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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C.

STATEMENT OF  
F. KEVIN BOLAND, SENIOR ASSOCIATE DIRECTOR  
RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION  
BEFORE THE  
SUBCOMMITTEE ON ENERGY CONSERVATION AND POWER  
AND THE  
SUBCOMMITTEE ON TELECOMMUNICATIONS, CONSUMER PROTECTION  
AND FINANCE  
COMMITTEE ON ENERGY AND COMMERCE  
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman:

We appreciate this opportunity to discuss proposed legislation (H.R. 2994) to amend the Public Utility Holding Company Act (PUHCA) and a compromise proposal dated October 17, 1983, concerning this legislation. My testimony is based on our August 1983 report on an Analysis of SEC's December 1981 Recommendation To Repeal The Public Utility Holding Company Act, and to the extent possible, relates the findings of that report to the compromise proposal.

Our report addressed federal and state regulatory gaps and identified problems that could result from SEC no longer having authority over holding companies. Our report dealt with the possibility of the act being repealed, not amended, and found that if the act is repealed, SEC would no longer have authority to approve the acquisition of assets and securities by utility holding companies, (2) approve the issuance of securities by utility holding companies, and (3) review the allocation of costs between the holding company and its service company and its utility subsidiaries.

Since repeal would significantly reduce SEC's authority, we recommended in our report that the Congress, in considering repealing or amending the act, address, through the appropriate congressional committees, the potential impacts that regulatory gaps at the federal level would have on state regulation and ultimately on consumers.

Although the compromise proposal does not present the same concerns we found with respect to regulatory gaps, it does significantly alter SEC's role and imposes new burdens on the states. It is unclear at this time what actual impacts the compromise proposal would have on regulatory activities and on how equipped the states and SEC would be to deal with the proposed responsibilities.

To the extent possible it is important that the ramifications of the amendments be fully understood by all parties affected by such changes. These hearings will help accomplish the process we recommended in our report.

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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C.

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HOLDING COMPANY ACT

In 1935, the Congress passed the Public Utility Holding Company Act to control and regulate holding companies.<sup>2</sup> The

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<sup>1</sup>Dated August 30, 1983 (GAO/RCED-83-118).

<sup>2</sup>The act defines a holding company as " \* \* \* any company which directly or indirectly owns, controls, or holds with power to vote, 10 per centum or more of the outstanding voting securities of a public-utility company or of a company which is a holding company \* \* \*."

act's provisions were intended to protect the public, investors, and consumers from abuses associated with the control of electric and gas utility companies through the holding company structure. The act directed SEC to reorganize these holding companies and to provide for continued surveillance of the corporate structure, financial transactions, and operational practices of public utility holding companies.

PUHCA is an extremely complex piece of legislation, and changes that are being proposed are also complex. The potential impacts that regulatory gaps and changes in the law would have on state regulation and ultimately on consumers need to be addressed. And, it is important that the ramifications of the amendments be fully understood by all parties affected by such changes.

#### GAO REPORT ON PUHCA

Our report addressed federal and state regulatory gaps and problems that would exist if PUHCA is repealed. Our report was based on extensive interviews with, and documentation obtained from, officials of SEC's Office of the General Counsel and Division of Corporate Regulation, Commissioners and/or staff of 15 state public service commissions, and officials from one registered and two exempt holding companies and utilities. Although the act addresses both gas and electric utility holding companies, our report was limited to electric utility holding companies.

Potential problems stem from the fact that SEC would no longer have authority to:

- (1) approve the acquisition of assets and securities by utility holding companies,

- (2) approve the issuance of securities by utility holding companies, and
- (3) review the allocation of costs between the holding company and its service company and its utility subsidiaries.

Currently, the act provides SEC with approval authority over such acquisitions and specifies the criteria such acquisitions must follow. If the act is repealed, interstate holding companies could acquire, subject to the Clayton Act, any non-utility subsidiary. Although SEC acknowledged in its June 2, 1982, statement<sup>3</sup> the possibility and benefits of acquiring a profitable company, SEC did not address the other side of the coin. Several state officials we contacted indicated that, in some instances, such acquisitions could adversely affect the rates that consumers pay for their electricity. They pointed out, for example, if an interstate holding company acquires a subsidiary that, in turn, becomes unprofitable, it could cause the bond rating for the utility to be lowered. Such an action could increase the utility's cost to borrow money, and this higher cost of capital could be passed on to the consumer through higher rates. Also, if SEC no longer approved acquisitions by holding companies, it would be possible in some cases for a holding company to invest its money in an unlimited number of non-utility subsidiaries and not have money available to meet the needs of the utility subsidiary.

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<sup>3</sup>Statement of the U.S. Securities and Exchange Commission concerning proposals to amend or repeal the Public Utility Holding Company Act of 1935, prepared for hearings before the Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs, and the Subcommittee on Energy Conservation and Power, House Committee on Energy and Commerce.

Another potential problem concerns the issuance of securities by registered holding companies. According to SEC, "the most serious financial abuses were those involving the securities issued by the holding company, not the operating subsidiaries." Currently, the act requires SEC to approve most types of security issuances by registered holding companies and their subsidiaries. Approval may be withheld if either the securities or the terms of their issuance fail to meet certain qualitative standards. SEC limits the type of securities issued by a holding company to common stock and short-term debt and limits an electric utility subsidiary's securities to long-term debt; preferred stock; and special debt, such as for pollution control. SEC's regulations limit the amount of the utility subsidiary's debt and equity and assist states by limiting the type of financing and securities presented to them.

SEC officials told us that without PUHCA there would be no federal or state agency to consider the consolidated effects of security issues of a holding company with utility subsidiaries when the company is in several states. State control and authority extend only to a company's operations within the state's boundaries; states have no authority to regulate activities outside their own jurisdiction. States do not have the same type of direct regulatory power over out-of-state parent holding companies that SEC has under PUHCA.

The number and variety of securities issued by both the holding company and the utility subsidiary could increase if the act is repealed. States may experience problems if they are called upon to consider a vast assortment of security issues whose

consequences in terms of soundness and rates to consumers may be difficult to evaluate for the particular utility and the holding company as a whole.

Further, if the act is repealed, SEC will no longer have authority to review allocation of costs for service companies of registered electric utility holding companies. In accordance with the act, service companies exist to serve companies, principally the operating utility subsidiaries, in their system "at cost, fairly, and equitably allocated among such companies." Service company activities center on accounting, administrative, financing, engineering, data processing, budget, and support services. Currently, each of the registered electric utility holding companies has a service company subsidiary. Under the act SEC can examine the books of service companies to assure that costs are equitably allocated. In the absence of the act, both state and SEC officials noted that no other federal or state agency could assure this. Officials further added that the chance of a service company's overcharging a utility subsidiary could increase without such a review. Such charges could eventually mean higher rates.

Several state officials that we interviewed were concerned about their ability to protect ratepayers if the act were repealed and that they would not be able to regulate interstate holding companies. They also believed that, as stated above, adverse situations would affect consumers if interstate holding companies were not regulated at the federal level. Additionally, states thought that new laws, additional resources, and expanded staff expertise may be needed at the state level to deal with the consequences of repeal.

Since repeal would significantly reduce SEC's authority while raising concern among states as to their ability to protect their ratepayers, we recommended that the Congress, in considering repealing or amending the act, address, through the appropriate congressional committees, the potential impacts that regulatory gaps at the federal level would have on state regulation and ultimately on consumers.

#### COMPROMISE PROPOSAL

Now let me turn to the issue of the recent compromise proposal. I will include in this discussion our responses to the questions you asked regarding the regulatory gaps that would be created by the compromise proposal and the effects of the compromise proposal on SEC. We have identified some regulatory differences between the proposal and the current Holding Company Act. We are concerned about how the changes could affect consumers. We would like to highlight two differences which appear to be the subject of much discussion. First, there would be, procedurally, a different form of regulation, involving the state commissions in the area of securities issues and acquisitions of non-utility businesses. Second, the compromise proposal specifically authorizes states legal access to the books, records, and accounts of an interstate holding company and/or its associate companies. Let me now elaborate.

#### Approval of securities

As we pointed out in our report, PUHCA requires SEC to approve most types of security issuances by registered holding companies and their subsidiaries. Approval may be withheld if either the securities or the terms of their issuance fail to meet certain qualitative standards. For example, SEC, being concerned

with the quality and cost of the securities to be issued, will only allow a declaration to become effective if

- (a) the securities are reasonably related to the capital structure of the issuing company and the holding company system and to earning power,
- (b) the particular security is appropriate for the economical and efficient operation of the system's business, and
- (c) the cost of financing is reasonable.

In broad perspective, SEC must assure that each financing fits the capital structure of the system and not prejudice future financing. SEC limits the type of securities issued by a holding company to common stock and short-term debt and limits an electric utility subsidiary's securities to long-term debt; preferred stock; and special debt, such as for pollution control. SEC's regulations limit the amount of the utility subsidiary's debt and equity. According to SEC, the limits on the type of financing and securities under the act assist states, which are presented with financing proposals fashioned by the policies and standards under the act.

The compromise proposal would significantly alter SEC's role. SEC would no longer be directly approving the financings of registered holding companies and their subsidiaries. In fact, no entity would actively approve such transactions. Rather, the states would be allowed 20 days from the date of filing to object to a proposal. If the State did not object within that timeframe, then the financing could go into effect. If a state objected within the 20 days, the SEC then has 30 days (actually 50 days from the date of filing) to issue an order disapproving the declaration on the grounds that it would "have a material detrimental

effect on consumers" or "result in an unreasonable risk that such material detrimental effect will occur." One federal official indicated to us that these standards could be difficult for SEC to prove since they are not clearly defined. Further, if the "effect on consumers" is interpreted in relation to consumer rates then SEC would be stepping into an area that is the responsibility of states. The official added that it would be difficult for SEC to make a decision in 30 days, especially if proposals from several companies are presented at the same time. The amount of consumer protection could be reduced under these circumstances.

The compromise proposal also authorizes the declaration by a registered holding company of a "general plan" for financing for a 24 month period. The proposal does not specify the contents of the general plan. Again this plan would be effective after a certain time period (45 days) unless a state objected. After an objection, the SEC has 60 days (actually 105 days from the date the declaration is filed) to issue an order disapproving the plan on the same basis as that for other securities: "a material detrimental effect on consumers" or "result in an unreasonable risk that such material detrimental effect will occur." If SEC does not issue an order disapproving the general plan, then it becomes effective. The point of this discussion is that it is difficult, if not impossible, to judge the impact on consumers of a 2-year general plan. The plan is probably not specific enough to judge its merits. Yet, the compromise proposal would allow the plan to become effective within 45 days after filing. Additionally, if several general financing plans are sent to SEC at the same time, it may be difficult for SEC to review them in a timely fashion. The question remains, are the consumers' interests being protected?

## Approval of acquisitions

As stated in our report, PUHCA provides SEC approval authority over acquisitions of any securities or utility assets or any other interest in any business by registered holding companies or their subsidiaries. PUHCA specifies the criteria the acquisitions must follow. For example, the act requires that utility acquisitions be confined to a single geographically defined area and that other acquisitions be related to the utility operations. An acquisition may not unduly complicate the capital structure of the holding company and its subsidiaries. In addition, an acquisition may not be detrimental to the public interest, interests of investors or consumers, or proper functioning of the holding company.

The compromise proposal reduces SEC's role and expands the types of areas into which a registered holding company can go. SEC has direct approval authority only with respect to applications to acquire utilities. The compromise proposal allows a registered holding company to file a 2-year diversification plan or an individual acquisition proposal with SEC. There are few restrictions on the types of acquisitions. A diversification plan is effective 45 days from the date of filing unless a state objects. After an objection, the diversification plan or individual acquisition is "deemed approved" if, after 60 days (actually 105 days from date of filing), the SEC has not issued an order disapproving the plan on the basis that the plan would "have a material detrimental effect on consumers" or "result in an unreasonable risk that such material detrimental effect will occur." These standards are not defined in the compromise proposal, and may therefore be difficult to apply. Also, it may be difficult for

SEC to review a diversification plan if several of them, as well as the general financing plans, come to SEC at the same time.

As explained in the compromise proposal, the diversification plan shall contain (1) the holding company's intentions about diversification, (2) statements describing the intended relationship between the public utility business and the non-utility business, (3) the proposed method of financing the non-utility business and their acquisition, and (4) the expected relationship between the aggregate of the non-utility business investment and the public utility business investment. This diversification plan provides information on the "intentions" of the holding company to diversify in a two-year period. A diversification plan which only states intentions in a general manner may be too general for a state or SEC to judge its benefits and shortcomings and its impact on consumers.

A holding company may apply for an individual non-utility acquisition. The application would become effective within 45 days of filing unless a state objects. If a state objects, the application would become effective, within 105 days of filing, unless the SEC issues an order disapproving it as having a "material detrimental effect on consumers," or as providing an "unreasonable risk" that such effect will occur.

The compromise appears to allow for a registered holding company to acquire less than a "significant interest" in any non-utility business without any state or SEC approval. The compromise would make it unlawful for a holding company to acquire only a "significant interest" unless the significant interest were acquired pursuant to an effective diversification plan or other separate authorization. The compromise would not make it unlawful

to acquire less significant interests. "Significant interest"<sup>4</sup> in the compromise proposal is complex and difficult to understand. This provision is not in PUHCA, and would decrease the authority SEC currently possesses under the act. This new provision also raises questions about its effect on consumers. As we stated in our report, if a holding company acquires another company, which may become unprofitable, it could cause the bond rating of the utility to be lowered, leading to an increase in a utility's cost to borrow money, and leading then to higher consumer rates.

#### Access to books

As stated in our report, SEC is authorized to review allocation of costs for service companies of registered electric utility holding companies. Service companies exist to serve companies, principally the operating utility subsidiaries, in their system "at cost, fairly, and equitably allocated among such companies." Service company activities center on accounting, administrative, financing, engineering, data processing, budget, and support services. Currently, each of the registered electric

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<sup>4</sup>The term "significant interest" means an interest in the net assets related to which as recorded on the books of the holding-company system when taken together with the net assets as so recorded of all other interests in any business (other than the public-utility business) acquired without authorization under section 10 would constitute (determined immediately after the acquisition of such interest by the holding-company system)-- (1) 10 per centum or more of the aggregate shareholders' equity in the holding company on a consolidated basis in the case of any holding company which was continuously registered with the Commission in the 12 month period prior to enactment of the Public Utility Holding Company Act Amendments of 1983; or (2) 10 per centum or more of the aggregate shareholders' equity on a consolidated basis in the public-utility companies which are associate companies of any registered holding company other than a registered holding company referred to in clause (1) of this paragraph.

utility holding companies has a service company subsidiary. SEC's authority in the area of allocation of costs gives it access to companies located in more than one state. SEC still retains this authority under the compromise proposal. The compromise expands the authority of the states' access to documents.

Under the compromise proposal, if a holding company denies a state access to its books and records, the state can then petition a district court for enforcement. However, the state bears the responsibility of identifying in detail the information requested and for justifying to the district court that the documents are needed in order for the state to perform functions imposed on it by law. The holding company and/or its associate company may end up not providing any documents if the state cannot produce sufficient justification of need. Although the compromise proposal provides more legislative clout for a state to obtain what it perceives as necessary information, there is still the possibility that the information request may be denied by the district court. The burden of proof is on the state.

The proposed legislation does not establish a minimum number of days before which the state can request enforcement action by the district court or specify the length of time allowed for a holding company to respond. A delay could prove, ultimately, to be injurious to consumers.

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PUHCA is an extremely complex piece of legislation and the changes that are being proposed are also complex. It is important that the ramifications of the amendments be fully understood by

all parties affected by such changes. It is for this reason that a full analysis is needed.

We recommended in our recent report that the Congress, in considering repealing or amending the act, address, through the appropriate congressional committees, the potential impacts that regulatory gaps at the federal level would have on state regulation and ultimately on consumers. These hearings are part of the process that we recommended. In conjunction with the hearings, we believe that a comprehensive analysis should be prepared. At this time, we do not see that this has been done. We anticipate that analysis of the impacts might include a section-by-section comparison of the compromise proposal and PUHCA, detailing what the changes would mean, who would and would not be affected, and the new opportunities that could occur. We believe such information is necessary for the Congress and affected parties to make an informed decision about PUHCA amendments.

This concludes my prepared statement. I will be pleased to respond to any questions you may have.