

PUHCA Repeal: Basic Overview

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Before the PUHCA of 1935

- Like baseball, the holding company is an American invention
- Originally, at common law, a corporation did not have the power to own the stock of another corporation except in satisfaction of debt or as a preliminary step toward a merger.
- Special legislative charters, beginning in 1832 with railroad, then 1860s with telephone companies allowed holding companies on a case-by-case basis

Before the PUHCA of 1935 - *continued*

- In 1888 New Jersey amended its General Corporation Law to permit holding companies
- By 1932 49 percent of investor owned electric utilities owned by three holding companies.

Before the PUHCA of 1935 - *continued*

- Early holding companies' corporate structure relied on pyramiding. Many also had pyramided securities – all dependent on the earnings of the electric utility operating company
- The collapse of 1929 led to lower earnings of electric utility operating companies
- The lower operating company earnings had a snowballing effect – the leveraging worked to push fixed securities into default

Purpose of the PUHCA of 1935: Eliminate Evil

- Congress enacted the PUHCA of 1935 to eliminate eleven evils that adversely affected investors and consumers:
 - Investors cannot obtain adequate information to appraise the financial position or earning power of issuers because of the absence of a Uniform System of Accounts
 - Securities are issued without consent of the states

Purpose of the PUHCA of 1935: Eliminate Evil - *continued*

- The PUHCA was enacted - *continued*
 - Securities are issued on the basis of fictitious or unsound asset values bearing no relationship to the amount invested or the earning power of the properties, and on the basis of paper profits from intercompany transactions or in anticipation of excessive revenues from utility subsidiaries

Purpose of the PUHCA of 1935: Eliminate Evil - *continued*

- The PUHCA was enacted - *continued*
 - 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, etc... or enter into transactions where arm's length bargaining is absent and free competition is restrained

Purpose of the PUHCA of 1935: Eliminate Evil - *continued*

- The PUHCA was enacted - *continued*
 - Service, management, construction, and other contracts involve the 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

Purpose of the PUHCA of 1935: Eliminate Evil - *continued*

- The PUHCA was enacted - *continued*
 - Control of utility subsidiaries is exerted through disproportionate investment
 - The growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties
 - There is a lack of effective public regulation
 - There is a lack of economies in raising capital

1935 PUHCA Regulation

- Originally, unless a holding company fell into one of five exemptions, it became a registered holding company
- Registered holding companies were required to operate as an integrated system and were subject to comprehensive reporting and financial requirements and restrictions

1935 PUHCA Regulation

- The most important of the original exemptions was the intrastate holding company exemption
- Later exemptions were created for qualifying facilities, exempt telephone companies, and exempt wholesale generators.

What Has Changed

- There is a Uniform System of Accounts
- There are stricter accounting and reporting standards and disclosure requirements— '33 + '34 Securities Acts + Sarbanes-Oxley
- There are independent financial analysts to protect investors
- More effective state regulation to protect consumers

Effect of the Repeal of PUHCA of 1935

- Holding company structures that would have triggered the comprehensive SEC regulatory requirements as a registered holding company are now permitted
- Formerly exempt holding companies and formerly registered holding companies are treated in the same matter

What Has Not Changed

- Problem of affiliated transactions
- Problem of cross-subsidies/cost misallocation
- Need to access books and records
- The need to address possible risk shifting and financial abuse

The PUHCA of 2005

- The PUHCA of 2005 provides access to books and records and allows states and the FERC to deal with both affiliate transactions and cross-subsidies to deal with the first three problems
- States might consider whether there is a need to address potential risk shifting and financial abuse through “ring-fencing” the operating utility
 - Merger and acquisition conditioning authority
 - Separate legislation or rulemaking