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Briefing Paper

REPEAL OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935: IMPLICATIONS AND OPTIONS FOR STATE COMMISSIONS

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Executive Summary

Repeal of the federal Public Utility Holding Company Act of 1935 (PUHCA 1935) is perhaps the most far-reaching provision in the Energy Policy Act of 2005 (EPAct 2005) regarding the future structure of the electricity industry and its markets. The repeal removes statutory and regulatory barriers to industry consolidation, conglomeration, and diversification. The PUHCA of 2005 (PUHCA 2005) replaces comprehensive regulation by the Securities and Exchange Commission (SEC) with much narrower authority for federal and state access to books and records. It allows both the Federal Energy Regulatory Commission (FERC) and state utility commissions to review affiliate transactions and to deal with cost allocations and cross subsidies.

Repeal is expected to encourage investment in electric utility infrastructure, but it may open up potential abuses where utilities under state jurisdiction are part of larger holding companies. Most state commissions have authority to deal with affiliate transactions, cost allocation, and cross-subsidy issues. Many state commissions are reviewing their authority to regulate holding company affiliates to decide whether existing protections are sufficient or whether additional state legislation or commission regulation is needed to fill the void.

In particular, ring-fencing provisions are desirable to prevent potential corporate abuse, whether the abuse is easily definable or subtle. This paper reviews approaches for providing more expansive state authority for commission access to books and records, as well as requirements that might be incorporated in statutes, commission regulations, or merger orders to insulate public utilities from holding company abuses.

State commissions have what might be viewed as a continuum of options. For the sake of exposition, this report identifies three approaches once a state has carefully reviewed its statute(s), existing authority, and existing merger conditions. First, a state commission may find that it can address ring-fencing to insulate a company from the holding company on a case-by-case basis relying on existing commission authority. The second approach calls for ring-fencing statutes or rulemakings but does not include limits on utility diversification. The third approach attempts to re-create the PUHCA 1935, including strictures on diversification, which might be the most problematic from the viewpoint of encouraging investment in electric utility infrastructure.

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The PUHCA 1935 was repealed by the EPAct 2005.

INTRODUCTION

Repeal of the federal Public Utility Holding Company Act of 1935 (PUHCA 1935) is perhaps the most far-reaching provision in the Energy Policy Act of 2005 (EPAct 2005) regarding the future structure of the electricity industry and its markets. The repeal removes statutory and regulatory barriers to industry consolidation, conglomeration, and diversification at the possible expense of consumers and investors. Repeal is expected to encourage investment in electric utility infrastructure, but it may open up potential abuses where utilities under state jurisdiction are part of larger holding companies. Many state commissions are reviewing their authority to regulate holding company affiliates to decide whether existing protections are sufficient or whether state legislation or commission rulemaking is needed to fill the void.

This research report lays out broad options for state commissions, including extended examples of three quite different approaches that represent alternatives that range from highly restrictive on holding company operations to less comprehensive and anticipatory. It begins with a brief history of PUHCA and the new statute and federal framework, discusses the implications of repeal, gives an overview of where states are starting from and what to look for in their existing statutes and rules, and provides the three examples. The report ends with a summary and conclusions.

BACKGROUND

PUHCA 1935

Congress enacted PUHCA 1935 to combat market imperfections inherent in holding company structure and operations.[1] Congress found investors and energy consumers may be adversely affected when any of 11 enumerated evils emerged.[2] They are:

- investors cannot obtain adequate information to appraise the financial position or earning power of the issuers because of the absence of uniform standard accounts
- securities are issued without the consent of the states
- securities are issued on the basis of fictitious or unsound asset values bearing no fair relationship to the amount invested or earning power of the properties, and on the basis of paper profits from inter-company transactions or in anticipation of excessive revenues from utility subsidiaries
- securities that require the utility to support an overcapitalized structure and tend to prevent voluntary rate reductions are issued
- utility subsidiaries are subject to excessive charges for services, construction work, equipment, and materials, or enter into transactions where arm's length bargaining is absent and free competition is restrained
- service, management, construction, and other contracts involve the

1 Section 1(a) of PUHCA, 15 U.S.C. §79(a).
2 Section 1(b) of PUHCA, 15 U.S.C. §79(b)

allocation of charges among utility subsidiaries in different states so as to make effective state regulation difficult
- control of utility subsidiaries affects the accounting practices, rates, dividends, and other policies of such companies so as to complicate and obstruct state regulation
- control of utility subsidiaries is exerted through disproportionate investment
- the growth and extension of holding companies bear no relation to economy of management and operation or coordination of related operating properties
- there is a lack of [economy of] effective public regulation
- there is a lack of economies in raising capital.[3]

The main thrust of PUHCA 1935 to eliminate the 11 evils was limits on holding company ownership of geographically remote utilities and restrictions on diversification beyond the electric and gas utility industries. Seventy years later, it is fair to say many of the evils identified by Congress no longer exist or are controlled through other forms of regulation. The Sarbanes-Oxley Act addresses the issues of corporate responsibility, accounting oversight, financial disclosure, and auditing requirements.[4] There are Uniform Systems of Accounts that provide for the reporting of regulated utility accounting information on a uniform and consistent basis. Use of a Uniform System of Accounts provides regulators and other parties with information needed for the ratemaking process and for other regulatory needs. It also allows separation of utility property and activities from non-utility operations. Most states require approval before utilities are allowed to issue major securities. States tend to monitor the issuance of securities so that the utility does not become overcapitalized given its assets, and now bond covenants also prevent overcapitalization.

PUHCA 2005

Repeal of PUHCA 1935 was urged to encourage the infusion of capital into the electric and gas industries, a central goal of EPAct 2005. It is hoped that PUHCA 1935 repeal will lead to economically efficient consolidation of the electric and gas industries. Without geographic limitations on holding companies, cross-commodity constraints, the requirement of vertical integration, and barriers that limited diversification to related industries, the industry will be free to take advantage of economies of both scope and scale, and new investment opportunities will be created. Market consolidation and investment by new diversified entities are expected to lead to portfolio diversity and vertical as well as horizontal diversification. Scale economies, to the extent they exist, can lead to unit cost reduction, leading to more competitive costs. Portfolio diversity can lower risk or, by creating options, make risk more manageable. Greater diversification can also create market position opportunities. Technically, in repealing PUHCA 1935, Congress in Section 1263 of EPAct 2005 substituted a new Public Utility Holding Company Act of 2005

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3 Section 1(b) of PUHCA, 15 U.S.C. § 79(b).
4 The Sarbanes-Oxley Act of 2002, Public Law 107-204, 116 Stat. 745 (30 July 2002).

The broad authority of the SEC under PUHCA 1935 is replaced primarily with access to books and records for FERC and state commissions.

Both FERC and state commissions have authority to check affiliate transactions, cost allocations, and cross-subsidies.

(PUHCA 2005).[5] PUHCA 2005 is much more limited than the original, however. The broad authority of the Securities and Exchange Commission (SEC) under PUHCA 1935 to regulate public utility holding companies is replaced primarily with statutory provisions dealing with access to books and records for both state commissions and the Federal Energy Regulatory Commission (FERC) (EPAct 2005 Sections 1264 and 1265). Both state commissions and the FERC have the ability to check affiliate transactions (Section 1267). And both state commissions and the FERC have the authority to deal with cost allocations and cross-subsidies. For the analysis in this paper, it is also important that PUHCA 2005 authorizes the states and federal agencies to protect utility customers with "otherwise applicable law" (Section 1269).

To use the authority to access books and records under PUHCA 2005, state commissions having jurisdiction over a public utility company in a holding company must make a written request for the records, wherever located, needed of the holding company or an affiliate or associate company. The written request must be for records that have been identified in reasonable detail in a proceeding before the state commission. The state commission must have determined that the records are relevant to costs incurred by the public utility and are necessary for the effective discharge of the responsibilities of the commission with respect to the proceeding. However, the production of the records under PUHCA 2005 is subject to terms and conditions as may be necessary and appropriate to safeguard against unwarranted disclosure to the public of any trade secrets or sensitive commercial information. Federal district courts located in the state of the state commission have jurisdiction to enforce compliance with state access to books and records pursuant to PUHCA 2005.[6]

The savings provision in EPAct 2005 Section 1265 provides that, under otherwise applicable state laws, state commissions are allowed to gain access to books and records. State commissions are also not precluded from exercising their authority under otherwise applicable laws to determine whether a utility company may recover in its rates any costs of an activity performed by an affiliate, or any costs of goods or services acquired by the utility from the affiliate. There is another savings provision in PUHCA 2005 pursuant to EPAct 2005 section 1267 that makes this clear.[7] A state commission could obtain books and records through exercise of its own authority pursuant to state statute, commission rule, or order. Such state authority might be broader than the federal access to books and records discussed above.

EPAct 2005 Section 1275 contains an explicit savings provision that allows state commissions to continue to exercise their authority under otherwise applicable law to deal with cost allocation and cross-subsidy issues.[8] PUHCA 2005 repeals the *Ohio*

5 See appendix A for the key provisions of the Public Utility Holding Company Act of 2005.

6 EPAct 2005, §1265.
7 EPAct 2005, §1267(b).
8 EPAct 2005, §1275(c).

Power[9] decision and provides FERC with authority to allocate the cost of non-power goods or administrative and management services provided by an associate company organized for that specific purpose to a public utility within the same holding company system. Before PUHCA 2005 and as a result of *Ohio Power*, the authority to make this allocation resided in the SEC, and FERC was required to accept cost allocations filed with and accepted by the SEC. EPAct Section 1275 of PUHCA 2005 can be triggered at the election of the holding company system or any state commission having jurisdiction over such a public utility. [10] When FERC makes such a cost allocation, under the *Nantahala* and *Gulf States* rulings, state commissions are required to abide by and flow through the costs from such allocations. This is a version of the filed rate doctrine, which holds that FERC-approved cost allocations between affiliated companies may not be subject to reevaluation in state ratemaking proceedings.[11] However, under *Kentucky West Virginia Gas* and *Pike County,* preemption arises under a FERC approved filed tariff only when the FERC approval diminished the buying utility's discretion, such that the utility had no option other than buying the FERC-jurisdictional service or paying the FERC established rate.[12].

FERC Rules

FERC has issued final rules implementing EPAct 2005.

On Dec. 8, 2005, the FERC issued a final rule that amended its regulations to implement the repeal of PUHCA 1935 and enact the relevant provisions of EPAct 2005[13]. The rule exempts several persons, entities, and types of transactions from the federal books and records requirements of PUHCA 2005. It also confirms that the FERC plans to use its existing powers under the Federal Power Act to police affiliate transactions.

State utility commissions, both individually and through the National Association of Regulatory Commissioners (NARUC), commented on several issues in the FERC's Notice of Proposed Rulemaking (NOPR).[14] The commenting state utility commissions asked, among other things, that the FERC explicitly incorporate state commission authority over transactions in their states into its regulations and explicitly confirm that the FERC access to information under Section 1264 does not preempt state com-

9 *Ohio Power Co. v. FERC*, 954 F. 2d (DC Cir. 1992), cert. denied, 498 U.S. 73 (1992).
10 EPAct 2005, §1275(b).
11 *Nantahala Power & Light Co. v. Thornburg,* 476 U.S. 953 (1986); see also *Mississippi Power v. Miss. Ex rel. Moore*, 487 U.S. 354 (1988) (when FERC orders a retail utility to take an action or limits the utility's ability to take an action, states may not set retail rates as if the utility had a choice of action). *Gulf States Util. Co. v. Federal Power Commission*, 411 U.S. 747 (1973).

12 See *Kentucky West Virginia Gas Co. v. Pa. Pub. Util. Comm'n,* 837 F.2d 600, 609 (3d Cir. 1988); and *Pike County Light & Power Co. v. Pa. Pub. Util. Com'n,* 465 A.2d 735, 737-38 (1983).
13 FERC, Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, 18 CFR Parts 365 & 366 (Docket No. RM05-32-000, Order No. 667), Issued 8 December 2005 (Final Rule).
14 FERC, Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, 70 Fed. Reg. 55,805, NOPR RM05-32-000 (2005). The state utility commissions that commented on the NOPR were: Arizona, Georgia, Indiana, Missouri, Ohio, Oklahoma, Wisconsin, and the California Electricity Oversight Board.

Ring-fencing insulates regulated utilities from credit risks and corporate abuse by unregulated parent and affiliate companies.

mission access under Section 1265.[15] States were concerned that, despite the language in Section 1265, because Section 1264 does not contain a savings clause preserving state access, language was needed in its regulations clearly maintaining state access to company books and records. In response to FERC's request for comments on the adoption of rules on cross-subsidization, encumbrances of utility assets, diversification, and structural separation, state commissions suggested that the FERC adopt several minimal ring-fencing measures.[16] Ring-fencing refers to measures taken to insulate regulated public utilities from credit risks and corporate abuse by unregulated parent companies or affiliates within a holding company system.

The FERC in its order agreed that there is no inherent conflict between state and federal access to information, and federal access should not preempt state commission access to information. Nonetheless, the FERC declined to adopt any regulatory text on this point.[17] The FERC's reply to the NOPR comments further stated that issues related to preemption are more appropriately addressed on a case-by-case basis. The FERC also rejected proposals to allow state commissions to continue to receive notices of investigations of public utilities. The FERC did not respond to a recommendation that a joint federal/state board be utilized to develop ring-fencing rules.

FERC concluded that it would not require formal filings of cost allocation agreements,[18] in which case the filed rate doctrine, discussed above, might not apply. Nevertheless, in the case of a utility system, the FERC's cost allocation determination could be binding and, perhaps preemptive, if a holding company system or a state with a utility in a holding company system requests a determination. The FERC has not decided at this time whether such a cost allocation determination has a preemptive effect and the FERC has not required that all cost allocation agreements be filed.

Concerning the possibility of the FERC taking proactive measures to prevent potential corporate abuses, FERC determined that EPAct 2005 did not grant it the authority to issue additional ring-fencing rules. Noting that federal and state commissions already have some authority to implement ring-fencing measures, the FERC opted to monitor industry activities without taking any immediate action.[19]

On April 24, 2006, FERC issued Order 669-A, in which the Commission set out its policies for the review of merger applications under Federal

15 See Arkansas PSC Comments at 21, Missouri PSC Comments at 26-27, NARUC Reply Comments at 3-4, Indiana Utility Regulatory Commission Comments at 6.

16 State utility commission comments suggested that the FERC adopt additional rules to protect against cross-subsidization and diversification. See Missouri PSC Comments at 30-32. NARUC urged the FERC to prohibit holding companies from encumbering the assets of public utilities. NARUC Comments at 13-14. See also Ohio PUC Comments at 6-8 and Arkansas PSC Comments at 24-32.

17 Final Rule at 105.

18 FERC, Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, 18 CFR Parts 365 & 366, Order 667 (Issued December 8, 2005).

19 Final Rule at 241.

Power Act section 203 as amended. Although discussion of FERC's merger authority goes beyond the scope of this report, it is worth noting that FERC will consider, in many circumstances, whether a proposed transaction will 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. FERC will make these determinations on a case-by-case basis. In many cases if a transaction involves any public utility with captive customers within a holding company, the holding company must report state actions or conditions related to the transaction with an explanation as to why the transaction does not result in cross-subsidization.[20] The FERC Order supplements but does not supplant state commission regulation of cost allocation, affiliate transactions, cross-subsidization, and corporate financial abuse.

IMPLICATIONS OF REPEAL

The repeal of PUHCA 1935 means that federal jurisdiction to provide broad oversight over holding companies and their utility and non-utility affiliates has been greatly reduced. The relaxation of federal regulation is meant to stimulate mergers and the creation of holding company systems. Further consolidation in these industries will lead to greater market concentration.

20 FERC Order 669-A, Transactions Subject to FPA Section 203, 18 CRF Parts 2 and 33 (Issued April 24, 2006).

In industries with high barriers of entry, such as those involved in electric and gas industry infrastructure, an increase in market concentration might tend to lead to increased prices. The potential for higher prices can sometimes lead to increased investment in an industry. Further, with the relaxation of restrictions on holding companies, a larger pool of potential investors is available.[21]

In spite of all intervening statutory and regulatory changes since PUHCA 1935, three major problem areas remain when dealing with holding companies today: transfer pricing between affiliates; the problems of cost allocation and cross-subsidization; and corporate financial abuse that is sometimes subtle and hard to pin down.

Three major problem areas remain:
1. transfer pricing,
2. cost allocation, and
3. cross-subsidization.

Transfer Pricing

Whenever a utility and its subsidiary or affiliate engage in transactions with each other, there is an incentive for the subsidiary or affiliate to charge above-market or above-cost prices for goods or services, counting on the utility to be able to pass through the expense in its rates. This is less than an arm's-length transaction and passing through of the cost might adversely affect customers, particularly captive customers who as a practical matter do not have choice. Hence, there is a moral hazard created by the holding company structure that allows costs to be shifted to a utility

21 The FERC's and states' authority to review, condition, approve, or disapprove mergers and consolidation based on increased market concentration goes beyond the scope of this report. However, this report does deal with other problems that might remain when dealing with holding companies. As noted below, in some cases merger authority can be used to address these concerns.

State commissions have dealt with affiliate transactions, but the number and type of entities involved have increased.

and to its captive customers. There is also the potential problem of favoritism by the utility toward its affiliate, particularly if the affiliate provides a factor of production that the utility can acquire more cheaply somewhere else.[22] The problem might exist even if the affiliate charges at cost and at or below market. Under various state codes of conduct dealing with affiliate transactions, when a utility bought from an affiliate, the affiliate transaction was set at the lower of cost or market price. When a utility sold to an affiliate, the transaction was set at the greater of cost or market. PUHCA 1935 limited these transactions to cost. While state commissions have dealt with affiliate transactions in the past, the repeal of PUHCA 1935 expands the number and type of entities that might have affiliate transactions with the state's jurisdictional utility.

22 The FERC dealt with affiliate transactions in Ameren Energy Generating Company and Union Electric Company, d/b/a AmericanUE, Opinion No. 473, Opinion and Order Affirming Initial Decision in Part, Denying Request for Rehearing and Announcing New Guidelines for Evaluating Section 203 Affiliate Transactions, 108 FERC para. 61,081 (July 29, 2004). The FERC accepts three examples of how to demonstrate a lack of affiliate abuse: (1) evidence of direct head-to-head competition between affiliated and unaffiliated suppliers; (2) evidence of the prices that non-affiliated buyers were willing to pay for similar services from the affiliate; and (3) "benchmark" evidence of prices, terms, and conditions of sales made by non-affiliate sellers. These are now supplemented by four solicitation guideline principles. They are (1) transparency – the competitive solicitation process should be open and fair; (2) definition – the product or products sought through the competitive solicitation should be precisely defined; (3) evaluation – evaluation criteria should be standardized and applied equally to all bids and bidders; and (4) oversight – an independent third party should design the solicitation, administer bidding, and evaluate bids prior to the company's selection. Given the subsequent enactment of PUHCA 2005 and FERC Order 665, supra, an interesting issue might be whether the affiliate transaction guidelines of Opinion 473 continue to be of general applicability or whether they are limited to purchasing power. In Order 665, FERC states it will not require any entities that are currently using the SEC's "at-cost" standard for traditional centralized service companies to switch to our "market" standard. With respect to traditional, centralized service companies that use the "at-cost" standard, FERC will apply a presumption that "at cost" pricing of the non-power goods and services they provide to public utilities within their holding company is reasonable, but persons may file complaints if they believe that use of cost pricing results in cost that are above market price. FERC will retain its existing "market" standard for non-power goods or services between special purpose subsidiaries and public utilities.

Cost Allocation and Cross-Subsidies

Problems of cost allocation and the potential for cross-subsidies arise whenever a utility and its subsidiary and/or affiliate share joint and common administrative, capital, or operating costs. Such are commonplace in a holding company environment. Indeed, they are necessary to create synergies that could benefit both ratepayers and investors. While joint and common costs may be desirable because they might create synergies, they must be allocated properly to make certain that costs are not shifted from competitive, unregulated utility or non-utility markets to the regulated utility. Under the PUHCA 1935, cost allocation for registered holding companies and their affiliates was determined by the SEC.

As noted above, under PUHCA 2005 a holding company system or a state with a utility in a holding company system can request a FERC cost allocation. While it may be that such a FERC cost allocation determination would be binding, perhaps preemptive, the FERC has not decided at this time that such a cost allocation determination would be preemptive. FERC has also decided that it will not require all cost allocation agreements to be filed.

Financial Abuse

PUHCA 1935 prevented financial abuse through comprehensive corporate and financial regulation of registered holding companies and their affiliates. Repeal opens the door to financial abuse, some forms of which are obvious and others that require more explanation. Financial abuse definitely, blatantly, and obviously occurs when utility assets or revenue streams are used as collateral for upstream or affiliate loans. Another obvious form of financial abuse would be the use of the utility as a cash cow for the holding company or its affiliates. Utility dividends or working capital are moved elsewhere in the holding company system and not available to the utility when needed for utility investment to maintain safe, adequate, and reliable service. In many instances, bond indenture covenants protect against these more blatant abuses. But such protection does not always exist, as evidenced by the attempted Western Resources financial abuse that was nipped in the bud by the Kansas Corporation Commission in 2002 on the grounds that a proposed corporate restructuring would leave utility operations saddled with non-utility debt, threatening reliable service to customers.[23]

Impact on Risk

Financial abuse that affects the perceived risk of a utility is more subtle but can be just as harmful. For example, if the utility provides an affiliate supplier with an assured (or likely) customer, then the riskiness of the affiliate or subsidiary decreases and the perceived riskiness of the utility could increase. An additional problem is that the utility's stand-alone cost of equity cannot be easily isolated without knowing with certainty the relative risk of its corporate subsidiaries and affiliates. Wall Street tends to view holding companies as a package; and yet, for purposes of ratemaking (including calculating the utility's stand-alone cost of equity and cost of debt) state commissions may be unable to isolate the jurisdictional utility's risk from that of the holding company.

Purchased Power Costs

Another subtle form of financial abuse is the effect that a holding company structure can have on purchased power costs. If the utility has an affiliate or subsidiary from which it can purchase power, that affiliate transaction might be advantageous to the affiliate. This goes beyond the typical problems of affiliate transactions because of the added shifting of risk from the affiliate to the utility, unless the purchased power contract is firm without recourse to unusual market events, including an increase in wholesale

The repeal of PUHCA 1935 opens the door to some forms of financial abuse.

23 Kansas Corporation Commission, Order 51, Order Requiring Financial and Corporate Restructuring by Western Resources, Inc. (November 2002), enforcing a previous Commission order dated July 20, 2001.

Each state commission must balance consumer protection and the possibility of additional investment in electric utility infrastructure.

Most state commissions have exercised some authority over holding companies.

power prices. For example, the affiliate power producer might have an assured customer during slack periods of demand, but if the wholesale prices go up, then the affiliate can engage in economic withholding from its utility affiliate and resell its power at the higher spot price. This shifts the market risk from the affiliate producer to the utility and its captive ratepayers.

Managerial Expertise

Another avenue for abuse is the excess reassignment of managerial expertise. While normal utility operations allow for employee cross-fertilization with re-assignments over time to develop experience, excess reassignment occurs in a holding company structure as the best managers tend to seek out assignments to unregulated activities, as those activities can produce the greatest profits and lead to the greatest rewards.

Synergistic Benefits

Still another subtle effect is the potential loss of synergistic benefits from too much diversification within holding companies. Industrial organizational theory supports vertical integration of the utility industry to reduce transaction costs unless greater savings could be acquired from competitive suppliers. Too much diversification can eliminate the cost savings from holding company structures that were vertically integrated and operated as a single integrated system.

Technological Innovation

Finally, the holding company structure can lead to utility expenditures that support technological innovations of unregulated subsidiaries or affiliates within the holding company. While these might speed the adoption of certain demand side and /or supply side options, technological innovation will be corralled to favor the activities of affiliates.

The point of marching through the parade of major potential abuses that can occur due to PUHCA repeal is to raise the many concerns for either the FERC or state commissions to consider in protecting consumers.

TRADITIONAL STATE AUTHORITY – THE STARTING POINT

Each state commission must address for itself how it evaluates the existing balance of consumer protection against the possibility of additional investment in electric utility infrastructure (particularly transmission and distribution) with repeal of PUHCA 1935. We have identified three critical areas that may be neglected with repeal: transfer pricing, cost allocation and cross-subsidies, and various flavors of financial abuse. This section of the report discusses the authority states typically have with regard to holding companies and suggests some capabilities to look for in reviewing state statutes and regulations. In the following section we give examples of choices states have made or are considering.

Most state commissions have traditionally exercised authority over registered holding companies and have acted in a manner that supplemented SEC regulation. Some states have decades old statutes that explicitly exert state authority over the formation of holding companies or changes of control of utilities.[24] Most commissions have authority to review the business relationships between an electric utility and its subsidiaries and affiliates on a periodic basis, mostly during rate proceedings. State commissions have authority over retail rates, and most state commissions also have authority to approve utility mergers and acquisitions,[25] to approve long-term utility financing, and over affiliate codes of conduct. And even before the PUHCA 1935 repeal most state commissions had their own independent authority to gain access to the books and records of utility subsidiaries, affiliates, and holding companies. In these statutes as well as in ad hoc proceedings state commissions have exercised a variety of levels of control over holding companies.[26]

Transfer Pricing

All state commissions except Nebraska, which has only publicly owned electric and gas utilities, address affiliate transactions. This authority exists whether or not a holding company is involved. In the case of affiliate transaction statutes, some commissions require the transactions to have prior approval by the commission.

Using existing authority, commissions can disallow all affiliate transactions until the utility proves them to be just and reasonable, because there is no presumption of prudence in an affiliate transaction. If implemented, this requires further commission retroactive oversight of the utility. If not well implemented, regulation becomes ineffective. There are other similar existing commission tools such as commission denial of dividend payments to the utility. But it might be fairer to the utility entity and holding company if they know in advance the rules they are expected to follow. Credit rating agencies take this point of view.

State commissions generally have authority over retail rates, utility mergers, long-term financing, affiliate codes of conduct, and affiliate transactions.

Cost Allocation and Cross-Subsidies

Nearly all state commissions have authority to deal with affiliate transactions, cost allocation issues and cross-subsidies. Access books and records underpins the ability to effectuate this authority. And some states use this independent authority to require periodic filing of affiliate transactions and cost allocation manuals by the utility, its affiliate, and its holding company.

Financial Abuse

Although commission authority concerning cost allocation, cross-subsidization, and transfer pricing is common, most state commissions have

24 For example, Hawaii Rev. Stat. §417E (1982); Conn. Gen. Stat. § 16-47 (1981); Del. L. §215(d); Wis Ch. 85-79 § 5(3); Ill. Pub. Util. Act Art. VII §7-204; Okla. Stat. tit 17, §191; Ohio House Bill 821 (1986); Oreg. §757.015: Ark. Stat. Ann. § 73-142.2(a); N.J.S.A. 48:2-51.1; Me. Rev. Stat. Tit. 35, §104 (1982); N.M. Stat. Ann. §62-3-3 (1982). For further information, see *infra*, fn.25 & 26.

25 State commission merger review authority statutes and codes can be found in the National Regulatory Research Institute's *Blue Pages* at http://www.nrri.ohio-state.edu/bluepages.

26 For a full discussion of state regulation of holding companies, including existing state statutes, see Hawes, *Utility Holding Companies*, chapter 4 and Robert E. Burns et al., *Regulating Electric Utilities with Subsidiaries,* NRRI 85-16 (January 1986).

Commissions might want to look at their existing authority.

not been concerned as to whether they have authority to protect against corporate abuses, such as those just described above. PUHCA 2005 lacks a grant of additional authority for federal agencies and the states to deal with the potential corporate financial abuses. States may use their otherwise applicable authority to protect consumers to deal with and to protect against potential corporate abuse. Commissions might wish to look at their existing authority to require:

- That regulated utilities maintain a separate corporate entity, especially a special purpose entity distinct from non-regulated affiliates[27]
- The utility to have its own board of directors and management
- Separate utility accounts and books from those of affiliates
- Independent cash management and debt for utilities
- Commission approval before securities can be issued
- Limits on dividends
- Restrictions on upstream loans
- Limits on loans to money pools, loan guarantees, and inter-company advances[28]
- Minimum equity requirements[29]
- Periodic ring-fencing reports[30]
- Access to company books and records.

Separate Corporate Entity

The requirement that regulated utilities maintain a separate corporate entity distinct from non-regulated affiliates can make it easier to distinguish between regulated utility activities and the non-utility related activities of non-regulated affiliates. Such a corporate structural separation makes it easier to identify potential corporate financial abuse.

Board of Directors and Management

The requirement that the utility have its own board of directors and management serves three functions. First, it insulates the utility from its holding company and allows the state regulator to send clear signals to the utility management about the expectations of the regulator. Second, it can allow the utility to operate separately should the utility holding company system become insolvent or go bankrupt. Third, an independent management could help to offset any

27 Many of these measures relate to protecting the integrity of utility companies. They are listed individually because they may be used separately.

28 The Public Service Commission of Kentucky protected the Union Light Heat and Power Company's (ULH&P's) credit rating by requiring that: "42. ULH&P will not guarantee the credit of any of its affiliates unless specifically approved by the Commission; and 43. All debt at the New Duke Energy and Cinergy levels will be non-recourse to ULH&P." *In the Matter of Joint Application of Duke Energy Corp…*, Case No. 2005-00228.

29 For example, the Public Utility Commission of Oregon Condition 6 required that "PGE [Portland General Electric Company] shall not make any distribution to Enron that would cause PGE's equity capital to fall below 48 percent of the total PGE capital without Commission approval." *In the Matter of the Application of Enron Corp.*, Order No. 97-196.

30 For example, the Wyoming Public Service Commission (Wyoming PSC) required that PacifiCorp file an annual detailed affiliate transactions report in its Order No. 20000-EA-98-141 (Condition 30). Such reports could also be required to include information relating to ring-fencing measures. The Wyoming PSC went on in Condition 30 to require that "ScottishPower and PacifiCorp will not assert regulatory preemption by [the] United Kingdom or foreign regulators."

tendency for there to be excessive reassignment of management expertise.

Separate Accounts and Books

The requirement that there be separate utility accounts and books from those of the affiliates also allows the commission to better check for financial abuse as well as to check cross-subsidies, cost misallocations, and affiliate transactions.

Cash Management and Utility Debt

Independent cash management and utility debt is necessary to provide that the utility is not unduly influenced by the financial transactions of its holding company and that the riskiness of holding company affiliate activities is not transferred to the utility and its ratepayers.

Issuance of Securities

Many state commissions have existing authority to approve the issuance of long-term debt and equity by the utilities. Not all commissions have authority to require approval of short-term debt. Requiring commission approval to issue securities can help to head off corporate financial abuse. Commissions can make certain that debt, equity, and other securities issued by the utility are for proper utility purposes and not to support the activities of an unregulated affiliate.

Dividends

Some commissions have existing authority to place limits on the dividends of a utility. Commissions might consider this authority desirable in a holding company context, so that during periods when the utility might need internally generated capital or working capital for maintenance or construction, the utility's dividends are not excessive. While stockholders expect utility dividends, they should not be set at such a level that the holding company and its affiliates are treating the utility as a cash cow.

Loans

State commissions might find it useful to have the authority to place restriction on upstream loans and to limit utility loans. Unrestricted upstream loans can have the effect of transferring risks from an unregulated utility to the utility and its ratepayers. Upstream loans should be carefully monitored by state commissions and should be allowed only when related to utility-related activities that the utility and its ratepayers will benefit from. Likewise, limits might need to be placed on the amount and types of utility loans.

Equity Requirements

State commissions might wish to place minimum equity requirements on its utility. The commission needs to be concerned that the utility might become overleveraged, raising its risk and its cost of capital. The commission also needs to be concerned about the utility's credit rating for the sake of investment in future infrastructure. Also, the state commission must be concerned that long-term purchased power contracts are not entered into with affiliates. Such long-term con-

A commission's authority to access books and records is the primary lever for gaining information about holding companies.

There are three general approaches to ring-fencing:
1. case-by-case via merger review
2. ring-fencing with diversification and
3. state mini-PUHCA statutes.

tracts might be treated on the financial markets as the equivalent of debt.

<u>Access to Books and Records</u>

A commission's authority to access books and records is the primary lever for gaining information and understanding the utility holding company's operations and potential abuses. State commissions can only be effective if they have adequate and timely access to books and records. Given the recognition of continued state authority to regulate affiliate transactions and to deal with cost allocation and cross-subsidies, state access to books and records is critical.

While states can rely on access to books and records pursuant to section 1265 of PUHCA 2005, commissions might find the restrictiveness of its provisions cumbersome. In particular, the requirement that books and records be identified in reasonable detail in a proceeding before the state commission seems to presume that the commission already has enough information to be able to identify the books and records that are relevant to costs in the proceeding. In reality, state commissions may require periodic, perhaps annual, filings of affiliate transactions and relevant cost allocation manuals before a state proceeding or investigation is filed in order to be able to identity in reasonable detail any additional books and records that might be needed. For this reason it might be desirable to have more expansive state authority to access books and records as well as to require periodic ring-fencing reports.

THREE GENERAL STATE APPROACHES TO RING-FENCING

As state commissions examine methods by which they can best protect utility consumers against potential corporate abuse, they are attempting to strike an appropriate balance between the Congressional intent that PUHCA 1935 be repealed in order to encourage investment in the electric and gas infrastructure and the Congressional authorization to exercise their state jurisdiction to protect utility consumers. Encouraging investment and consumer protection are state goals as well as federal ones but could be somewhat in conflict. Policy options may be viewed as occurring along a continuum from most encouraging to investors and least anticipatory of new consumer protection needs to least encouraging to investment and most protective of consumers. Commissions already have many legal arrows in their quivers to assure that they can attract infrastructure investment and provide consumer protection. How proactive a commission wishes to be in pursuing new options at the state level depends on its evaluation of the existing balance. If it finds that existing law and commission rules appear to be sufficient, the commission will likely wish to handle new cases individually (the first option). If it finds that PUHCA 1935 repeal leaves gaps, the commission can either take an incremental approach of filling holes, without imposing new state limits on diversification (the second option), or it can opt to promote a full-blown initiative to enact a state-level version of the PUHCA 1935 (the third option). This section of the report discusses an Oregon merger review that represents the first approach, a Maryland staff proposal that exemplifies the second, and Wisconsin's "mini-PUHCA" the third.

If a state finds that it is already at an appropriate balance, and the right approach is case-by-case, a merger proposal presents the opportunity to formally address the issues created by the repeal of PUHCA 1935.[31] Most state commissions have the authority to review and approve or deny proposed mergers[32] and can include ring-fencing conditions in their merger approvals. Using a commission's conditioning authority when addressing mergers provides an opportunity to deal with the utility, the holding company, and its affiliates in a straightforward and predictable manner. The Oregon Public Utility Commission provides an example of case-by-case ring-fencing through merger review.

Some states might identify gaps in existing authority and choose a more proactive approach. Addressing consumer protection simply using existing commission authority might require constant commission vigilance. State commissions might also find it difficult to monitor every financial transaction that could lead to a definite or subtle corporate abuse unless there are existing reporting requirements and rules of the road to lay out expectations.

A state might choose statutes and/or commission regulations that lay out ring-fencing provisions without prohibiting diversification, choosing a balance that provides consumer protection while allowing infrastructure investment from outside the industry. The Maryland Public Service Commission staff proposed such a regulatory approach. A statutory approach offering the greatest protection from corporate financial abuses would include: (1) structural restrictions that maintain public utilities as separate entities, as well as the requirement that public utilities maintain separate accounts; (2) state utility commission access to the books and records of companies in a holding company system with company reporting requirements; (3) requirement of commission authorization for securities offerings, dividends, and distributions; (4) restrictions on affiliate transactions; (5) guarantees that public utilities will not be involved in any bankruptcy proceedings of parents or affiliates; and (6) clear penalties for violations. Penalties might range from the imposition of monetary penalties for violations to ratepayer reimbursement to forced divestiture and restructuring. Another possibility has been practiced in Virginia, where penalties have been es-

Most state commissions have the authority to approve or deny mergers.

31 EPAct 2005 also amended the FERC's merger review authority under FPA §203. EPAct 2005 §1289 increased the minimum threshold value for transactions subject to FPA §203 to $10 million, requires the FERC to make cross-subsidization findings, and required the FERC to promulgate new merger and acquisition review rules. The new rules were set out in the FERC Order 669 Transactions Subject to the Federal Power Act Section 203, issued 23 December 2005, 18 CFR Parts 2 & 33.

32 Except Florida, Michigan (indirect), Montana, and Nebraska. Indiana has no authority over mergers involving holding companies. Commissions in these states might seek merger authority or legislation authorizing ring-fencing authority.

The Public Utility Commission of Oregon has employed the case-by-case approach.

tablished for companies whose bond ratings have fallen below a set amount.

Finally, other states might opt for greater authority, essentially passing state "mini-PUHCA" statutes that provide state commissions with authority to review all transactions and to limit holding company diversification. The model for this approach is the Wisconsin PUHCA statute, arguably the most comprehensive state consumer protection statute.

Case-by-Case through Merger Review: Public Utility Commission of Oregon

State public utility commissions have used merger reviews to implement ring-fencing very effectively. A recent example of ring-fencing within existing commission authority that might be of interest is the Public Utility Commission of Oregon's (Oregon PUC's) merger approval proceeding for MidAmerican's application to acquire PacifiCorp.[33] PacifiCorp is a vertically integrated electric utility serving retail customers in six states: California, Idaho, Oregon, Utah, Washington, and Wyoming. Thus, six state commissions were involved in approving the acquisition. Oregon had a particularly keen interest in the transaction because PacifiCorp is an Oregon corporation. MidAmerican Energy Holding Company (MEHC) is an Iowa corporation. MEHC's largest investor is Berkshire Hathaway.

Statutory Authority

The Oregon Legislative Assembly codified the state's interest in non-utility businesses controlling public utilities: "the protection of customers of public utilities…is a matter of fundamental statewide concern…an attempt by a person not engaged in the public utility business in Oregon to acquire the power to exercise any substantial influence over the policies and actions of an Oregon public utility which provides heat, light or power could result in harm to such utility's customers, including but not limited to the degradation of utility service, higher rates, weakened financial structure and diminution of utility assets.[34]"

Within this general policy, the Oregon PUC has statutory authority to regulate the acquisition of an Oregon utility. An entity interested in acquiring an Oregon utility must first apply at the commission. The general standard for approval of MEHC's application for authority to exercise influence over a utility in Oregon is a net benefits test.[35] To meet the test, the transaction should not harm customers and must not impose a detriment to Oregon citizens as a whole. The potential benefits and harms resulting from the proposed merged organization are weighed against the utility as currently configured.[36] The commission may

33 In the Matter of MidAmerican Energy Holdings Company Application for Authorization to Acquire Pacific Power & Light, dba PacfiCorp, Public Utility Commission of Oregon Docket No. UM 1209 (MEHC Application).

34 Oregon Revised Statutes §757.506.

35 Oregon Revised Statutes §757.511.

36 In re Oregon Electric Company, Order 05-114 at 18. The Oregon net benefits standard is a legal test. Both the transaction costs and the other harms and benefits are weighed. The OPUC

condition an order authorizing an acquisition upon specific requirements.[37]

In Oregon, the commission has further statutory authority to impose ring-fencing measures that protect against affiliate transaction abuses, misallocation of costs and cross-subsidies, and financial abuses. The commission regulates the issuance of utility securities.[38] Commission approval must be obtained before a utility may guarantee another's debt.[39] Approval is also required for the sale of utility property.[40] The commission regulates affiliate transactions, and approves contracts between utilities and affiliates.[41] Commission rules set out the procedure for approving affiliate transactions.[42] An annual report detailing affiliate interests and transactions is required.[43] The Public Utility Commission of Oregon has employed these statutes and regulations to require ring-fencing provisions in MEHC's acquisition of PacifiCorp.

derived the standard from their statutory authority to allow mergers that are in the public interest. The net benefits standard is very similar to the no harm standard, but a bit stricter. The transaction must create a tangible benefit that is substantial enough to outweigh the risks of the transaction. The transaction must be more than neutral. It must improve the status quo for citizens. The benefits and costs need not be economic, nor do costs need to be transactions costs. The commission looks at the totality of the circumstances. Thus, each transaction must be looked at on a case-by-case basis.

37 In addition to the statutory requirements, the Oregon Administrative Rules §860-027-0200 set out information that must be provided to the commission with an application to acquire an energy utility. The rule requires, among other things, a schedule detailing capital structure, an explanation of how bond rating and capital costs will be affected, an organizational structure listing affiliate interests, a description of the cost allocation method, a description of any plans to sell or pledge utility assets, and a copy of any existing or proposed agreement between the energy utility and any businesses that will become affiliated interests.

38 Oregon Revised Statutes §§ 757.405 – 757.415.

39 Oregon Revised Statutes § 757.440.

40 Oregon Revised Statutes § 757.485.

41 Oregon Revised Statutes §§ 757.490 - 757.495.

42 Oregon Administrative Rules §§ 860-027-0040 – 860-027-0044.

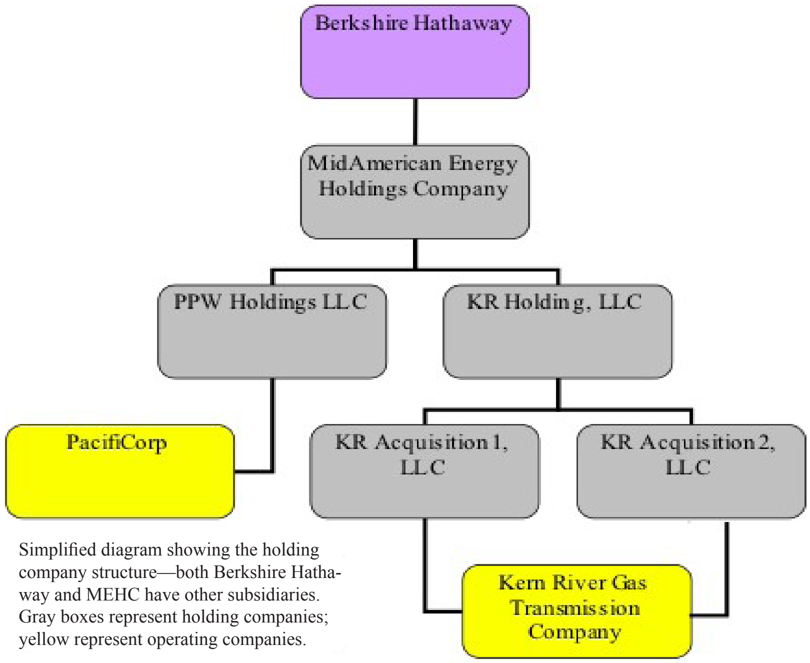
The Public Utility Commission of Oregon required ring-fencing provisions in MidAmerican's acquisition of PacifiCorp.

<u>Separate Corporate Structure</u>

MEHC will wholly own PacifiCorp if the acquisition is successful, but indirectly. A special purpose entity—PPW Holdings LLC (PPW)—will be set up as a ring-fencing measure.[44] This type of special purpose corporate structure serves to separate the regulated utility from its parent and affiliates and helps to prevent corporate financial abuse, while making it easier to track affiliate transactions and cross-subsidies. PPW will serve to ring-fence PacifiCorp by maintaining a separate credit rating and bankruptcy remoteness. PPW will be a legally separate intermediate holding company between MEHC and PacifiCorp as a direct subsidiary of MEHC. It will receive an equity infusion from the sale of MEHC preferred stock to Berkshire Hathaway and other equities to third parties, but will have no debt of its own. The sole purpose of PPW is to own the common equity of PacifiCorp. PPW will have an independent director, whose consent will be required to place PPW or PacifiCorp into bankruptcy. PPW will require PacifiCorp to maintain separate assets, books, and employees, and will prohibit the commingling of assets. The non-recourse structure of PPW prevents liabilities of MEHC or its subsidiaries from being charged to PacifiCorp. The credit of PacifiCorp or

43 Oregon Administrative Rules § 860-027-0100.

44 MEHC Application, Stipulation, Appendix 1.



Simplified diagram showing the holding company structure—both Berkshire Hathaway and MEHC have other subsidiaries. Gray boxes represent holding companies; yellow represent operating companies.

Source: Authors' construct

A special purpose corporate entity was established to separate the regulated utility from its parent and affiliates.

PPW cannot be used to satisfy the obligations of, or be used as security for the debt of MEHC. Likewise, neither PPW nor PacifiCorp may acquire the obligations of MEHC or its affiliates.

Two additional provisions directly address the reasons for establishing a special purpose entity. To protect the credit rating of PacifiCorp, the PPW operating agreement may not be modified without the approval of the independent director and a written confirmation by each relevant rating agency that the change will not result in the downgrade or withdraw of any rating assigned by it to PacifiCorp's debt. The second purpose of PPW is to protect PacifiCorp from being drawn into a bankruptcy of MEHC. PPW can only be dissolved upon the entry of a judicial decree. If MEHC is dissolved, PPW will have at least one person who will automatically become a member in its stead. MEHC agrees to waive the right to dissolve PPW, even in the event of bankruptcy. Furthermore, PPW can only file for bankruptcy or insolvency with unanimous written consent of everyone on the board, including the independent director.

In addition to creating a ring-fenced corporate entity, MEHC made several sets of commitments in its application to acquire PacifiCorp. Some of the commitments apply to all of the concerned states (these commitments will be referred to by number); other commitments are specific to Oregon (referred to by a number preceded by an O, e.g., O1, O2).[45] These commitments address three categories of concern: (1) those relating to the holding company system, (2) the financial stability of the utility, and (3)

45 MEHC Application, Stipulation, Exhibit 1.

effects on the operations of the utility.

Holding Company System Commitments

Commitments that relate to the holding company system include several allowing access to information in Oregon. These commitments provide independent authority for a more expansive state access to books and records, allowing the Oregon PUC to better monitor to prevent affiliate transaction abuse and cross-subsidies. Commitment 3 requires PacifiCorp to maintain separate accounts in Portland, Oregon. Commitment 4 allows for commission access to all books and records that relate to transactions between PacifiCorp and its affiliated interests or that are otherwise relevant to the business of PacifiCorp. Berkshire Hathaway is bound by this provision. Berkshire Hathaway is also bound by Commitment 17, which grants state utility commissions unrestricted access to all written information provided by and to credit rating agencies that pertains to PacifiCorp or MEHC. Commitment 6 allows the commission or its agents to audit the accounting records of MEHC and its subsidiaries that are the bases for charges to PacifiCorp. Several provisions allow the Oregon commission to regulate the portion of the multi-state utility located in Oregon. Commitment 9 prohibits cross-subsidization between regulated and non-regulated businesses or between any regulated businesses and requires PacifiCorp and MEHC to comply with all applicable commission orders and rules. Commitment 14 calls for commission approval of cost allocation methods and sets out principles which such methods must comply with. Commitment O3 provides that MEHC and PacifiCorp will interpret Oregon statutes to require commission approval of any contract between PacifiCorp and any affiliate of Berkshire Hathaway or MEHC. Commitment O4 states that MEHC and PacifiCorp will interpret Oregon statutes to require commission approval of any transaction resulting in a merger of PacifiCorp with another public utility, without regard to whether that public utility provides service in Oregon. Commitments 16 and O13 exclude the costs of the merger transaction from PacifiCorp's accounts.

Financial Stability Commitments

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Another group of commitments relate to the financial stability of PacifiCorp and the associated issue of diversification. These commitments provide some protection against corporate financial abuse. Commitment 11 prohibits diversification of PacifiCorp, but not MEHC or its other affiliates from holding diversified businesses. It also makes all of the commitments applicable to the ring-fencing provisions for PPW. Commitment 15 obligates MEHC and PacifiCorp maintain separate debt and preferred stock, and for PacifiCorp to maintain its own credit rating. MEHC and PacifiCorp also commit in Commitment 18 that the latter will not make any dividends to PPW or MEHC that reduce PacifiCorp's common equity capital below 48.25% of its total capital without commission approval. Commitment 20 prohibits PacifiCorp from making loans, transferring funds, or pledging any assets in favor of MEHC, Berkshire Hathaway, or their respective subsidiaries

The commission required provisions to protect the regulated utility's financial stability and credit rating.

The commission's goal was bankruptcy remoteness for the utility.

without commission approval. In addition, Commitment 21 bars MEHC and PacifiCorp from advocating for a higher cost of capital compared to what PacifiCorp's cost of capital would have been, employing commission standards, absent MEHC's ownership.

The Oregon specific commitments also contain provisions concerning the financial stability of PacifiCorp. Commitment O14 provides that, in the event of a ratings downgrade by two or more rating agencies of PacifiCorp's long-term debt within a year of the acquisition, the assumed yield for any incremental debt issued by PacifiCorp will by reduced by 10 basis points for each notch that PacifiCorp is downgraded. Moreover, if that debt issued is recalled and refinanced, PacifiCorp agrees to hold customers harmless. Commitment O15 prohibits PPW from having any debt in its capital structure immediately following the closing of the transaction. It further provides that the consolidated capital structure of PPW will not contain common equity capital below 48.25%. MEHC also commits to providing the commission 30 days prior notice if PPW intends to issue debt. Commitment O18 bars PacifiCorp from making dividends to PPW or MEHC if PacifiCorp's unsecured debt rating falls below BBB- by S&P of Fitch (Baa3 by Moody's). Bankruptcy remoteness is the goal of O17, which requires MEHC to obtain a non-consolidation opinion demonstrating that the ring-fencing around PPW is sufficient to prevent PPW and PacifiCorp from being pulled into an MEHC bankruptcy. If the ring-fencing provisions are insufficient, MEHC commits to propose and implement, upon commission approval, provisions sufficient to prevent PPW and PacifiCorp from being pulled into an MEHC bankruptcy.

<u>Operational Commitments</u>

A final group of commitments concern the operations of PacifiCorp. Commitment 1 requires MEHC and PacifiCorp to maintain existing customer service guarantees and performance standards through 2008. Commitment 45 extends the commitment until 2011, and requires commission approval for modifications. Commitments O20-O22 oblige MEHC and PacifiCorp to fund programs to benefit low-income customers. Commitment 47 requires MEHC to maintain adequate staffing in each state. Commitment O2 directs MEHC to maintain PacifiCorp's corporate headquarters in Oregon and to ensure that senior management personnel in Oregon have authority to make decisions on behalf of PacifiCorp. MEHC and PacifiCorp commit to rate credits totaling $142,500,000 through 2010 in O7 (described in detail in O8-O12). PacifiCorp and MEHC commit to invest in renewable resources in Commitments 39, 40, O23, O25, O26, O27, and O28. They also commit to emissions reduction control measures in 41, 42, 43, O31, and O32. Finally, MEHC and PacifiCorp commit in O33 not to support before 2016 any legislation in Oregon to eliminate or impair retail access.

<u>Discussion of Approach</u>

Developing ring-fencing measures for a merger on a case-by-case basis might sometimes be problematic.

First, during a merger approval proceeding, there are usually many issues on the table. Often the entities desiring the merger offer to trade some conditions to obtain merger approval. Usually, an immediate rate decrease and/or a rate freeze is offered as a potential condition. State commissions might find it difficult to insist on ring-fencing provisions for long-term consumer protection when immediate rate relief or short-term service quality guarantees are offered, perhaps in its stead. Second, conditioning mergers on a case-by-case basis could create an uneven playing field within a state. This can be particularly troublesome in retail choice states. Inconsistent merger conditions can also create an uneven playing field in wholesale markets. To ensure that ring-fencing measures taken in merger reviews are consistent, state commissions might have a policy in place before proceedings are initiated and might treat prior merger cases as precedent.

Ring-Fencing with Diversification Allowed: Maryland Public Service Commission

The second general approach states might take to fill in gaps in existing legislation is ring-fencing that continues to allow utility diversification. Unlike the mini-PUCHA approach outlined below, ring-fencing places few restrictions on the establishment of a utility holding company or on diversification. Rather, the focus is on preserving the financial status of a utility within a holding company system. A variety of measures can be employed to ring-fence a utility, including protections against corporate financial abuse, structural separation, and restrictions on affiliate transactions. Like the approach that re-creates many of the PUHCA 1935 provisions at the state level, ring-fencing helps to maintain a utility company's credit rating by separating it from parents or affiliates. Because this approach also requires rules imposed by statute or regulations, it supplies the certainty of being proactive. This also distinguishes it from the case-by-case approach.

An intermediate approach between using existing commission authority in a merger proceeding and enacting ring-fencing statutes has been proposed by staff members of the Maryland Public Service Commission. In an analysis of ring-fencing measures, the commission staff concluded that existing commission authority combined with proposed affiliate transaction regulations and the adoption of an annual ring-fencing report would adequately protect utilities and their customers.[46] In attempting to devise ring-fencing measures that operate in a proactive manner without unduly burdening the operation of utilities and their relation-

The Maryland Public Service Commission has employed ring-fencing while allowing diversification.

46 Andrew N. Beach *et al.*, Maryland Commission Staff Analysis of Ring-Fencing Measures for Investor-Owned Electric and Gas Utilities, *The NRRI Journal of Applied Regulation*, vol. 3, December 2005, pp. 1-12.

The Maryland PSC staff recommended:
• reviewing existing authority
• amending regulations where necessary
• proactive ring-fencing and
• no prohibitions on holding company diversification.

ships within holding company systems, the staff members determined that requiring an annual ring-fencing report could provide an opportunity to act on a weakness in a utility's ring-fence on a case-by-case basis before an event affects the utility's service or rates.[47] The approach of the Maryland commission staff can be summarized as:

- review existing commission authority
- amend regulations where necessary
- employ ring-fencing authority in a proactive manner
- no prohibitions on holding company diversification are included.

Statutory Authority

The general regulatory powers granted to the Maryland Public Service Commission (PSC) by the Public Utility Companies Article of the Annotated Code of Maryland include provisions relevant to ring-fencing. The PSC has general and supervisory regulatory authority over utilities in Maryland.[48] The PSC also has the power to examine books and records.[49] The PSC has the authority to set just and reasonable rates for utilities.[50] The PSC has some authority over cost allocation manuals as well.[51] More specifically, a utility may not assign, lease, or transfer a franchise or a right conferred by that franchise without permission from the PSC.[52] The Maryland statutes also place some restrictions on securities and debt transactions of state utilities.[53] Commission authorization is also required for a utility to assume or guarantee a debt payable more than a year after issuance.[54]

The commission proposed new regulations to strengthen consumer protection.

Maryland's public utility statute also mandates a set of reporting requirements. Utilities must file annual reports containing information regarding corporate structure and debt holdings[55], information concerning stock and indebtedness[56], information on business activities of the utility and its affiliates,[57] and about the relationships of officers and directors with a utility, parent, or affiliate.[58]

Maryland's Electricity Industry Restructuring Act contains several provisions addressing affiliate transactions[59]. Utilities may not give undue or unreasonable preference to affiliates.[60] The statute calls on the PSC to require affiliate codes of conduct.[61] It also requires functional, operational, structural, or legal separation of regulated and non-regulated businesses.[62] Furthermore, the PSC is empowered to conduct investigations into any anti-competitive conduct.[63]

Draft Regulations

The PSC's regulations also pro-

47 *Id.* at p. 2.
48 Annotated Code of Maryland §§ 2-112, 2-113.
49 Annotated Code of Maryland § 2-115.
50 Annotated Code of Maryland § 4-102.
51 Annotated Code of Maryland § 4-208.
52 Annotated Code of Maryland § 5-202.
53 Annotated Code of Maryland §§ 5-203, 6-101, 6-102, 6-103, 6-104.
54 Annotated Code of Maryland § 5-203.
55 Annotated Code of Maryland § 6-205.
56 Annotated Code of Maryland § 6-207.
57 Annotated Code of Maryland § 6-208.
58 Annotated Code of Maryland § 6-209.
59 Annotated Code of Maryland § 7-501 *et seq.*
60 Annotated Code of Maryland § 7-501(b)(3)(i).
61 Annotated Code of Maryland §§ 7-505(b)(10), 7-505(b)(13).
62 Annotated Code of Maryland § 7-505(b)(10)(iii).
63 Annotated Code of Maryland § 7-514.

vide ring-fencing measures consistent with the statute. In addition, the PSC has proposed draft subtitle 49 to the Code of Maryland Regulations to strengthen consumer protection. These draft provisions would set out rules regarding loans, guarantees, and asset transactions between utilities and affiliates. The draft regulations would require utilities to record asset transactions over a specified value with affiliates in their financial records based on asymmetric pricing to the extent permitted by law. Restrictions would be placed on loans or debt guarantees to affiliates. A cost allocation manual would also be required.

Staff Proposal

The PSC staff recommends that the PSC require an annual ring-fencing report.[64] The report would resemble Oregon's affiliate transaction report, but with a broader scope. Ten items of content are suggested.

Information Required in Ring-Fencing Report

The staff of the Maryland PSC recommends an annual report that would provide the information needed to determine whether a utility is adequately separated within the holding company system. The report would include:

- a complete organizational chart
- a description of ring-fencing measures
- a list of shared corporate officers and other key personnel
- a corporate risk assessment indicating financial exposure
- description of regulated company's capital structure and that of its affiliates
- a description of limitations placed on non-utility asset investments
- a summary of financing secured by the assets of, or guaranteed by, the regulated company on behalf of non-regulated entities
- identify all shared assets
- indicate any defaults of material obligations or bankruptcy filings by affiliates
- a description of any protections that exist between the regulated company and non-regulated affiliates that mitigate the risk of the regulated company in the event of a bankruptcy of an affiliate.

Discussion of Approach

Structural constraints that maintain public utilities as separate entities within a holding company system combined with ring-fencing measures provide strong security for utilities. Such measures at a minimum include restrictions on affiliate transactions such as cross-subsidization, cost allocation, and transfer pricing, as well as state utility commission access to books and records. Credit ratings services prefer this approach because it provides the greatest degree of certainty.[65] If adequate ring-fencing measures are in place, credit rating services will not

The Maryland PSC required an annual ring-fencing report.

64 See the Appendix in Andrew N. Beach *et al.*, Maryland Commission Staff Analysis of Ring-Fencing Measures for Investor-Owned Electric and Gas Utilities, *The NRRI Journal of Applied Regulation*, vol. 3, December 2005, pp. 1-12.

65 See e.g., Sharon Bonelli, "Ring-Fencing," PowerPoint presentation, 2005. A copy of this document is available at http://www.nrri.ohio-state.edu/dspace/handle/2068/621.

link parent and affiliate debt with that of a utility. Under PUHCA 1935, the credit rating of registered holding companies tended to be higher than companies that were exempt from PUHCA 1935. This method also provides certainty because it is preemptive; state regulators do not need to wait for a rate case or a merger review to look into affiliate transactions, ownership transfers, diversification, and other matters.

Wisconsin has a mini-PUHCA statute.

State Mini-PUHCAs: Ring-Fencing with Diversification Restrictions: Wisconsin Public Service Commission

The third general approach that states can take to protect jurisdictional utilities and their ratepayers is to re-create some of the provisions of PUHCA 1935 in a state statute, including limits on utility diversification.

Wisconsin has perhaps the most complete statutory model of a "mini-PUHCA." Wisconsin's Utilities Holding Company Act includes a requirement of public service commission approval before any person acquires more than 10% of the outstanding voting securities of a public utility holding company.[66] Holding companies systems are prohibited from operating in a manner that materially impairs the credit of any public utility.[67] The commission may regulate the issuance of securities by utilities.[68] Public utilities are also prohibited from lending to or guaranteeing the debts of parents or affiliates.[69] A distinctive feature of Wisconsin's approach is the asset cap provision. This provision limits public utility investment in non-utility businesses to 25%.[70] Furthermore, within three years after it is formed, a holding company may not have non-utility affiliate assets exceeding 40% of that 25%.[71] These provisions limiting holding company diversification distinguish Wisconsin's approach from the other two models described above. In this sense, Wisconsin's state PUHCA goes beyond ring-fencing the utility to restrict the actions of other entities in the holding company system.[72]

<u>Discussion of Approach</u>

A potential disadvantage of a state PUHCA with ring-fencing measures is that some might be hesitant to invest in public utilities located there. Strong protections for jurisdictional utilities and their ratepayers limit

66 Wisconsin Statutes §196.795(3).
67 *Id.* §196.795(5)(g).
68 *Id.* §§196.795(5)(a) & (b), 201.01(2), and 201.03(1).

69 *Id.* §196.795(5)(c) & (d).
70 *Id.* §196.795(6m)(b).
71 *Id.* §196.759(6m)(b)(3).
72 Section 196.795(6m)(b) states that the sum of the assets of all nonutility affiliates in a holding company system may not exceed the sum of the following: a) 25% of the assets of all public utility affiliates in the holding company system engaged in the generation, transmission or distribution of electric power; b) a percentage of the assets, as determined by the commission, which may be more, but may not be less than 25% of all public utility affiliates in the holding company system engaged in providing utility service other than the generation, transmission or distribution of electric power; c) for any public utility affiliate which is in the holding company system and which engages in more than one type of utility service, a percentage of assets equal to the amount of the public utility affiliate's assets devoted to public utility service, other than the generation, transmission and distribution of electric power, multiplied by a percentage, as determined by the commission, which may be more, but may not be less than 25%, plus 25% of all remaining assets of such public utility affiliate.

the flexibility of holding companies. The Wisconsin statutes were challenged in the federal courts by a holding company dissatisfied with them.

The legal challenge to the Wisconsin statutes was mainly based on concerns with the commerce clause of the federal constitution. A utility holding company filed suit against the Wisconsin Public Service Commission arguing that the relevant Wisconsin statutes violate the commerce clause. The federal district court granted summary judgment in favor of the commission. On appeal, the 7th Circuit Court of Appeals held that, with one exception, the Wisconsin statutes were constitutional.[73]

The commerce clause of the United States Constitution grants the U.S. Congress the authority to regulate interstate commerce. A corollary of this rule is the negative or "dormant" commerce clause. The dormant commerce clause provides that states may not discriminate against or burden interstate commerce. Where a state law is not unconstitutional on its face, the courts employ several tests to balance state interests with the burden on interstate commerce. The 7th Circuit judges determined that a statutory provision mandating an in-state corporation was unconstitutional. The other challenged provisions (limits on diversification, securities regulation, and takeover provisions) were all held to be constitutional. The judges stated that "Wisconsin clearly has an interest in policing its public utilities to protect the welfare of ratepayers."[74] The statutes were not unconstitutional on their face because they imposed equal burdens on Wisconsin and foreign companies. The court balanced the burden of obtaining commission approval for certain acts and the prohibition of other acts against the benefits of the statutes to public utilities and their ratepayers, particularly the protection against cross-subsidization and deceptive cost allocations. The judges determined that the benefits outweighed the burdens, stating that: "The need to prevent abuses made possible by the presence of a holding company is extremely important and imperative for the proper functioning of any regulatory scheme. The dangers inherent in the mere existence of utility holding companies render a great need for structural regulation of those companies."[75]

Although the law seems settled in this area, the repeal of PUHCA 1935 might renew arguments that state statutes with similar provisions violate the commerce clause. Opponents of regulation might argue that EPAct 2005 preempts some state authority because the PUHCA 2005 affects a commerce clause analysis for the purposes of determining whether a federal statute has a preemptive affect.[76] Pursuant to

A federal court of appeals held that, with one exception, Wisconsin's mini-PUHCA statute was constitutional.

73 *Alliant Energy Corp. v. Bie*, 330 F.3d 904 (7th Cir. Wisconsin 2002), U.S. Supreme Court certiorari denied, 124 S.Ct. 1077 (2004) and 124 S.Ct. 1047 (2004). The U.S. Supreme Court denied certiorari without comment.

74 *Id.* at page 910.

75 *Id.* at page 918.

76 Because of the savings provisions in PUHCA 2005, it is clear that Congress does not intend the FERC to occupy the field. Concurrent regulation is envisioned. Even so, some might argue that there are commerce clause limitations on state regulation of holding companies. A commerce clause analysis is a balancing test, which is set out in Pike v. Bruce Church, Inc., 397 U.S. 537 (1970): "In determining the validity of state statutes affecting interstate commerce….when the state statute

Each state commission must determine its existing authority and which approach it wishes to take.

PUHCA 2005, both the U.S. Congress and FERC have encouraged consolidation and diversification in the electricity industry. States might argue that the benefits of state regulation of holding companies still outweigh the burdens that might be imposed on interstate commerce. Nonetheless, states should carefully draft any statutes regulating utility holding companies to ensure that a balance is struck between state interests and interstate commerce.

SUMMARY AND CONCLUSIONS

EPAct 2005 repealed PUHCA 1935, replacing it with the much narrower authority of PUHCA 2005. Each state commission must address for itself how it wishes to balance the need to assure consumer protection against the possibility of additional investment in electric utility infrastructure (particularly transmission and distribution) that the repeal is expected to stimulate. We have identified three critical areas that may be neglected with repeal of PUHCA 1935: transfer pricing, cost allocation and cross-subsidies, and various flavors of financial abuse. A self-assessment of existing authority will establish the baseline for consideration of what a state commission might need to do to both strike a proper balance and to fill in any gaps in authority. Most state commissions already have authority to deal with affiliate transactions, cost allocation issues, and cross-subsidies. Most state commissions have independent authority over access to books and records that underpins the ability to effectuate this authority. State commissions might examine their own independent authority to books and records to determine whether to require periodic filing of affiliate transactions and cost allocation manuals by the utility, its affiliate, and its holding company. Where additional authority of a ring-fencing nature may be needed, it is to prevent potential obvious and subtle corporate financial abuse.

In many cases, state merger statutes allow states to pursue a case-by-case approach by conditioning the merger. In such cases, state commission conditioning authority is used to provide ring-fencing measures in order to protect consumers from affiliate transaction abuse, cross-subsidies, and, most importantly, potential corporate financial abuse. An alternative, more proactive statutory and/or regulatory approach to ring-fencing offering the greatest protection from corporate financial abuses would include: (1) structural restrictions that maintain public utilities as separate entities that maintain separate accounts; (2) state utility commission access to the books and records with company reporting requirements; (3) requirement of commission authorization for securities offerings, dividends, and distributions; (4) restrictions on affiliate transactions; (5) guarantees that public utilities will

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regulates evenhandedly to effectuate a legitimate local public interest and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on interstate commerce is clearly excessive in relation to the putative local benefit. If a legitimate local purpose is found, then the question becomes one of degree. .. the extent of the burden that will tolerated will depend … on the nature of the local interest involved and on whether it could be promoted as well with a lesser impact on interstate activities."

not be involved in any bankruptcy proceedings of parents or affiliates; and (6) clear penalties for violations.

These two ring-fencing approaches provide greater predictability for investors and also might provide consumer protection while at the same time enhancing infrastructure investment opportunities so long as diversified entities face no direct barrier to investing.

A third approach that attempts to recreate the PUHCA 1935 might be the most problematic from the viewpoint of encouraging investment in electric utility infrastructure. State enactment of PUHCA 1935 style provisions not only provide a highest degree of consumer protection against corporate abuse, but can also inhibit much of the investment community from purchasing an equity interest in a regulated utility.

Until there is more experience concerning where a proper balance between providing for consumer protection and encouraging infrastructure investment is established, state public utility commissions can play their role as "laboratories of democracy" with decentralized public policy experiments where each state attempts to reach the right balance taking into consideration its own local conditions and preferences. As states gain more experience, useful next steps might be to catalog state statutory authorities and ring-fencing provisions. Given the possible moral hazard that ratepayers face should there be cross-subsidies, abusive affiliate transactions, or corporate abuse, there is a clear state interest and benefit in being able set the proper balance between consumer protection and encouraging new infrastructure investment.

State commissions can play their role as "laboratories of democracy".

APPENDIX A: KEY PROVISIONS OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 2005

TITLE XII—ELECTRICITY

Subtitle F—Repeal of PUHCA

§ 1261. SHORT TITLE.
This subtitle may be cited as the ‘‘Public Utility Holding Company Act of 2005’’.

§ 1264. FEDERAL ACCESS TO BOOKS AND RECORDS.
(a) IN GENERAL.—Each holding company and each associate company thereof shall maintain, and shall make available to the Commission, such books, accounts, memoranda, and other records as the Commission determines are relevant to costs incurred by a public utility or natural gas company that is an associate company of such holding company and necessary or appropriate for the protection of utility customers with respect to jurisdictional rates.
(b) AFFILIATE COMPANIES.—Each affiliate of a holding company or of any subsidiary company of a holding company shall maintain, and shall make available to the Commission, such books, accounts, memoranda, and other records with respect to any transaction with another affiliate, as the Commission determines are relevant to costs incurred by a public utility or natural gas company that is an associate company of such holding company and necessary or appropriate for the protection of utility customers with respect to jurisdictional rates.
(c) HOLDING COMPANY SYSTEMS.—The Commission may examine the books, accounts, memoranda, and other records of any company in a holding company system, or any affiliate thereof, as the Commission determines are relevant to costs incurred by a public utility or natural gas company within such holding company system and necessary or appropriate for the protection of utility customers with respect to jurisdictional rates. (d) CONFIDENTIALITY.—No member, officer, or employee of the Commission shall divulge any fact or information that may come to his or her knowledge during the course of examination of books, accounts, memoranda, or other records as provided in this section, except as may be directed by the Commission or by a court of competent jurisdiction.

§ 1265. STATE ACCESS TO BOOKS AND RECORDS.
(a) IN GENERAL.—Upon the written request of a State commission having jurisdiction to regulate a public-utility company in a holding company system, the holding company or any associate company or affiliate thereof, other than such public-utility company, wherever located, shall produce for inspection books, accounts, memoranda, and other records that—
(1) have been identified in reasonable detail in a proceeding before the State commission;
(2) the State commission determines are relevant to costs incurred by such public-utility company; and
(3) are necessary for the effective discharge of the responsibilities of the State commission with respect to

such proceeding.
(b) LIMITATION.—Subsection (a) does not apply to any person that is a holding company solely by reason of ownership of one or more qualifying facilities under the Public Utility Regulatory Policies Act of 1978 (16 U.S.C. 2601 et seq.).
(c) CONFIDENTIALITY OF INFORMATION.—The production of books, accounts, memoranda, and other records under subsection (a) shall be subject to such terms and conditions as may be necessary and appropriate to safeguard against unwarranted disclosure to the public of any trade secrets or sensitive commercial information.
(d) EFFECT ON STATE LAW.—Nothing in this section shall preempt applicable State law concerning the provision of books, accounts, memoranda, and other records, or in any way limit the rights of any State to obtain books, accounts, memoranda, and other records under any other Federal law, contract, or otherwise.
(e) COURT JURISDICTION.—Any United States district court located in the State in which the State commission referred to in subsection (a) is located shall have jurisdiction to enforce compliance with this section.

§ 1266. EXEMPTION AUTHORITY.
(a) RULEMAKING.—Not later than 90 days after the effective date of this subtitle, the Commission shall issue a final rule to exempt from the requirements of section 1264 (relating to Federal access to books and records) any person that is a holding company, solely with respect to one or more—
(1) qualifying facilities under the Public Utility Regulatory Policies Act of 1978 (16 U.S.C. 2601 et seq.);
(2) exempt wholesale generators; or
(3) foreign utility companies.
(b) OTHER AUTHORITY.—The Commission shall exempt a person or transaction from the requirements of section 1264 (relating to Federal access to books and records) if, upon application or upon the motion of the Commission—
(1) the Commission finds that the books, accounts, memoranda, and other records of any person are not relevant to the jurisdictional rates of a public utility or natural gas company; or
(2) the Commission finds that any class of transactions is not relevant to the jurisdictional rates of a public utility or natural gas company.

§ 1267. AFFILIATE TRANSACTIONS.
(a) COMMISSION AUTHORITY UNAFFECTED.—Nothing in this subtitle shall limit the authority of the Commission under the Federal Power Act (16 U.S.C. 791a et seq.) to require that jurisdictional rates are just and reasonable, including the ability to deny or approve the pass through of costs, the prevention of cross-subsidization, and the issuance of such rules and regulations as are necessary or appropriate for the protection of utility consumers.
(b) RECOVERY OF COSTS.—Nothing in this subtitle shall preclude the Commission or a State commission from exercising its jurisdiction under otherwise applicable law to determine whether a public utility company, public utility, or natural gas company may recover in rates any costs of an activity performed by an associate

company, or any costs of goods or services acquired by such public-utility company from an associate company.

§ 1268. APPLICABILITY.
Except as otherwise specifically provided in this subtitle, no provision of this subtitle shall apply to, or be deemed to include—
(1) the United States;
(2) a State or any political subdivision of a State;
(3) any foreign governmental authority not operating in the United States;
(4) any agency, authority, or instrumentality of any entity referred to in paragraph (1), (2), or (3); or
(5) any officer, agent, or employee of any entity referred to in paragraph (1), (2), (3), or (4) acting as such in the course of his or her official duty.

§ 1269. EFFECT ON OTHER REGULATIONS.
Nothing in this subtitle precludes the Commission or a State commission from exercising its jurisdiction under otherwise applicable law to protect utility customers.

§ 1270. ENFORCEMENT.
The Commission shall have the same powers as set forth in sections 306 through 317 of the Federal Power Act (16 U.S.C. 825e–825p) to enforce the provisions of this subtitle.

§ 1271. SAVINGS PROVISIONS.
(a) IN GENERAL.—Nothing in this subtitle, or otherwise in the Public Utility Holding Company Act of 1935, or rules, regulations, or orders thereunder, prohibits a person from engaging in or continuing to engage in activities or transactions in which it is legally engaged or authorized to engage on the date of enactment of this Act, if that person continues to comply with the terms (other than an expiration date or termination date) of any such authorization, whether by rule or by order.
(b) EFFECT ON OTHER COMMISSION AUTHORITY.—Nothing in this subtitle limits the authority of the Commission under the Federal Power Act (16 U.S.C. 791a et seq.) or the Natural Gas Act (15 U.S.C. 717 et seq.).
(c) TAX TREATMENT.—Tax treatment under section 1081 of the Internal Revenue Code of 1986 as a result of transactions ordered in compliance with the Public Utility Holding Company Act of 1935 (15 U.S.C. 79 et seq.) shall not be affected in any manner due to the repeal of that Act and the enactment of the Public Utility Holding Company Act of 2005.

§ 1275. SERVICE ALLOCATION.
(a) DEFINITION OF PUBLIC UTILITY.—In this section, the term ''public utility'' has the meaning given the term in section 201(e) of the Federal Power Act (16 U.S.C. 824(e)).
(b) FERC REVIEW.—In the case of non-power goods or administrative or management services provided by an associate company organized specifically for the purpose of providing such goods or services to any public utility in the same holding company system, at the election of the system or a State commission having jurisdiction

over the public utility, the Commission, after the effective date of this subtitle, shall review and authorize the allocation of the costs for such goods or services to the extent relevant to that associate company.

(c) EFFECT ON FEDERAL AND STATE LAW.—Nothing in this section shall affect the authority of the Commission or a State commission under other applicable law.

(d) RULES.—Not later than 4 months after the date of enactment of this Act, the Commission shall issue rules (which rules shall be effective no earlier than the effective date of this subtitle) to exempt from the requirements of this section any company in a holding company system whose public utility operations are confined substantially to a single State and any other class of transactions that the Commission finds is not relevant to the jurisdictional rates of a public utility.

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