Calendar No. 584

104TH CONGRESS *2d Session*	SENATE	REPORT 104–365

THE PUBLIC UTILITIES HOLDING COMPANY ACT OF 1996

R E P O R T

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 1317

SEPTEMBER 9, 1996.—Ordered to be printed

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THE PUBLIC UTILITIES HOLDING COMPANY ACT OF 1996

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Mr. D'AMATO, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

[To accompany S. 1317]

The Committee on Banking, Housing, and Urban Affairs, to which was referred the bill (S. 1317) to repeal the Public Utility Holding Company Act of 1935, to enact the Public Utility Holding Company Act of 1995, and for other purposes, having considered the same, reports favorably thereon with an amendment in the nature of a substitute and recommends that the bill (as amended) do pass.

INTRODUCTION

On June 26, 1996, the Senate Committee on Banking, Housing, and Urban Affairs met in legislative session and marked up and ordered to be reported S. 1317, a bill to repeal the Public Utility Holding Company Act of 1935 ("PUHCA") and to enact the Public Utility Holding Company Act of 1996, and for other purposes, with a recommendation that the bill do pass, with an amendment in the nature of a substitute. The Committee's action was taken by a voice vote. Senators Bryan, Moseley-Braun, and Murray asked to be recorded as voting in the negative.

HISTORY OF THE LEGISLATION

The Public Utility Holding Company Act of 1996, S. 1317, was introduced on October 12, 1995 by Senators D'Amato, Dodd, Murkowski, Johnston, Shelby, Mack, Faircloth, Dole and Lott. Senators Cochran, Heflin, Akaka, Coverdell, Inouye, Warner, Coats, Grams and Bennett were added as cosponsors. The bill has two purposes: first, to repeal the Public Utility Holding Company Act of 1935; and second, to put in place a new, less pervasive regulatory struc-

ture that allows for greater diversification in the utility industry while ensuring that utility customers do not pay for diversification through increased energy rates.

The full Committee conducted a legislative hearing on S. 1317 on June 6, 1996. The Committee received testimony from: Senator Frank H. Murkowski, Chairman of the Senate Committee on Energy and Natural Resources (the "Energy Committee"); Senator J. Bennett Johnston, Ranking Member of the Energy Committee; the Honorable Elizabeth A. Moler, Chair, Federal Energy Regulatory Commission (the "FERC"); Barry P. Barbash, Director, Division of Investment Management, Securities and Exchange Commission (the "SEC"); Robert W. Gee, Chairman, Electricity Committee, National Association of Regulatory Utility Commissioners (the "NARUC"); E. Linn Draper, Jr., Chairman, President & CEO, American Electric Power Company; Ronald J. Tanski, Vice President and General Counsel, National Fuel Gas Company; Lloyd Levitin, Former Chief Financial Officer, Pacific Enterprises; John Hughes, Executive Director for Technical Affairs, Electricity Consumers Resource Council (on behalf of Coalition for Customer Choice in Electricity, "ELCON"); and Larry Frimerman, Federal Liaison, Ohio Consumers' Counsel (on behalf of National Association of State Utility Consumer Advocates, "NASUCA"). The American Gas Association also submitted testimony.

Additional comments, suggestions, and assistance in considering and evaluating the legislation were received from the State regulators, the staff of the Energy Committee, the SEC, the FERC, and other private and public individuals.

PURPOSE AND SUMMARY

The bill reported by the Committee has two purposes: the legislation would repeal PUHCA, streamlining regulation and eliminating unnecessary duplication, thus facilitating competition in the energy industry. PUHCA no longer serves its original purpose of restructuring the energy industry and protecting investors and consumers from holding company abuses. The nature of the utility industry has changed, the state and federal governments have implemented regulatory controls, and Congress has enacted federal energy laws and federal securities laws—all of which more than adequately protect consumers and utility rate payers. In light of these developments, PUHCA has become obsolete.

The Committee recognizes that repealing PUHCA not only streamlines regulation, but also takes the necessary first step in creating true competition in the electricity industry. As Senator Johnston testified at the Committee's hearing on repealing PUHCA: "the transition to competitive retail markets will be hindered and more costly unless PUHCA is repealed as a first step down the restructuring road * * * true and fair retail completion will be thwarted without PUHCA repeal." [1] The Committee believes

[1] Testimony of Senator J. Bennett Johnston, Hearing on the Public Utility Holding Company Act of 1995: Senate Committee on Banking, Housing and Urban Affairs, June 6, 1996 at 2.

Senator Johnston also testified that without PUHCA repeal "efforts by the States to implement retail competition, such as those in New York, California, Rhode Island, New Hampshire and others, will be frustrated." (Testimony of Senator J. Bennett Johnston, *Id.* at 4.)

that the debate on comprehensive energy reform should be reserved for the Energy Committee, the FERC, and the states.

Perhaps most importantly, S. 1317 would provide for additional consumer protections. Most critical to consumer protection, the bill would enhance regulatory oversight of the ratemaking process. The Committee believes that the regulators must be able to ensure that consumers pay only for costs associated with utility services. S.1317 would augment the existing ratemaking authority of Federal and State energy regulators. This authority would allow regulators to review the records of utility transactions in order to protect ratepayers from unfair rate increases and any abusive practices.

The bill would also allow the FERC and the states to more effectively protect ratepayers by addressing a problem created by the decision of the Court of Appeals for the District of Columbia Circuit Court in *Ohio Power Company* v. *FERC*[2] (*"Ohio Power"*). The court in *Ohio Power* held that the FERC did not have authority to regulate certain costs in setting utility rates when those costs had previously been approved by the SEC and put into question the states' authority in this area. S. 1317 would remove the SEC from the ratemaking process and it would restore the FERC's (and implicitly the states') full ratemaking authority.

Finally, S. 1317 would ensure that regulators have the necessary authority to protect consumer rates by granting the FERC and the state public service commissions the authority to review a holding company's books and records, to the extent necessary to review rates. The legislation would give the FERC and state public service commissions access to books and records of all utility holding companies, their associates, affiliates, and subsidiaries, that are relevant to the determination of rates.[3] The bill also contains an enforcement mechanism to ensure that the state commissions will be able to implement this newly expanded books and records review authority.

PURPOSE AND SCOPE

Background

The "unregulated" energy industry

In the early 1900's utility holding companies expanded rapidly—"fueled" by growth in the electric and gas industries and financing from Wall Street.[4] As a result of this rapid growth, industry power was concentrated among a handful of large interstate holding company systems.[5] In the late 1920's, at Congress's request, the Federal Trade Commission ("FTC") undertook an extensive study of the public utility industry. At the conclusion of this seven year study, the FTC published a 107 volume report. The FTC report was followed by a second, two-year Congressional study. Both these studies uncovered a myriad of utility industry abuses facilitated by

[2] *Ohio Power Company* v. *FERC,* 954 F.2d 779 (D.C. Cir. 1992).

[3] These provisions augment the existing books and records authority of both the FERC (as contained in the Federal Power Act, 16 U.S.C. 825) and the state commissions.

[4] SEC Study, Regulation of Public Utility Holding Companies, Division of Investment Management, June 1995 ("SEC Study") at 1.

[5] *Id.* at 3.

the holding company structure, such as the issuance of securities based on unsound assets, mismanagement and exploitation of subsidiaries, interaffiliate dealing, and the use of the holding company structure to evade effective regulation.[6]

The studies found that the utility holding companies' pyramidal corporate structure facilitated most of the industry abuses. Holding companies bought other holding companies—creating up to 10 layers of ownership between the utility subsidiary and its holding company. Since it was difficult to determine the true assets and liabilities of the company, this structure greatly increased the speculative nature of the holding companies securities. The holding companies manipulated market rates for their securities and inflated their capital structure by forcing subsidiaries to buy supplies from affiliates at exorbitant above market prices. The holding company structure made it virtually impossible to trace these abusive interaffiliate transactions. As a result of the abuses, investors were defrauded, subsidiary companies were forced to pay excessive prices for services, and in the end, energy prices were grossly inflated.

States were unable and ill-equipped to regulate these multistate holding companies effectively. At that time, many states did not have a utility-related regulatory structure in place and the Supreme Court considered state regulation of multistate holding companies a violation of the Commerce Clause of the Constitution.[7]

The new regulatory regime—The Public Utility Holding Company Act of 1935

Congress enacted the Public Utility Holding Company Act ("PUHCA") in 1935 to remedy these holding company abuses. First, PUHCA mandated the simplification of the utility holding company structure. The breakup of the mammoth holding company systems was achieved by imposing an "integration requirement," which limited holding companies to owning only energy and energy-related companies in discrete geographic areas.

Second, PUHCA gave the SEC authority to oversee these companies.[8] Under this regulation, holding companies with multistate utility operations were required to register with the SEC and thus become subject to the full panoply of regulation imposed by PUHCA.[9] Prior SEC approval was required for certain corporate transactions engaged in by registered holding companies such as:

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[6] *Id.* at 3.

[7] *Id.* at 2.

[8] *Id.* at 7.

The Congress determined that the SEC should oversee holding companies and PUHCA since the agency had "expertise in financial transactions and corporate finance." *Id.* at 7.

[9] *Id.* at 7–8.

The companies are referred to as "registered utility holding companies" since they come within the purview of PUHCA. Currently there are 15 such registered utility companies. There are 12 registered electric holding companies: Allegheny Power System, American Electric Power Company, Central and South West Corporation, CINergy Corporation, Eastern Utilities Associates, Entergy Corporation, GPU Corporation, New England Electric System, Northeast Utilities, PECO Energy Power Company, The Southern Company, and Unitil Corporation. Also, there are three registered gas companies: Consolidated Natural Gas Company, National Fuel Gas Company, and Columbia Gas System.

PUHCA allowed the SEC to conditionally exempt from all provisions of the Act, except those governing utility acquisitions, certain holding companies which are "predominately intrastate in character and carry on their business substantially in a single state." 15 U.S.C. Sec. 79c(a)(1). These companies are referred to as "exempt utility holding companies". There are currently approximately 150 exempt utility holding companies.

securities issued, utility assets acquired, and some merger activities; and restrictions against interaffiliate loans and diversification into non-utility businesses were imposed. PUHCA also subjected registered holding companies to extensive reporting and accounting requirements.

The studies begin a twenty year debate on PUHCA

Congress has debated the issue of PUHCA reform for nearly twenty years. The industry, the regulators, the Congress, and consumer and environmental protection groups agree that the SEC has completed its task—assigned over sixty years ago—of simplifying the utility holding company structure and that many of the remaining PUHCA provisions duplicate other Federal or state laws or are unduly burdensome.

In 1932—three years before PUHCA became law—thirteen large holding companies controlled 75% of the electric utilities while eleven companies held over 80% of the gas pipelines.[10] Currently there are only 12 registered electric utility holding companies and 3 registered gas utility holding companies which together, at the end of 1993, owned only 19% of all investor-owned utility assets.[11] The remaining exempt gas and electric utility holding companies own over half of all such utility assets.

In 1977, the General Accounting Office (the "GAO") issued a report on the SEC's enforcement of PUHCA.[12] The GAO initiated the report in response to an inquiry from Congressman John Dingell, then Chairman of the Subcommittee on Energy and Power of the House Committee on Interstate and Foreign Commerce. The GAO reported that many of PUHCA's objectives had been met by the SEC's actions to reorganize and simplify the pyramidal corporate structures and that, as a result, financial conditions in the gas and electric utility industries had become more stable. Recognizing that Congress may need to reform PUHCA, the GAO included in its recommendations that the SEC undertake a complete study on PUHCA. [13]

The SEC recommended to Congress in 1981 that Congress repeal PUHCA: "on the basis that the reorganization of holding companies contemplated under [PUHCA] had been completed and that the remaining provisions were either duplicative of other regulatory schemes or no longer necessary to prevent the abuses that led to enactment of [PUHCA]." [14] Senator D'Amato, then Chairman of the Securities Subcommittee of the Banking Committee, and Senator Johnston, then Ranking Member of the Energy Regulation Subcommittee of the Energy Committee, acted on the SEC's recommendation by introducing three separate bills to reform PUHCA. These measures sparked Congressional debate on PUHCA

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[10] CRS Report 93–266 A. *The Public utility Holding Company Act of 1935: Legislative History, Background and Recent Amendments*, at 2.

[11] SEC Study, *supra* note 4, at vii; *see also,* note 9, *supra.*

[12] Report to the Congress "The Force of The Public Utility Holding Company Act has Been Greatly Reduced by Changes in the Securities and Exchange Commission's Enforcement Policies," FGMSD–77–35, June 20, 1977.

[13] *Id.* at 16–17.

[14] CRS Report, *supra* note 10, at 15.

reform.[15] Senator D'Amato set the tenor of the debate in his statement introducing the legislation on the Senate floor. He said that PUHCA reform was necessary because: "the Public Utility Holding Company Act is a major impediment to meaningful attempts to improve the economic well-being of the utility industry." [16]

In 1983, the GAO responded to the SEC's recommendations and to Senator D'Amato and Johnston's legislation by issuing yet another report on PUHCA. In this report, the GAO agreed that a number of PUHCA's provisions duplicated other laws. The GAO also identified regulatory gaps that would occur if PUHCA were repealed. For example, the report cited "approvals of acquisitions and financing of holding companies and the review of cost allocations between holding companies and their service companies and utility subsidiaries" as areas in which PUHCA provided the only authority for regulation. The GAO also cited the concerns of state regulators regarding their ability to regulate utility holding companies.[17] The Committee convened a hearing regarding PUHCA reform on June 14 and 15, 1983, but took no further action during that legislative session.

During the 20 year debate on PUHCA reform, Congress successfully enacted piecemeal amendments to the Act to respond to the changing dynamics of the energy industry. For example, in 1978, Congress adopted the "Public Utility Regulatory Policies Act" to exempt certain new energy generation facilities from PUHCA regulation. In 1992, Congress enacted the "Energy Policy Act" to amend PUHCA and encourage competition in the wholesale energy market. In 1995, Congress enacted the "Telecommunications Act," which included a provision to encourage competition in the new telecommunications industry by allowing registered holding companies to establish exempt telecommunications subsidiaries. While Congress created limited opportunities for utility holding company diversification with these amendments to PUHCA, it has not yet had the opportunity to accomplish comprehensive reform of the Act itself.

Recent SEC study triggers committee action

In 1994, the SEC began a comprehensive study of PUHCA. The study considered the effectiveness of the SEC's administration of PUHCA and examined initiatives for modernizing PUHCA in light of changes in the energy industry. In June 1995, the SEC's Division of Investment Management published a comprehensive report on the findings of the study, including the history of PUHCA, subsequent administrative and legislative changes to PUHCA, and the energy industry in general.

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[15] In 1981, three measures were introduced by Senators D'Amato and Johnston regarding PUHCA: S. 1869, a bill to amend the Public Utility Holding Company Act of 1935 to simplify its administration and to remove restrictions no longer necessary to the protection of investors and consumers; S. 1870, a bill to amend the Public Utility Holding Company Act of 1935 to improve financial performance in the electric and gas utility industries by removing unnecessary impediment to the exercise of sound and prudent business judgement by utility executives; and S. 1871 a bill to amend section 2 of the Public Utility Holding Company Act of 1935. (November 19, 1981, Congressional Record at 28357)

[16] Statement of Senator Alfonse D'Amato, November 19, 1981, Congressional Record at 28357.

[17] Analysis of SEC's Recommendation to Repeal the Public Utility Holding Company Act, General Accounting Office, GAO/RCED–83–118, August 30, 1983, at i–v.

The SEC report concluded that PUHCA has accomplished its basic purpose of protecting investors, simplifying the utility industry and preventing industry abuses. The report further concluded that PUHCA, in many respects, either duplicated other state or federal regulation or was no longer necessary to prevent the recurrence of the abuses that led to the statute's enactment.[18] Although the SEC had first made this same finding in 1981, in the 1995 report the SEC examined more closely the effect of PUHCA repeal on the FERC and states' ability to continue to protect consumers.

The SEC report recommended that Congress repeal PUHCA (subject to certain conditions) since "the current regulatory system imposes significant costs, in direct administrative charges and foregone economies of scale and scope, that often cannot be justified in terms of benefits to utility investors."[19] The SEC recommended that Congress retain certain PUHCA provisions, noting that otherwise consumers could be exposed to some of the same abuses that PUHCA was enacted to prevent. As SEC Chairman Arthur Levitt cautioned: "as long as electric and gas utilities continue to function as monopolies, the need to protect against the cross-subsidization of non-utility operations will continue to exist * * * the best means of guarding against cross-subsidization is likely to be thorough audits of books and records and federal oversight of affiliate transactions."[20]

The legislation reforming PUHCA

The 1935 act has become ineffective and burdensome

Although the SEC recommended that Congress enact certain safeguards to protect consumers, it also outlined many of the ways PUHCA's burdensome regulation unnecessarily restricts the growth of the registered holding companies, the hundreds of exempt companies, and free-standing utility companies. As the SEC report illustrates, developments in other areas of the law have rendered PUHCA obsolete. For example, PUHCA requires that holding companies make frequent disclosures and statements to the SEC. While these safeguards may have been necessary in 1935, the SEC can effectively protect investors through disclosures required under the Securities Act of 1933 and the Securities Exchange Act of 1934. PUHCA requires that the SEC review many acquisitions and mergers of utility and holding companies. The FERC also has jurisdiction to review and approve these transactions and in practice, the SEC generally defers to the FERC's decisions on competition issues.[21] PUHCA restricts holding companies from owning utility

[18] SEC Study, *supra* note 4, at 128–133.

[19] SEC Study, *supra* note 4, at x.

[20] Statement of Arthur Levitt, Chairman, the Securities and Exchange Commission, Hearing regarding the Regulation of Public Utility Holding Companies: Subcommittee on Telecommunications and Finance and Subcommittee on Energy and Power, Committee on Commerce, House of Representatives, August 4, 1995 at 6.

[21] Most State commissions also have the authority to prevent mergers that are not in the "public interest." Thirty-three of forty-three State commissions responding to an SEC survey indicated that they have jurisdiction over utility mergers. Thirty responded that they regulate the acquisition of utility assets. (Written response to questions, Barry P. Barbash, Director, Division of Investment Management, Securities and exchange Commission, Hearing on the Public Utility Holding Company Act of 1995: Senate Committee on Banking, Housing and Urban Affairs, June 6, 1996 at 2.)

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subsidiaries that are not in the same geographic area. The Committee heard testimony that the integration requirement is now outdated and a barrier to the production of efficient energy.[22] Anticompetitive concerns may be dealt with under the Federal antitrust laws and the FERC's assessment of market power concerns during its merger and acquisition review.[23]

The Committee considered the SEC report and agreed with its conclusion that: "[g]iven the developments in the industry and in other regulatory regimes, a less structural, more targeted regulatory approach now seems appropriate."[24] In crafting the Public Utility Holding Company Act of 1995, the Committee followed the SEC's recommendations to conditionally repeal PUHCA subject to certain conditions. Mindful that consumers need protection from unfair rates, the Committee strengthened the ability of Federal and state regulators to protect consumers from unfair rate increases. S. 1317 would address any regulatory gaps opened up by PUHCA repeal so that regulators would have ample authority to protect consumers.

The SEC testified before the Committee, "Senate Bill S. 1317 largely implements the [legislative] option recommended by the SEC, by providing the FERC and the state regulators with broad authority to inspect books and records of companies in holding company systems."[25] NARUC testified that this legislation is "an approach most consistent with the NARUC's policy position adopted in March 1995."[26]

Protecting consumers from paying unfair rates

During the Committee's consideration of PUHCA repeal, the regulators, consumers, and industry groups identified as their primary

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The review of mergers and acquisitions by the FERC and the states make PUHCA's merger and acquisition review provisions unnecessary. In addition, the diversification provisions of PUHCA are also unduly burdensome on both registered holding companies, exempt holding companies and the energy industry in general. As the SEC report concludes: "the [non-utility] diversification restriction limits the ability of other companies to enter the utility business. There may be many companies involved in manufacturing, energy, finance, telecommunications or other businesses that would be interested in diversifying into the utility industry. There may be substantial economies to be achieved by allowing these companies to acquire and operate utilities." (SEC Study, *supra* note 4, at 132–133.)

[22] In 1935, Congress believed that this "integration requirement" would improve regulation. For example, PUHCA prevents exempt holding companies from expanding and investing—exempt holding companies cannot diversify or acquire utilities interstate without falling under PUHCA's restrictive registration provisions. Senator Johnston testified before the Committee about the burden that the geographic limitations impose: "PUHCA's out-dated geographic restrictions don't just apply to a few large companies here and there. These geographic restrictions directly circumscribe the investment options of 75–80 percent of the investor-owned utility industry." (Testimony of Senator J. Bennett Johnston, *supra* note 1, at 2.)

[23] The SEC report commented that "the SEC's review of the potential anti-competitive effects of utility acquisitions parallels review by the Department of Justice and Federal Trade Commission under the federal antitrust laws" (protections are contained in the Hart-Scott-Rodino, Sherman, and Clayton Acts). (SEC Study, *supra* note 4, at 130.)

FERC Chair Elizabeth Moler testified that the FERC considers the effect of the mergers or acquisitions on rates and competition. "Market power, which falls under effect on competition, is one of the most important factors in analyzing mergers, acquisitions and disposition of facilities." (Written response to questions, Elizabeth Moler, Chair, Federal Energy Regulatory Commission, Hearing on the Public Utility Holding Company Act of 1995: Senate Committee on Banking, Housing and Urban Affairs, June 6, 1996 at 2.)

[24] SEC Study, *supra* note 4, at 133.

[25] Testimony of Barry Barbash, Director, Division of Investment Management, Securities and Exchange Commission, Hearing on the Public Utility Holding Company Act of 1995: Senate Committee on Banking, Housing and Urban Affairs, June 6, 1996.

[26] Testimony of Robert Gee on behalf of NARUC, Hearing on the Public Utility Holding Company Act of 1995: Senate Committee on Banking, Housing and Urban Affairs, June 6, 1996 at 2.

concern that repeal could provide utility companies with the opportunity to finance diversification by increasing energy rates to utility customers. According to these groups, the parent holding company could fund the operation of its non-utility subsidiaries and its diversification through affiliate transactions. The parent company would then be able to subsidize such non-utility transactions and consumers would end up paying for the transaction through higher rates.[27]

Representatives from ELCON and NASUCA testified to the Committee that repeal of PUHCA before deregulation of the entire utility industry could lead to consumers paying for non-utility diversification. John Hughes for ELCON testified that preapproval or arms-length dealing was the best way to prevent unfair affiliate transactions.[28]

Larry Frimerman, testifying for NASUCA, elaborated that: "[i]f PUHCA were repealed or substantially modified, neither the remaining regulatory framework nor the current state of competition would be sufficient to protect consumers. Effective regulation must retain both rate and structural reviews, with a rational allocation of responsibility between state and federal regulators. [T]here are substantial gaps and variations in existing state regulation of multi-state holding companies. These gaps would need to be filled, and current regulatory problems created by the *Ohio Power* and *Mississippi Power & Light* Court decisions would need to be corrected prior to Congressional consideration of removal of any PUHCA protections."[29]

The Committee considered how to best ensure that the FERC and state regulators would be able to prevent the funding of non-utility investments through utility rates and other unfair affiliate transactions. The Committee followed the regulators' recommendations to prevent unfair rates. To enable the FERC and the States to best protect consumers, the legislation would improve the regulators' ability to determine whether a public utility company may recover in rates costs associated with affiliate transactions. According to the FERC's testimony before the Committee, S. 1317 would give the FERC authority to protect registered system ratepayers against these abusive affiliate contracts.[30] NARUC testified that S.

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[27] ELCON testified to the Committee that "[t]he concern here is that the potential for self dealing, unfair cost allocation, and cross subsidization between regulated and unregulated affiliates to the detriment of the captive ratepayers of the regulated affiliate * * *. No captive ratepayers of a regulated entity—whether they be residential, small business, or large industrial consumers—should ever be forced to subsidize the unregulated, diversified investments of the regulated entity's parent company or any unregulated affiliate. (Testimony of John Hughes on behalf of ELCON, Hearing on the Public Utility Holding Company Act of 1995: Senate Committee on Banking, Housing and Urban Affairs, June 6, 1996, at 7.)

NASUCA testified to the Committee that "[n]o cost associated with an off-system investment, or with regulating such an investment to protect captive customers, should be borne by ratepayers. (Testimony of Larry Frimerman on behalf of NASUCA, Hearing on the Public Utility Holding Company Act of 1995; Senate Committee on Banking, Housing and Urban Affairs, June 6, 1996 at 7.)

[28] ELCON testified that "[a]ll transactions between unregulated and regulated affiliate must be at arm's length and subject to regulatory oversight." Testimony of John Hughes, *Id.* at 7.

[29] Testimony of Larry Frimerman, *supra* note 27.

[30] Testimony of Elizabeth Moler, Chair, Federal Energy Regulatory Commission, Hearing on the Public Utility Holding Company Act of 1995: Senate Committee on Banking, Housing and Urban Affairs, June 6, 1996 at 8–9.

Chair Moler also testified that "the new Act would recognize the affiliate abuse protections under otherwise applicable law. These changes, in conjunction with greater access to books and records, would give the FERC broader authority than it now has to protect public utility rate-

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1317 would "greatly assist State commissions' efforts to protect customers of multi-state electric utility holding companies from potential abuses. By ensuring the State's ability to access multi-state holding company books and records, audit multi-state holding companies and regulate affiliate transactions within a holding company system, States will be able to effectively meet the challenge of protecting customers from abusive practices." [31]

To further guard against potential affiliate abuse, the SEC suggested in its testimony to the Committee that legislation include authority for the FERC to preapprove affiliate transactions to ensure that public utilities do not subsidize non-utility companies. The Committee, however, intends this legislation to allow diversification and promote competition with only necessary barriers to entry. The Committee believes that preapproval of affiliate transactions would not be necessary and would only be burdensome to both the holding companies and to the FERC. FERC Chair, Elizabeth Moler, assured the Committee that: "cross-subsidization can most effectively be addressed as a rate issue. The [Federal Energy Regulatory] Commission does not need new regulatory powers to protect consumers from cross-subsidization of non-utility business if PUHCA is repealed and S. 1317 is enacted." [32]

The Committee accepted the FERC's assurance that it could protect consumers through the ratemaking process. Consequently, the Committee did not include a provision requiring preapproval of affiliate transactions. In the final analysis, the SEC concurred with the Committee, stating in a letter to Chairman D'Amato: "Insofar as the FERC will succeed to the SEC's regulatory authority over utility holding company systems, the final decision whether broader authority is desirable should be made in consultation with [the FERC]." [33]

Closing the Ohio Power gap

In order to ensure that the FERC and states have unqualified authority to disallow costs associated with certain affiliate transactions, S. 1317 would solve the regulatory conundrum caused by a 1992 Court of Appeals decision, in *Ohio Power Company* v. *FERC,* 954 F.2d 779 (D.C. Cir. 1992). In *Ohio Power,* the court held that the SEC's approval of costs associated with an affiliate transaction under PUHCA preempted the FERC's determination of whether costs related to that transaction should be included in rates. As a result of *Ohio Power,* the FERC must currently allow costs approved by the SEC to be passed on to consumers through increases in utility rates even if those costs exceed market value.

The Committee also heard testimony from the state regulators that *Ohio Power* could be interpreted in the future to preempt the states' ability to disallow unfair costs being passed on to consumers. Chairman Robert Gee of NARUC testified at the Committee's

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payers against affiliate abuses. The changes would permit the FERC to protect ratepayers against affiliate abuses. The changes would permit the FERC to protect ratepayers in all types of electric and gas holding company systems and provide addition access to books and records to monitor affiliate abuse. (Testimony of Elizabeth Moler, *Id.* at 17.)

[31] Testimony of Robert Gee, *supra note 26,* at 6.

[32] Responses to written questions, Elizabeth Moler, *supra* note 23, at 3.

[33] June 25, 1996 letter from SEC Chairman Arthur Levitt to Chairman D'Amato.

hearing about possible future effects of *Ohio Power* on state authority:

> [The *Ohio Power*] decision clearly threatens State regulation concerning the costs of interaffiliate transactions sought by the utility to be recovered in retail rates. Accordingly, the NARUC strongly believes that the costs of all non-power transactions between holding company affiliates be subject to review by the appropriate State and Federal ratemaking authority * * * Legislation should therefore clarify States' unrestricted authority over affiliate transactions.[34]

S. 1317 would address the *Ohio Power* problem by increasing the energy regulators' ability to protect consumers. S. 1317 would eliminate the *Ohio Power* regulatory gap by eliminating PUHCA and the conflicting jurisdiction over ratemaking between the SEC and the FERC. The legislation would explicitly grant authority to state and federal regulators so that the regulator overseeing the ratemaking function has the final say as to whether costs associated with an affiliate transaction may or may not be fairly passed on to consumers.

Expanding the regulators' access to company books and records

The Committee heard testimony from the regulators that the most important tool for regulators to keep companies from passing on non-utility costs to ratepayers is sufficient access to company books and records.

The SEC recommended that if PUHCA were repealed "Congress [must] ensure state access to books and records, and provide for federal audit authority and oversight of affiliate transactions."[35] FERC Chair Elizabeth Moler testified about the regulators' need for additional books and records authority: "The best way to protect consumers from subsidizing non-utility related activities is to * * * ensure that Federal and State rate regulators have sufficient authority, when necessary to protect ratepayers, to inspect the books and records of jurisdictional utilities and gas companies, any holding company of which that utility or gas company is a member, and any associate company within the holding company system."[36]

To address the regulators' concerns about books and records, the Committee included in S. 1317 provisions to strengthen the regulators' authority to obtain records of all the companies in a holding company system.[37] Section 5 of S. 1317 permits the FERC to examine all books and records of a holding company and each of its subsidiaries and affiliates relevant to costs incurred by a utility com-

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[34] Testimony of Robert Gee, *supra* note 26, at 3–4.

[35] SEC Study, *supra* note 4, at 133–134.

[36] Written responses to questions, Elizabeth Moler, *supra* note 23, at 1.

FERC currently has authority to access books and records of utility companies. S. 1317 would clarify this existing authority to ensure that it has full access to all companies in a holding company system.

[37] The legislation would give the FERC additional authority to access books and records of all companies in a holding company system. The FERC raised a concern at the Committee's hearing that S. 1317 not be construed to limit existing FERC authority in any way. The Committee clarifies in section 9 of the legislation that access would supplement the FERC's existing ratemaking authority under section 301 of the Federal Power Act and section 8 of the National Gas Act.

pany and as "necessary or appropriate for the protection of utility customers."

The Committee believes that State regulators must also have access to records of all companies in a holding company system in order to set rates, allocate costs, and guard against potentially abusive affiliate transactions.

According to the SEC study, many States are unable to readily obtain the books and records of an out-of-state company.[38] The groups representing manufacturers and consumers who testified before the Committee raised concerns about the State commissions' inability to regulate the out of State utility operations of multistate companies. The Committee addressed these concerns in the legislation. Section 6 of S. 1317 would grant to State commissions access to all the books and records of every company in a holding company system, no matter where that company is located, to the extent that the State commissions need such access to set consumer retail rates of a public utility in its jurisdiction. S. 1317 also allows any Federal district court in a state to enforce that State commissions access to company books and records.

The Chairman of the State regulatory commission group, NARUC, Robert Gee, testified to the Committee that the books and records provision of S. 1317: "would greatly assist State commissions' effort to protect customers of multistate electric utility holding companies from potential abuses. By ensuring the States' ability to access multistate holding company books and records, audit multistate holding companies and regulate affiliate transactions within a holding company system, States will be able to effectively meet the challenge of protecting customers from abusive practices." [39]

NARUC also indicated to the Committee that it was concerned that S. 1317's effective date of 1 year from the enactment of the statute would not provide sufficient time for States' to implement the books and records provision. "This deadline may not be sufficient to allow State commissions to obtain necessary authorities from their respective legislatures to 'fill gaps' created by the Act's repeal." [40] As a result of these concerns, and to assure the continued protection of ratepayers, the Committee lengthened the effective date to 18 months after enactment. The Committee believes this additional time will afford each state legislature and commission time to implement the books and records provision.[41]

A level playing field for all

Among other things, the Committee intends for this legislation to put all utility companies on a level playing field. This left the Committee to deal with the question of how to treat the formerly exempt holding companies. FERC Chair Moler suggested in her testimony to the Committee that legislation to repeal PUHCA include only narrow exemption provisions—which would grandfather previously approved activities and transactions but not exempt holding

[38] SEC Study, *supra* note 4, at 134.
[39] Testimony of Robert Gee, *supra* note 26, at 6.
[40] June 13, 1996 letter from NARUC to Chairman D'Amato.
[41] A June 20, 1996 memo to the Committee staff from NARUC staff indicates that all but one of the State legislatures will meet next year.

companies from affiliate abuse oversight.[42] The NARUC testified to the Committee that the exemption provision should "ensure that all utility holding companies are subject to comparable regulatory treatment regardless of corporate form." In particular, NARUC asserted that access to books and records should "apply to *all* holding companies, whether currently regulated or exempt."[43]

The Committee agrees with the regulators that all holding companies should be subject to similar regulation. As a result, S. 1317 would allow a company to continue to engage in all activities and transactions in which it may currently engage. Further, all transactions and companies in the holding company system—whether currently registered or exempt—would be subject to the newly expanded Federal books and records provisions, unless the FERC finds that a transaction is not relevant to its ratemaking jurisdiction.

Companies that are holding companies only because they own any of three specialized energy companies (Exempt Wholesale Generators ("EWGs"), Foreign Utility Holding Companies ("FUCOs"), and/or Qualified Facilities ("QFs")) are exempted from the books and records provision of S. 1317. The Committee recognized that these companies have no traditional utility affiliate companies so there is no possibility of affiliate abuse and no need for FERC access to affiliate books and records. However, if any of these companies acquires a traditional utility affiliate, it would lose its exemption.

SECTION-BY-SECTION ANALYSIS OF S. 1317: "THE PUBLIC UTILITY COMPANY ACT OF 1996"

Section 1. Short title

Section 1 provides that S. 1317 may be cited as the "Public Utility Holding Company Act of 1996."

Section 2. Findings and purposes

Section 2 sets out the findings and purposes of the Act. The "findings" of the Act state that the constraints placed on holding company systems by the Public Utility Holding Company Act of 1935 are no longer relevant but that there is continuing need for limited Federal and State regulations to protect the ratepayers of electric utilities and natural gas companies. The "purpose" of the Act is to eliminate unnecessary regulation through repeal of the Public Utility Holding Company Act of 1935, while facilitating effective State and Federal rate regulation, by assuring access to holding company system books and records that are relevant to setting utility rates.

Section 3. Definitions

Section 3 defines the terms used in the Act. The definitions of "affiliate," "associate company," "company," "electric utility company," "gas utility company," "holding company," "public utility company," "state commission," "subsidiary company" and "voting security" are taken from the definitions in section 2 of the Public

[42] Testimony of Elizabeth Moler, *supra* note 30, at 3.
[43] June 13, 1996 letter from NARUC to Chairman D'Amato (*emphasis added*).

Utility Holding Company Act of 1935, 15 U.S.C. §79b(a). The Act preserves the "10 per cent or more" threshold used by the 1935 Act to define a "holding company" and a "subsidiary company". As in the 1935 Act, the alternative definition for these two terms (the "controlling influence" test) is also used.

The terms "exempt wholesale generator" and "foreign utility company" have the same meaning as in sections 32 and 33, respectively, of the 1935 Act as those sections existed on the day before the effective date of this Act. These terms were added to the 1935 Act by title VII of the Energy Policy Act of 1992.

The terms "jurisdictional rates", "natural gas company" and "public utility" are taken from the Natural Gas Act and the Federal Power Act. Specifically, the term "natural gas company" tracks the language of section 2(6) of the Natural Gas Act, 15 U.S.C. §717a(6). The term "public utility" tracks that of Section 201(e) of the Federal Power Act, 16 U.S.C. §824(e). The term "jurisdictional rates" is intended to encompass the full ratemaking jurisdiction of the Federal Energy Regulatory Commission's authority to set rates under the Federal Power and Natural Gas Acts.

Section 4. Repeal of the Public Utility Holding Company Act of 1935

Section 4 repeals the 1935 Act, effective 18 months after the date of enactment of this Act.

Section 5. Federal access to books and records

Section 5 provides the Federal Energy Regulatory Commission authority to inspect such books and records of holding companies, associate companies, subsidiary companies and affiliate companies as the Commission deems relevant to its ratemaking responsibilities under the Federal Power and Natural Gas Acts. To this end, companies are required to maintain and make available to the Commission such books, accounts, memoranda and other records as the Commission deems relevant to rate setting. The Commission's authority under this section supplements its authority over books and records under the Federal Power and Natural Gas Acts.

This section imposes a confidentiality requirement taken from the confidentiality requirement in section 301(a) of the Federal Power Act. Consistent with current practice under the FPA, except as may be directed by the Commission or the courts, no member, officer, or employee of the Commission may divulge facts or information obtained during the course of examinations authorized under this section.

Section 6. State access to books and records

Section 6 provides State regulatory commissions authority to inspect books, accounts, memoranda, and other records of a holding company or associate or affiliate companies as may be necessary to effectively set rates and carry out State regulation of public utility companies in a holding company system. The authority is to be exercised by written request and subject to such terms and conditions as are necessary and appropriate to safeguard against unwarranted disclosure to the public of any trade secrets or sensitive commercial information.

The rights of the States under this section are enforceable in Federal district court.

The authority granted by section 6 is intended to supplement existing State authorities. To ensure this result, section 6 provides that it does not preempt applicable State law concerning access to business information or in any way limit the rights of a State to obtain books, records, or other information under Federal law, contract, or otherwise. Some of these rights are set out in section 201(g) of the Federal Power Act, 16 U.S.C. § 824(g).

Section 7. Exemption authority

Section 7 provides the Commission authority to exempt certain entities from the requirements of section 5, with respect to access to books and records and requires the exemption of certain entities from those requirements.

Section (7)(a) requires the Commission, not later than 90 days after enactment, to issue a final rule exempting from the requirements of section 5 any person that is a holding company solely by reason of owning one or more (a) qualifying facilities (QFs); (b) exempt wholesale generators (EWGs); (c) foreign utility companies; or (d) any combination thereof. The purpose of this provision is to ensure that businesses whose activities are solely limited to ownership of these categories of generation investment will not be subject to the requirements of section 5. In addition, the Commission may by rule or order exempt any person or class of transactions from the requirements of section 5 if it finds that the books, records, accounts, memoranda or other records or class of transactions are not relevant to the exercise of its jurisdiction to set rates.

Section 8. Affiliate transactions

Section 8 makes explicit that nothing in the Act precludes the Commission or a State Commission from determining under otherwise applicable law whether a public utility company may recover in rates any costs of an activity performed by an associate company, or any costs of goods or services acquired by the public utility company from an associate company.

Section 9. Applicability

Section 9 makes clear that the Act does not apply to the United States, a State or any political subdivision of a State, any foreign governmental authority not operating in the United States, or any agency, authority, instrumentality, officer, agent or employee of these entities.

Section 10. Effect on other regulations

Section 10 provides that nothing in this Act precludes the Commission or a State Commission from exercising its jurisdiction under otherwise applicable law to protect gas and electric utility consumers from paying too much for goods and services provided by associate companies and that from cross subsidies of associate companies by regulated public utility companies.

Section 11. Enforcement

Section 11 refers to authorities contained in the Federal Power Act to provide the Commission full authority to enforce the provisions of the Act. These authorities include the authority: (I) to receive and proceed on complaints; (ii) to investigate any facts, conditions, practices or matters necessary to determine whether there has been a violation of the Act or any rule, regulation or order issued under the Act; and (iii) to hold hearings. Section 11 also gives the Commission authority to implement rules of practice and procedure and to perform any and all acts necessary to carry out the provisions of the Act.

Section 12. Savings provisions

Section 12 provides that, in general, nothing in the Act prohibits a person from engaging in activities or transactions in which it is legally engaged or authorized to engage on the date of enactment if that person continues to comply with the terms of any such authorization. This savings provision ensures that prior authorizations made by the Securities and Exchange Commission and the Federal Energy Regulatory Commission continue in force under this Act.

This section also provides that nothing in the Act limits the authority of the Commission under the Federal Power Act (including section 301 of that Act) or the Natural Gas Act (including section 8 of that Act).

Section 13. Implementation

Section 13 requires the Commission to promulgate such regulations as may be necessary or appropriate to implement the provisions of this Act. These regulations are to be promulgated not later than 18 months after the date of enactment.

Section 13 also requires the Commission to submit a report to Congress detailing technical and conforming amendments to Federal law necessary to implement the provisions of this Act. This report is required eighteen months after the date of enactment.

Section 14. Transfer of resources

Section 14 provides for the transfer of relevant books and records from the Securities and Exchange Commission to the Federal Energy Regulatory Commission.

Section 15. Effective date

Section 15 provides that the Act shall take effect 18 months after date of enactment.

Section 16. Authorization of appropriations

Section 16 authorizes to be appropriated funds necessary to carry out the Act.

Section 17. Conforming amendment to the Federal Power Act

Section 17 repeals section 318 of the Federal Power Act, 16 U.S.C. 825q. This section recognizes that repealing the 1935 Act will eliminate any concerns about the possibility of conflicting deci-

sions of the Securities and Exchange Commission and the Federal Energy Regulatory Commission.

REGULATORY IMPACT STATEMENT

The bill significantly reduces regulatory burden on certain utility holding companies and associated costs to utility consumers. The bill also reduces the SEC's regulatory burden by eliminating the SEC's regulatory role with respect to utility holding companies registered under the Public Utility Act of 1935.

As stated in Section 2 of the Act, the purpose of the Public Utility Holding Company Act of 1996 is to eliminate unnecessary regulation through repeal of the Public Utility Company Act of 1935 while facilitating effective state and Federal regulation.

Section 5 of the bill expands the FERC's authority to inspect books and records of holding companies, associate companies and affiliate companies as the FERC deems relevant to its ratemaking responsibilities under the Act. The Committee expects that this provision will facilitate the FERC's ability to effectively execute its supervisory responsibilities

Section 7 of the bill requires the FERC to promulgate rules exempting certain entities from Section 5 of the Act providing federal access to books and records. The Committee intends for this rulemaking to enhance the FERC's ability to regulate under the new Act.

CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirements of paragraph or subsection 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

COST OF LEGISLATION

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, July 3, 1996.

Hon. ALFONSE M. D'AMATO,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 1317, the Public Utility Holding Company Act of 1996, as ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs on June 26, 1996. The bill would repeal the Public Utility Holding Company Act, and assign certain new responsibilities to the Federal Energy Regulatory Commission (FERC). CBO estimates that enactment of S. 1317 would reduce the need for appropriated funds for the Securities and Exchange Commission (SEC) by about $1 million in fiscal year 1998 and by about $2 million a year thereafter. Any additional costs imposed on the FERC would be offset by user fees the agency is mandated to charge to industries it regulates. The bill would not affect direct spending or receipts, so pay-as-you-go procedures would not apply.

Federal Budgetary Impact. Section 4 of S. 1317 would repeal the Public Utility Holding Company Act effective 18 months following

enactment. Based on information from the SEC, we estimate this would reduce the agency's costs by about $1 million in fiscal year 1998 (once the repeal is effective), and by about $2 million a year thereafter. In total, we estimate discretionary savings of about $9 million over the 1998–2002 period, assuming that SEC appropriations are reduced consistent with the bill.

Section 5 would authorize the FERC to have access to any records of public utilities and natural gas companies that are necessary for the commission to protect utility customers with respect to interstate transactions involving electricity and natural gas. Based on information from FERC, CBO estimates this activity would cost the agency about $2 million annually starting in 1998. If this amount is provided to the FERC in annual appropriations acts, it would be offset by fees that the agency is required to charge the industries it regulates. Therefore, the new responsibilities that the bill would create for the FERC would have no net budgetary impact.

Mandates Statement. S. 1317 contains no intergovernmental mandates as defined in Public Law 104–4. However, states could choose to issue new regulations or pass new legislation in order to fill any gaps created by the repeal of the Public Utility Holding Company Act of 1935. Based on information from the National Association of Regulatory Utility Commissioners, CBO expects that the costs associated with any new state regulations or legislation would be minimal.

S. 1317 would impose no new private-sector mandates as defined in Public Law 104–4. The bill would transfer regulatory authority for business-related transactions of public utility holding companies from the Securities and Exchange Commission to the Federal Energy Regulatory Commission and state regulators. Moreover, the bill would terminate current requirements to report extensive financial data to the SEC and would require only that federal and state regulators have access to books, accounts, and other records of all companies in the public utility holding company system. S. 1317 would also exempt certain independent power producers, wholesale generators, and foreign utilities from having to make these data available to regulatory authorities.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts for Federal costs are Kim Cawley and Rachel Forward, the CBO staff contact for State and local impacts is John Patterson, and the contacts for private-sector impacts are Richard Farmer and Patrice Gordon.

Sincerely,

PAUL VAN DE WATER
(For June E. O'Neill, Director).

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