Under Section 203 of the Federal Power Act, as

left many consumer groups worried that the merger would "burden retail ratepayers with the merged companies' plan to expand its competitive power business," resulting in higher rates and lowered quality of service for ratepayers.[167]

The Maryland Public Service Commission (PSC) presented the biggest hurdle for FPL and Constellation. The utilities proposed the merger just months prior to the expiration of a six-year rate freeze that was instituted by Baltimore Gas & Electric, a subsidiary of Constellation, in response to Maryland's transition into a deregulated energy market.[168] In light of rising energy prices, Baltimore Gas & Electric announced that expiration of the rate caps would result in a 72% rate increase for consumers, which the Maryland PSC approved without a hearing.[169] Outraged at the rate increases, Maryland legislators passed three bills to impede the proposed merger: H.B. 1713, which gave the legislature the right to investigate and potentially veto the deal; S.B. 1099, which blocked the merger unless Constellation agreed to refund $528 million in stranded costs to ratepayers it collected under restructuring rules; and S.B. 1102, which fired the appointed Public Service Commissioners and replaced them with individuals appointed by the State Legislature.[170] The Maryland Court of Appeals overturned the Legislature's removal of the Commissioners, but left in place a provision that barred the PSC from ruling on the Constellation-FPL merger, further stalling regulatory action on the merger.[171] In response, FPL filed suit in Baltimore Circuit Court pushing for timely review of the merger and requesting that the PSC be permitted to issue a decision.[172]

Additionally, due to the proposed rate hikes, Maryland legislators also passed legislation requiring Constellation to cut $386 million from future residential electricity bills regardless of whether the merger was approved.[173] This credit was in addition to another $214 million credit offered to ratepayers by Constellation to expedite the merger's approval, in turn, providing Maryland retail customers a total of $600 million in

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amended under the Public Utility Holding Company Act of 2005, FERC is required to act on proposed section 203 transactions within 180 days, but if "good cause" is shown, may extend this period for an additional 180 days. Order No. 669, 71 Fed. Reg. at 1368–69.

[167] *Time Will Tell if PUHCA, Merger Rules Strike Desired Balance in New Investment, Protection*, PLATTS : INSIDE F.E.R.C., May 1, 2006, at 5.

[168] Paul Adams, *Constellation And FPL Give Up On Merger*, BALT. SUN, Oct. 26, 2006, at 1A, *available at* http://ktla.trb.com/business/bal-te.bz.merger26oct26,1,5965192,print.story.

[169] *Id.*

[170] *Constellation-FPL Group Merger Raises Concerns of Cross-Subsidization*, FOSTER ELECTRIC REP., Apr. 19, 2006, at 10.

[171] Adams, *supra* note 168.

[172] *Id.*

[173] Jay Hancock, *Time, Politics May Doom Merger of Utilities*, BALT. SUN, Oct. 11, 2006, at 1D.

credits.[174] Despite the proposed ratepayer credits, the merger remained in limbo as a consequence of the Maryland legislature's bill preventing the PSC from ruling on the merger. On October 25, 2006, FPL and Constellation announced they were abandoning their proposed merger, due to "continued uncertainty over regulatory and judicial matters in Maryland and the potential for a protracted open-ended merger review process."[175] Constellation's Chairman, President and CEO, Mayo Shattuck, blamed the merger's demise on " . . . risks and uncertainties [of the merger that] were too significant to overcome."[176] Consumer advocates, fearing that the merger would hand ownership of a majority of Maryland's power plants to an out-of-state company, were relieved at Constellation's decision to pull the merger.[177] Termination of the merger will result in a loss of $214 million in merger-related credits for 1.1 million ratepayers,[178] which equals approximately $1.62 in savings a month to Baltimore Gas & Electric residential customers over the course of 10 years.[179]

C. Future Trends of Mega-mergers

Prior to PUHCA repeal, critics were concerned that repealing the depression-era law would lead to a wave of big utility mergers valued at billions that would leave ratepayers with increased electric bills and unreliable service. The PSEG-Exelon and FPL-Constellation deals are indicative that state regulatory commissions are stepping up to the plate and exercising long-held authority to deny mergers if they do not find them in the interest of ratepayers and the state.[180] John McConomy,

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174 *Id.*

175 *Regulatory Uncertainty Prompts FPL, Constellation to Terminate Merger Plans*, PLATTS : INSIDE F.E.R.C.'S GAS MKT. REP., Nov. 3, 2006, at 24.

176 *Id.*

177 Adams, *supra* note 168.

178 *Id.*

179 Tricia Bishop, *With Deal Goes $1.62 Credit on BGE Customers' Bills*, BALT. SUN, Oct. 26, 2006, *available at* http://www.baltimoresun.com/business/bal-te.bz.rates26oct26,0,7013556.story?coll=bal-home-columnists.

180 Prior to PUHCA repeal, numerous states had varying degrees of oversight by statute or conditions imposed in rate and merger and acquisition proceedings. A survey conducted by the National Association of Regulatory Utility Commissioners (NARUC) in the 1990s revealed that all but three states (Florida, Michigan, and Montana) held authority to approved mergers and acquisitions, and in turn the ability to condition their approval. Additionally, almost all states also maintain authority over affiliate transactions and cost allocations. Gee, *supra* note 105, at 44. Furthermore, "[s]tates do have more latitude in determining problems with deals, because statutes constrain FERC to only look at wholesale issues, such as transmission pricing and competitors' access to services. States may also scrutinize possible retail effects—prices consumers actually are paying." Donna Block & Cecile Kohrs Lindell, *Power Transfer*, THE DEAL, L.L.C., Oct. 17, 2005, http://www.thedeal.com/servlet/ContentServer?pagename=TheDeal/TDDArticle/TDStandardArticle&bn=NULL&c=TDDArticle&cid=1128454358445.

analyst for PricewaterhouseCoopers, said that "[t]he actions of [the] Maryland PSC (MPSC) and the New Jersey Board of Public Utilities (NJBPU) were a huge factor in the decision to take the proposed mergers of Exelon and PSEG, and FPL and Constellation, off the table during 2006."[181] Similarly, Tyson Slocum, Director of the Energy program at Public Citizen, also noted that "[s]tate regulators have a lot of power . . . . The leadership is going to be at the state level on these deals."[182] The pattern of failed mergers due to obstacles presented by state public utility commissions demonstrate the power that state commissions possess to block mergers of utilities.

State regulators seeking concessions for consumers have proved to be the biggest obstacle in achieving approval of mergers between giant utility companies. In 2007, Platts reported that the failure rate for mergers among electric and gas utilities was "very high," with 25% of all proposed deals failing to gain state approval.[183] Denial of recent mergers has also exhibited that "[t]ypically the acquiring utility must offer something of value to consumers in exchange for state regulatory approval . . . ."[184] Traditionally, state utility commissions have usually placed a heavy focus on the costs of mergers to retail customers and rarely approve merger and takeover proposals that they do not believe provide adequate compensation to customers.[185] Companies seeking mergers must show that the "combined utility will have a stronger financial platform, will be a more-efficient and lower-cost operation, have better management, allow system investment, and will be in the public interest."[186] In some instances, state regulators have found that it is not enough just to show that the merger will not cause harm and is in the public interest; but that companies must also demonstrate that mergers *actually* benefit consumers.[187] Southern Company Chairman and CEO, David Ratcliffe, noted that utilities seeking merger approval "need to do a lot more legwork on the front end" to convince state regulators as to

[181] *Transatlantic Divide Opens As Global Electricity and Gas Market Mergers and Acquisitions Take Off, PricewaterhouseCoopers Reports*, FOSTER NAT. GAS REP., Jan. 26, 2007, at 15 [hereinafter *Transatlantic Divide*].

[182] Block & Lindell, *supra* note 180.

[183] *Utilities 'Crying Out' for Consolidation, But States Stand In the Way, say Officials*, PLATTS: INSIDE FERC, July 2, 2007, at 2 [hereinafter *Utilities 'Crying Out'*].

[184] Robert Manor, *Utility Stability? Sector Crackles with Mergers,* CHIC. TRIB., Aug. 20, 2006. Manfred Wiegand, an analyst with PricewaterhouseCoopers, noted that, "[w]e are seeing record deal levels, but more than ever, it is regulators and politicians that are deal makers or breakers in the utilities sector." *PricewaterhouseCoopers Reports That Last Year's Global Boom in Electric and Gas Merger Activity Did Not Extend to North America*, FOSTER ELECTRIC REP., Jan. 31, 2007, at 9 [hereinafter *PricewaterhouseCoopers Reports*].

[185] Angle & Hoecker, *supra* note 3.

[186] *Utilities 'Crying Out'*, *supra* note 183, at 3.

[187] Rebecca Smith, *Power Struggle Pits Utilities vs. States*, WALL ST. J., July 24, 2006, at B2.

"why these deals make sense and how they will benefit customers in the long term."[188]

Despite the lukewarm response by state regulators and resulting slowed mergers and acquisitions (M&A) activity in the utility industry, companies will not shy away from the prospect of billion-dollar deals for long.[189] PUHCA repeal has opened the door for new opportunities in the M&A sector. The utilities that recognize how to take advantage of these changes to the law while at the same time protecting ratepayer interests will be the ones at the forefront of the industry, because state utility commissions will be more inclined to approve their mergers. It is clear state regulators have become more involved in reviewing holding company operations since the repeal of PUHCA; and, as illustrated by state enactment of mini-PUHCA statutes, this enhanced scrutiny will vary by jurisdiction. Regulatory proceedings for mergers typically address concerns over: the impact of gas and electric rates on ratepayers; cost savings to ratepayers and utilities; service reliability; market power; the impact of the proposed merger on the state economy and employment; and the companies' state and local civic commitment.[190] As discussed in further detail in the following section, state commissions are also enacting statutes post-PUHCA to better regulate holding companies and protect ratepayers and the financial integrity of utilities. Utilities can expect that regulators will continue to rule with a heavy hand, imposing stringent requirements and expecting utilities to share a large chunk of merger savings to consumers to offset rising electricity prices.[191]

VI. EFFECTS OF PUHCA REPEAL ON THE UTILITY INDUSTRY

A. *Consolidation of the Electric and Gas Industry*

Eliminating regulatory hurdles present in PUHCA will lead to significant consolidation in the electric and gas industry. Robert Wason, Chief Analyst and Branch Chief of the Office of Public Utility Regulation in the Division of Investment Management at the SEC, suspects that continued consolidation of the utility industry "will by 2012 place 90% of the U.S. investor-owned electric and gas utility industry in the hands of

[188] Housley Carr & Ray Posposil, *Constellation-FPL Merger Collapse to Hurt BGE Ratepayers, Chills Future Industry Mergers*, ELECTRIC UTIL. WK., Oct. 30, 2006, at 1.

[189] PricewaterhouseCoopers reported that electric and gas merger deals in Europe and Asia Pacific soared in 2006, increasing 56% and 141%, respectively, while activity involving corporate U.S. utilities plummeted. *PricewaterhouseCoopers Reports*, *supra* note 184, at 9. North American electricity deal values in 2006 fell 64% from the previous year's level to $20.7 billion, which is not far above the $16.7 billion level of 2003. "The sharp downturn came as companies 'addressed aggressive regulatory approaches from some state regulators during a U.S. midterm election year that coincided with the ending of rate freezes and reaction to the repeal of the Public Utility Holding Company Act.'" *Transatlantic Divide*, *supra* note 181, at 15.

[190] *Utilities 'Crying Out'*, *supra* note 183, at 3.

[191] Smith, *supra* note 187, at B2.

just forty conglomerate systems."[192] Nonetheless, as seen with the mergers between Exelon and PSEG, and FPL and Constellation Energy, consolidation will be tempered by federal and state regulatory approvals of merger transactions. Further, restrictions requiring utilities to be confined to a single integrated system have now been lifted as a result of PUHCA repeal. Because PUHCA expressly required the confinement of utilities to a single region or state, utilities on the east coast, for example, were restricted from merging with utilities on the west coast. Carl Wood, former Commissioner of the California Public Utilities Commission, said, "[i]t's almost certain there will be M&A activity that wouldn't have occurred without the repeal of PUHCA. PUHCA's repeal is profound, because in some respects under PUHCA, mergers had to make technical sense, with contiguous territories."[193]

The ability of utilities to merge with other companies outside of a single state or region offers utilities an opportunity to diversify across geographic regions. Regional diversification will allow utilities to more efficiently manage electricity demand by utilizing their peaking power so units are not left idle.[194] This results in lower costs to utilities and diversification of fuel sources, so a utility is not heavily dependent on a single fuel to meet consumer demand.[195] Even if utilities face issues of market power when looking to merge with their neighbor, companies can always "hop over them," setting their sights on other utilities.[196] The American Public Power Association (APPA) agrees that PUHCA repeal will promote further consolidation in the industry; however, the APPA does not believe this comes without a price. According to the association, consolidation of the industry will likely result in fewer utilities, which

[192] Robert P. Wason, Chief Financial Analyst, Office of Pub. Util. Reg. in the Div. of Inv. Mgmt., Address at the 28th Annual Public Utility Holding Company Conference (Aug. 25, 2005). Ken Hurwitz, a partner with the law firm Haynes & Boone, believes consolidation in the industry will be more extensive. "I would go as far as to say that within the next five to ten years, the current number of electric utilities—which numbers more than 100—could shrink to 10." Michael T. Burr, *How Many Deals, and How Soon? By Opening the Field to Far-Flung Deals, PUHCA's Repeal Changes the Merger Game*, PUB. UTIL. FORT., Oct. 2005, at 39. Mayo Shattuck, CEO of Constellation Energy, said he believes we will be down from 100 major electric utilities in this country to 50 within a few years. He pointed out that Japan has only seven utilities for 120 to 130 million people. Keith Martin, *Will PUHCA Repeal Hasten Utility Consolidations?*, PROJECT FIN. NEWSWIRE, Aug. 2005, at 22. Although the American Public Power Association believes that PUHCA repeal will bring more mergers, it does not believe the industry will be consolidated at the rate predicted by others. "The pace of mergers will increase—but well short of consolidation from 100 to 50 major utilities—and at least some of the new mergers will follow the 'get big' pattern of the proposed Exelon-Public Service Enterprise Group ("PSEG") and Duke-Cinergy mergers." AM. PUB. POWER ASS'N, *supra* note 132, at 4.

[193] Burr, *supra* note 192, at 39.

[194] Geddes, *supra* note 49, at 4.

[195] *Id.*

[196] Burr, *supra* note 192, at 39.

could potentially lead to a less competitive market that would be harmful to consumers.[197]

Furthermore, critics of PUHCA 1935 contend that consumers have been paying excessively high prices for electricity from small systems, because the industry is fragmented and the U.S. has a national grid system that limits the transportation of power.[198] Increased consolidation in the industry will lead to more efficient utilities, yet there are still concerns that incumbent utilities and institutional investors will have the upper hand and could use their tenure to charge higher margins.[199] The creation of larger utilities brings fears of decreased reliability and commitment to service, paired with increased rates. Scott Hempling, a lawyer who frequently represents public utility commissions, noted that under PUHCA 1935, "U.S. customers who still have essentially no choice in their local power company at least could know that they were not being served by a huge conglomerate with only a minor interest in providing reliable electric service."[200]

B. Infrastructure Growth Through Private and Foreign Investment

The repeal of PUHCA will also lead to increased capital flowing into the utility industry from non-utility businesses, due to the removal of barriers originally imposed by the Act. "Outside companies will be attracted to the industry, some perceiving convergence opportunities, some looking for the earnings stability of regulated utilities, and others—pursuing a 'buy low, sell high' strategy—hoping to turn a quick profit on the assets."[201] In particular, the introduction of non-utility investors into the industry will funnel more capital towards electric and gas infrastructure growth. During hearings on the Energy Policy Act of 2005, Thomas Kuhn, CEO of Edison Electric Institute, testified that PUHCA acted "as a substantial impediment to new investment in energy infrastructure, keeping billions of dollars of new capital out of the industry . . . . [T]his outdated statute has contributed to the failure of the

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[197] *The Energy Policy Act of 2005: Hearings Before the Subcomm. on Energy and Air Quality of the H. Comm. on Energy and Commerce*, 109th Cong. 149–51 (2005) (statement of Alan. H. Richardson, President, American Public Power Association). According to Public Citizen, antitrust laws do not prohibit "only three or four parent companies from owning all the nation's utilities and would not stop utilities from owning other businesses or vice-versa. In other words, ExxonMobil can own Southern Company, PG&E and Verizon, and still pass muster under the antitrust laws." PUHCA FOR DUMMIES, *supra* note 76.

[198] Marianne Lavelle, *A Surge of Mergers: Repeal of 1935 Law Spurs Power Companies' Consolidation*, U.S. NEWS & WORLD REP., Feb. 5, 2006. There are more than 3,000 U.S. utilities, with 240 investor-owned companies generating about three quarters of the industry's power. *Id.*

[199] Roger Stark, *A Continuing Reign of Incoherence*, PUB. UTIL. FORT., Dec. 2005, at 52.

[200] Lavelle, *supra* note 198.

[201] AM. PUB. POWER ASS'N, *supra* note 132, at 4.

electricity infrastructure to keep pace with growing electricity demand and the development of regional wholesale markets."[202] However, skeptics of PUHCA repeal claim that the existing transmission grid of the U.S. was built under PUHCA by utility investment, and FERC's deregulation policies have been the real cause of slowed investment into the grid.[203] Lynn Hargis, of Public Citizen, believes that "FERC has illegally deregulated wholesale electric rates. Everyone is trying to go to the most pricey markets to sell their power and so there's congestion in those markets and in those areas and, obviously, the utilities who have the transmission in those areas are not real [sic] eager to help out their competitors."[204] Hargis also blames utilities giving up control of their facilities to regional transmission operators as a cause of the lack of investment in the transmission grid.[205] Whatever the case may be, the electric industry is struggling to finance upgrades and expansions, particularly to the electric grid, needed to support the growing demand for energy. Furthermore, with mounting concerns over environmental degradation and global warming, capital is needed to support the costs of building more clean generation plants.

Private investment funds have already shown significant interest in infrastructure assets, a trend that will likely continue in the next ten years.[206] The acquisition of PacifiCorp by MidAmerican Energy Holdings Co. (MidAmerican), owned by Warren Buffett's Berkshire Hathaway, is exemplary of the type of private investment the utility industry will see more of in the future. MidAmerican's $9.4 billion acquisition of PacifiCorp produced a utility that is serving more than two million households and businesses.[207] The merger required approval from six states in which PacifiCorp operates, including Utah, Wyoming, Idaho, Washington, Oregon, and California.[208] Despite approval being required

[202] *Hearings, supra* note 197, at 134 (statement of Thomas R. Kuhn, President, Edison Electric Institute).

[203] *Losing Hold at 70*, *supra* note 68.

[204] *Id.*

[205] *Id.*

[206] The Rise of Infrastructure Funds, Collaboratory for Research on Global Projects, Mar. 22, 2006, http://crgp.stanford.edu/news/global_projects_the_rise_of_infrastructure_funds.html. Four new infrastructure funds were announced in March 2006. The Carlyle Group is raising a $1 billion fund; Dubai International and HSBC are creating a $500 million fund; the Infrastructure Development Finance Corporation (IDFC) in India is setting up a fund valued at $350–$450 million; and Macquarie Bank created a $946 million fund in a South Korea IPO. *Id.*

[207] Gail Kinsey Hill, *On Horizon: Mega-Utility Trend?*, OREGONIAN, June 24, 2005, at B1.

[208] James Van Nostrand, Presentation: State Regulation After the Repeal of PUHCA, Energy Bar Association Annual Meeting (Apr. 27, 2006) [hereinafter State Regulation Post-PUHCA] (on file with author).

from numerous public utility commissions, the transaction surprisingly closed within ten months of its announcement.[209]

Additionally, billionaire Warren Buffett pledged to spend upwards of $10 billion on development of the energy sector. "PacifiCorp needs to spend an estimated $5 billion through 2010 on transmission systems, and Berkshire Hathaway, which owns MidAmerican, is well positioned to raise the capital."[210] In fact, MidAmerican announced it was investing $69.8 million in PacifiCorp for infrastructure projects, including transmission improvements and renewable energy purchases.[211] The company pledged to spend $1 billion a year for the next five years to build new power plants and upgrade facilities, including an expansion of the current network of transmission lines.[212] More investors in the market will also provide greater stability to the industry. "A market populated with many diverse investors also means that the utility system will be more robust (less susceptible to systemic risk) and able to withstand the financial collapse of holding companies and public utilities from time to time."[213]

Moreover, there is discussion that repeal of PUHCA will also bring with it a surge of foreign investors, who are interested in the stable and steady cash flow provided by utilities. Merrill Lynch recently reported that with the weak U.S. dollar and U.S. valuations generally lower, there is a strong possibility that there will be a foreign bid for a U.S. utility in the near future.[214] However, some analysts believe the flop of ScottishPower's ownership of PacifiCorp will likely put off foreign investment.[215] ScottishPower acquired PacifiCorp in 1999, banking on the swift progress of deregulation, but instead faced price spikes in 2000 and 2001 and poor hydro power conditions in the Pacific Northwest that resulted in significant losses to the company.[216] Skeptics are also concerned that opening up the industry to foreign investment could result in countries, such as China, acquiring U.S. utilities and harming the nation's economy by meddling with the electric grid.[217] Numerous countries have passed

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[209] *Id.* The original transaction had been structured to comply with PUHCA 1935 and included linked transmission paths between the systems of MidAmerican and PacifiCorp to fulfill the geographic integration requirement of PUHCA 1935. Berkshire Hathaway's voting interest was also 9.9% (compared to its 83.75% economic interest) due to use of convertible preferred stock. *Id.*

[210] Burr, *supra* note 192, at 39.

[211] Gail Kinsey Hill & Dylan Rivera, *MidAmerican Invests $70 Million in PacifiCorp*, OREGONIAN, Nov. 30, 2006, at C2.

[212] *Id.*

[213] Melnyk & Lamb, *supra* note 8, at 21.

[214] *Merrill Lynch says European Utilities View U.S. Acquisitions Only as Plan B*, GLOBAL POWER REP., Jan. 25, 2007.

[215] *Id.*

[216] *Id.*

[217] Lynn N. Hargis, *When China Owns Our Utilities*, TRUTHOUT, June 30, 2005, http://www.truthout.org/article/lynn-n-hargis-when-china-owns-our-utilities.

laws in the past decade allowing foreign ownership of public infrastructure which was almost non-existent twenty years ago.[218]

C. *State Regulators Fill in the Blanks Post-PUHCA*

As state commissions discover the regulatory gaps created by the repeal of PUHCA, we can expect states to both exercise authority defined in PUHCA 2005, which grants them access to holding-company books and records, and recreate the PUHCA regulatory model on a state level. State commissions have expressed concerns that, post-PUHCA, there is the potential for a variety of abuses by holding companies. Some of the these abuses include utility company cross-subsidization of affiliate company transactions; diversification of utilities by investments in unrelated businesses, which could put their credit ratings at risk; improper use of utility company assets or revenue as collateral for affiliate loans; utilities and subsidiaries engaging in transfer pricing, potentially resulting in utilities being charged prices in excess of market prices for goods and services; and the use of utilities as "cash cows" to make excessive dividend payments.[219] With this in mind, there is the need for public utilities to play an active role in ensuring the protection of ratepayers and the financial integrity of utilities. In light of PUHCA repeal, the Arkansas Public Utility Commission noted that "[s]tate utility regulatory commissions must now attempt to fill the post-PUHCA regulatory gap as the primary protectors of ratepayers from abusive practices by public utilities."[220]

In response, many states have already enacted new statutes replacing regulatory oversight originally provided by PUHCA. California, Kansas, Maryland, Arkansas, and New Jersey are just a few of these states. New Jersey, in particular, enacted a statute that prohibits a holding company which owns a New Jersey electric or gas utility to invest more than 25% of its combined assets from utility and utility-related subsidiaries into investments that are unrelated to the New Jersey utility.[221] Arkansas, on the other hand, enacted new statutes to prevent cross-subsidization between regulated public utilities and non-regulated affiliates that provide non-utility services.[222] The rules prohibit utilities from providing or sharing financial resources, such as loans, extensions of credit, assumption of debt, and indemnification of affiliates, with unregulated

[218] *The Rise of Infrastructure Funds*, *supra* note 206.

[219] Gee, *supra* note 104, at 43; State Regulation Post-PUHCA, *supra* note 208.

[220] *Arkansas Commission Adopts New Rules Governing Utility Transactions With Affiliates*, ELECTRIC UTIL. WK., Dec. 25, 2006 [hereinafter *Arkansas Commission*].

[221] *New Jersey Sets Investment Restrictions on Holding Companies After PUHCA Repeal*, ELECTRIC. UTIL. WK., Aug. 21, 2006.

[222] *Arkansas Commission*, *supra* note 220. The state's distribution cooperatives and the Arkansas Electric Cooperative are exempted from this regulation. *Id.*

utilities.[223] Utilities are also restricted from incurring debt for any business other than regulated utility service in the state.[224]

Many states with "mini-PUHCA" statutes in effect prior to PUHCA repeal will continue to diligently enforce these statutes. For example, the Wisconsin Utilities Holding Company Act (WUHCA) caps non-utility investments at 25% of the total assets of the utility, requires Wisconsin utility holding companies to incorporate in Wisconsin, and requires the Public Service Commission of Wisconsin to approve an acquisition of 10% or more of a utility holding company's voting shares.[225] The asset cap provision of WUHCA requires that within three years of formation, a holding company's non-utility affiliate assets may not exceed 40% of the overall 25% allowance of non-utility investments.[226] In addition, holding companies are prohibited from operating in any manner that "materially impairs the credit of any public utility."[227]

States may also find refuge in relying more heavily on ring-fencing to protect captive customers of holding companies. Ring-fencing allows a state commission to protect regulated utilities and consumers without imposing additional barriers to investment or unnecessary regulation.[228] Essentially, ring-fencing refers to certain measures taken to insulate regulated public utilities from credit risks and corporate abuses of parent companies or affiliates within a holding company system.[229] Some examples of these measures include dividend restrictions, equity ratio requirements, unregulated investment restrictions, maintenance of stand-alone bond ratings, collateralization requirements, working capital restrictions, prohibitions on inter-company loans, prohibitions on utility asset sales, and independence of board members.[230]

As illustrated by the fall of Enron, ring-fencing works to protect subsidiaries from the actions of their parent companies. Although PUHCA was in effect at the time of the Enron and PGE merger, Enron

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[223] *Id.*

[224] *Id.*

[225] Gee, *supra* note 105, at 47.

[226] ROBERT BURNS & MICHAEL MURPHY, NAT'L REGULATORY RESEARCH INST., BRIEFING PAPER: REPEAL OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935: IMPLICATIONS AND OPTIONS FOR STATE COMMISSIONS 24 (2006) (citing § 196.795(6m)(b)(3)).

[227] *Id.* In response to the stringent requirements of WUHCA, investor-owned utilities challenged the constitutionality of the statute. The Court of Appeals for the 7th Circuit found that the provision requiring utilities be incorporated in Wisconsin violated the Dormant Commerce Clause, and was thus found unconstitutional; however, the Court upheld the other provisions of WUHCA. Gee, *supra* note 105, at 47. *See Alliant Energy Corporation, et al. v. Bie, et al.,* 330 F.3d 904 (7th Cir. 2003).

[228] *See* Gee, *supra* note 105, at 46.

[229] BURNS & MURPHY, *supra* note 226, at 6. Fitch Ratings notes that the aim of ring-fencing is "to insulate an insurer [i.e. the utility] from the credit risks of its holding company and affiliate companies." Gee, *supra* note 105, at 46 (citing U.S. UTILITIES SURVEY OF STATE PUBLIC SERVICE COMMISSIONS, FITCH RATINGS 2 (2004).

[230] Gee, *supra* note 105, at 46.

was considered an intrastate holding company, and thus exempt from PUHCA 1932 requirements.[231] The Public Utility Commission of Oregon (OR PUC) employed ring-fencing by imposing several conditions on the acquisition of PGE by Enron. These requirements provided, among other things, that PGE maintain separate preferred stock and debt ratings, PGE not make any distribution to Enron that would cause its equity to fall below 48 percent of its total capital without first obtaining approval of the OR PUC, and Enron notify the OR PUC of upstream dividend payments from PGE.[232] These ring-fencing mechanisms provided enough protection for PGE to maintain its financial integrity upon the bankruptcy of Enron. PGE did, however, experience a temporary loss of credit and constrained access to capital due to Enron's fall.[233] In sum, ring-fencing methods have proven to be successful mechanisms for state regulators to insulate regulated utilities from holding company abuses that could result in serious harms to regulated utilities, such as credit downgrading or bankruptcy.

Whether states decide to employ "mini-PUHCA" statutes or ring-fencing mechanisms to ensure holding companies are properly regulated, it is certain that regulations will vary by jurisdiction. In the wake of PUHCA repeal, states will look to each other for guidance on how to address regulatory gaps. Public utility commissions will also remain concerned about cross-subsidization, affiliate transaction abuse, and potential downgrading of credit ratings for utilities. These concerns will shape the way state commissions approach holding company acquisitions of public utilities in the future.

VII. CONCERNS OVER PUHCA REPEAL

Despite the potential benefits of PUHCA repeal, numerous consumer advocate groups, public power associations and public utility commissions have expressed serious concerns over its repeal. The APPA and Public Citizen, in particular, have repeatedly stressed that PUHCA was an important consumer protection statute that ensured effective state and federal regulation of holding companies by defining permissible structures of holding company formation.[234] Alan Richardson, president and CEO of the APPA, noted that

> [t]he Holding Company Act was passed by Congress to protect the interests of investors, consumers, and the public interest. It

[231] Enron had a "single state" exemption that required the company to incorporate in Oregon, where PGE was located; however, Enron remained headquartered in Texas. PUHCA FOR DUMMIES, *supra* note 76, at 8.

[232] Gee, *supra* note 105, at 46.

[233] *Id.*

[234] *H.R. 3406, The Electric Supply and Transmission Act of 2001: Hearing Before the Subcomm. on Energy and Air Quality of the H. Comm. on Energy and Commerce*, 107th Cong. 137–44 (2001) (statement of Alan Richardson, American Public Power Association).

> addressed abusive practices of utility holding companies that included corporate pyramiding schemes, watered stock, cross subsidies between affiliates in the same holding company, and other practices between affiliates that were destructive of competition and harmed consumers. . . . PUHCA is one of two federal statutes (along with the Federal Power Act) that provides the structural and regulatory framework for the nation's electric utility industry and the interstate, wholesale market for electricity. . . . Repeal could lead to further deterioration in system reliability.[235]

The original intent of PUHCA was to break up the unconstrained and excessively large trusts that controlled the nation's electric and gas distribution networks prior to 1935.[236] As mentioned, another feature of PUHCA was to restrict holding companies so they could only engage in business that was "essential and appropriate for the operation of a single integrated utility."[237] This eliminated the participation of non-utilities in wholesale electric power sales. PUHCA also required utilities to be geographically integrated, therefore reducing the size and geographic market of a utility.

Opponents are worried that PUHCA repeal will now enable holding companies to gamble with ratepayer money by investing in risky business ventures that could significantly downgrade utility credit ratings.[238] Utilities provide a steady flow of cash and often have captive customers, thus creating an attractive source of revenue for venture capitalists.[239] As a consequence, ratepayers would suffer higher rates because holding companies would use ratepayer returns to subsidize other businesses, yet provide little benefits to ratepayers in return.[240] When PUHCA was in effect, supporters believed that it limited executives from siphoning off utility profits and investing them in unrelated, risky business ventures that would do nothing to improve service reliability or keep rates low for ratepayers.[241] Standard & Poor's and Fitch found that PUHCA-regulated utilities maintained good credit ratings and a low cost of capital, because they were restricted from investing in riskier businesses that could

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[235] Kenneth Betz, *Repeal of PUHCA Once Again Pushed as Solution to Utility Dilemma*, SUSTAINABLE FACILITY, June 1, 2001, http://www.sustainablefacility.com/Articles/Cover_Story/8af1d00e3ce38010VgnVCM100000f932a8.

[236] ENERGY INFO. ADMIN., THE RESTRUCTURING OF THE ELECTRIC POWER INDUSTRY 12 (2000), *available at* http://tonto.eia.doe.gov/ftproot/other/x037.pdf.

[237] *Id.*

[238] Campaign for Quality Construction, National Energy Policy and Cross-Subsidization, http://www.constructionalliance.org/pdf/position_papers/CQCenergypuhca.pdf (May 2005).

[239] PUHCA FOR DUMMIES, *supra* note 76, at 5.

[240] *Id.*

[241] Press Release, Public Citizen, Dozens of Public Interest Organizations Urge Congress to Save Important Consumer Protection Act in Energy Bill (June 9, 2005), *available at* http://www.citizen.org/pressroom/print_release.cfm?ID=1965 [hereinafter Public Citizen Press Release].

downgrade their credit ratings.[242] Now that PUHCA is repealed, there is a fear that oil companies, investment banks, insurance companies, and construction firms, among others, could own and potentially exploit public utilities for the benefit of other businesses.[243]

There is also concern that the repeal of PUHCA will reduce the ability of state regulators to regulate large interstate utilities that will be formed as a consequence of PUHCA repeal.[244] Lynn Hargis of Public Citizen, Inc. notes that PUHCA "was really designed to maintain local control—to put a limit on the size of the companies. They had to operate in a single region of the country, which basically allowed state commissions to regulate them effectively."[245] By requiring a holding company to incorporate in the same state as the utility it owned, state regulators were able to monitor and regulate a holding company's finances to protect the utility.[246] PUHCA attorney Scott Hempling also notes that limiting the geographic scope of a holding company was important, "so the acquisition of utility companies [was] motivated not merely by investment goals, but also by operational improvement."[247] Since there is no longer a geographic limitation on mergers between utilities, there are ever-growing concerns that even with FERC's new access to books and records of holding companies, state utility commissions will find themselves unable to properly police anti-competitive behavior.[248] The Fitch credit rating agency also found that there are gaps and holes in some state regulatory regimes with regard to "regulating securities issuance, payment of dividends and upstream distributions, and affiliate transactions."[249] Thus, it is likely that post-PUHCA states will enact and further strengthen regulatory statutes to ensure consumer protection.

VIII. CONCLUSION

Repeal of PUHCA will result in increased merger and acquisitions activity in the electric and gas industry. However, the pace and degree of future mergers and acquisitions will be tempered by the role state public utility commissions play in merger review. State regulators have made it

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[242] *Losing Hold at 70*, *supra* note 68.

[243] Public Citizen Press Release, *supra* note 241.

[244] *Id.*

[245] *Losing Hold at 70*, *supra* note 68.

[246] PUHCA FOR DUMMIES, *supra* note 76, at 4.

[247] *Losing Hold at 70*, *supra* note 68.

[248] PUHCA FOR DUMMIES, *supra* note 76, at 2. "It is clearly impossible for a state (or even federal) utility commission, with its limited staff, to review, much less understand and control, the books and records of a huge conglomerate like ChevronTexaco or ExxonMobil. *Id.*

[249] Evan Silverstein, *PUHCA Repeal A Door Opens*, ELECTRIC PERSPECTIVES, Jan./Feb., 2006, *available at* http://findarticles.com/p/articles/mi_qa3650/is_200601/ai_n17170735.

clear that mega-mergers will not pass muster if ratepayers do not receive a hefty portion of the resulting merger benefits. Thus, merging companies will have to provide large incentives to states and ratepayers for proposed mergers to proceed.

In addition, the concerns of state commissions today are not drastically different than those identified when PUHCA was in effect. Commissions remain concerned about possible holding-company abuses including cross-subsidization of affiliate transactions and the use of utilities as "cash cows" for risky non-utility ventures that could possibly lower a utility's credit rating. Thus, state commissions are exercising long-held (but rarely used) authority, such as access to holding company books and records, to ensure consumer protection. FERC's expanded jurisdiction over holding companies under EPAct 2005 will also provide necessary oversight to ensure consumer protection, while at the same time encouraging growth and investment in utilities. FERC Chairman Joseph Kelliher noted that Congress "granted the Commission new authority to protect consumers . . . to prevent the accumulation and exercise of generation market power . . . [to impose] significant penalty authority . . . [and] to assure greater price transparency . . . ."[250] This new-found authority will enable the Commission to appropriately regulate holding companies in a post-PUHCA framework without hampering future investment in the industry, particularly for necessary infrastructure upgrades.

State public utility commissions will also continue to respond to regulatory loopholes and gaps created by the repeal of PUHCA by instituting mini-PUHCA statutes and utilizing ring-fencing mechanisms to protect utilities from the faults of their parent companies. Skeptics of PUHCA repeal, however, still worry that repeal of the law will open up a Pandora's Box of regulatory gaps and loopholes that states will be unable to monitor, in turn making it easier for companies to squander capital from utilities at the expense of consumers. Nonetheless, it is clear from the failed mergers of PSEG and Exelon and FPL and Constellation that the new regulatory scheme will make consolidation in the industry a slow and challenging process.

[250] Joseph T. Kelliher, Chairman, Fed. Energy Reg. Comm'n, Statement on PUHCA Reform (Sept. 21, 2005), *available at* http://www.ferc.gov/news/statements-speeches/kelliher/2005/09-21-05-kelliher-puhca.pdf.