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BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: : Docket Numbers  
PUBLIC UTILITY HOLDING COMPANY ACT OF : AD07-2-000  
2005 AND FEDERAL POWER ACT SECTION 203 :

- - - - -x

Room 2C  
Federal Energy Regulatory  
Commission  
888 First Street, NE  
Washington, DC  
Thursday, December 7, 2006

The above-entitled matter came on for technical  
conference, pursuant to notice, at 9:35 a.m.

BEFORE:

CHAIRMAN JOSEPH T. KELLIHER

1 APPEARANCES:

2 COMMISSIONERS PRESENT:

3 COMMISSIONER SUEDEEN G. KELLY

4 COMMISSIONER MARC SPITZER

5 COMMISSIONER PHILIP MOELLER

6 COMMISSIONER JON WELLINGHOFF

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1 P R O C E E D I N G S

2 (9:35 a.m.)

3 CHAIRMAN KELLIHER: Good morning. I want to  
4 welcome everyone to today's Technical Conference on Issues  
5 Related to the Section 203 of the Federal Power Act and the  
6 Public Utility Holding Company Act of 2005.

7 In particular, I want to thank two of our state  
8 regulatory colleagues, Commissioner Ray Baum of Oregon, and  
9 Commissioner Robert Garvin from Wisconsin.

10 I also want to thank them for traveling so far to  
11 be with us today. Commissioner Garvin has actually traveled  
12 pretty far recently. He was in Iraq for a number of months,  
13 so I want to thank him for coming home safely and for  
14 joining us today. We appreciate your coming.

15 Now two of the Commission's earliest initiatives  
16 under the Energy Policy Act of 2005, were rulemakings  
17 addressing amendments to the Commission's corporate review  
18 authority under Section 203 of the Federal Power Act and  
19 implementation of the Public Utility Holding Company Act of  
20 2005.

21 The Energy Policy Act strengthened the ability of  
22 the Commission to prevent the exercise of market power by  
23 expanding our review authority to encompass transfers of  
24 generation-only facilities and certain holding company  
25 mergers and acquisitions.

1                   Now, I'm pleased that Congress gave us this new  
2 authority. I personally asked Congress to grant us this new  
3 power, because I believe that we needed new regulatory tools  
4 to discharge our historic duty to protect consumers against  
5 market power exercise.

6                   Congress agreed and gave us the tools we needed  
7 and we moved very quickly to implement our new review  
8 authority by issuing the Final Rule by unanimous vote.

9                   Although the merger review language in the Energy  
10 Policy Act expanded the scope of the Commission's review, it  
11 also largely embraced the three-part public interest test  
12 that the Commission had established in the Merger Policy  
13 Statement.

14                   Under that test, the Commission's merger review  
15 concentrates on the impact on competition, rates, and  
16 regulation.

17                   The new law made an important change in the  
18 public interest test, however, requiring that the Commission  
19 make specific findings that a proposed transaction will not  
20 result in cross-subsidization of non-utility associate  
21 companies within a holding company's system, or the pledge  
22 or encumbrance of utility assets for the benefit of an  
23 associate company, unless consistent with the public  
24 interest.

25                   Preventing cross-subsidization, is, of course,

1 not a new responsibility for the Commission. It's something  
2 that has been a fundamental duty of the Commission since  
3 1935, and a duty that we discharge whenever we set rates.

4 Preventing cross-subsidization at the point of a  
5 merger, is a new responsibility for us, however. Now, there  
6 are questions about how the Commission should discharge this  
7 new responsibility, and some questions relate to the level  
8 of deference we should afford our state colleagues in this  
9 area.

10 The subject of any safeguards against cross-  
11 subsidization, such as ring fencing, would seem generally to  
12 be a state-regulated utility.

13 While the Commission must protect wholesale  
14 captive customers and transmission customers against  
15 inappropriate cross-subsidizations of non-regulated  
16 activities, the primary beneficiary of any such safeguards,  
17 would seem to be the retail consumer, which is normally the  
18 charge of state regulators and not the Commission.

19 Now, as a general matter, state commissions have  
20 authority to protect retail consumers against cross-  
21 subsidization, and most state commissions have authority  
22 review utility mergers.

23 One question before us, then, is whether, in the  
24 exercise of our cross-subsidization authority, we should  
25 rely on state commissions to exercise their authority to

1 protect state interests and protect retail consumers;  
2 whether we should act independently on behalf of retail  
3 consumers.

4 If we act independently, Commission actions could  
5 conflict with, and, perhaps, nullify actions by state  
6 commissions.

7 Now, the question of whether the Commission  
8 should examine a merger's effect on retail consumers, has  
9 arise before. When the discussion last arose, the  
10 Commission concluded in the Merger Policy Statement, that,  
11 quote, "Where the state commissions have the authority to  
12 act on the merger, we intend to rely on the state  
13 commissions to exercise their authority to protect state  
14 interests," end quote.

15 Unless the state lacks authority and specifically  
16 asks the Commission to set them, the Commission has reviewed  
17 impacts only on wholesale matters. The question is whether  
18 we should reach the same conclusion here.

19 Now, the Public Utility Holding Company Act of  
20 2005, is a very different law from the 1935 Act. PUHCA 2005  
21 is primarily a statute that gives the Commission and states,  
22 increased access to the books and records of public utility  
23 holding companies and their member companies, if necessary,  
24 to protect utility customers with respect to jurisdictional  
25 rates.

1                   With one minor exception, PUHCA 2005 does not  
2                   give the Commission any new substantive authority.

3                   Now, although these statutory changes did not  
4                   take effect until February 8th of 2006, the Commission was  
5                   required by the Energy Policy Act, to complete its PUHCA  
6                   implementation rules by December 8th of 2005, and we met  
7                   that deadline.

8                   However, because of the interrelationship between  
9                   PUHCA and some of the Section 203 amendments and the desire  
10                  to give a measure of regulatory certainty as to what  
11                  corporate transactions might be jurisdictional under the  
12                  Section's 2003 amendments.

13                  The Commission also completed its Section 203  
14                  final rule in December of 2005.

15                  The Commission subsequently refined both Rules  
16                  with several Rehearing Orders issued earlier this year.

17                  Today we fulfill a promise me made in the Final  
18                  Rules and Rehearing Orders, to review a number of issues in  
19                  a technical conference to be held no later than one year  
20                  after the effective date of the new provisions.

21                  Now that we've gained some experience under the  
22                  new laws, our hope is that this dialogue, the dialogue  
23                  today, will help the Commission to determine whether  
24                  additional steps need to be taken to address our regulatory  
25                  responsibilities or whether current policies and regulations

1 are sufficient at this time.

2 Our regulatory goals is to allow increased  
3 investment opportunities in the utility sector, and removal  
4 of unnecessary regulatory burdens, as envisioned by Congress  
5 when it repealed PUHCA 1935, but, at the same time, ensure  
6 just and reasonable rates and the protection of energy  
7 customers.

8 We look forward to hearing from today's  
9 panelists, and we will hold the record open for other  
10 interested persons to file written comments, until January  
11 26th of 2007.

12 With that, I'd like to recognize any of my  
13 colleagues who might want to make some brief remarks. Mark?

14 COMMISSIONER SPITZER: Thank you, Mr. Chairman.  
15 And I would like to welcome my friends, Ray Baum and Bob  
16 Garvin this morning, and very much look forward to their  
17 insights, as well as that of the other panelists.

18 This is an issue that has very interesting  
19 academic -- has seen academic debate, but also has practical  
20 consequences.

21 I am probably more interested in the latter,  
22 particularly the interface between state-adjudications and  
23 the responsibilities vested upon this Agency by the 2005  
24 Energy Policy Act.

25 I know that my colleagues, and, particularly, the

1 Chairman, are students of history, and it's important to  
2 reflect, at least just briefly, upon the historical origins  
3 of the '35 Act, contrasted with the developments that gave  
4 rise to the provisions in the 2005.

5 The 1935 Act, I view largely as securities-  
6 related, and, particularly, focused on investor protections.

7 Given the stock market crash of 1929 and the  
8 collapse of many of the utility holding companies, the fact  
9 that investors lost their entire investments in the utility  
10 sector, and, obviously, in 1935, the sector was as vital to  
11 the American economy as it is today, Congress stepped in to  
12 facilitate investment, to provide new rules governing the  
13 securities industry, generally, in 1933 and 1934 and then in  
14 1935, investor protections specifically with respect to the  
15 energy sector.

16 The Act of 2005 is oriented much towards  
17 ratepayer protections. The Chairman alluded to some of the  
18 wholesale rate protections that were provided in the 2005  
19 Act, but there are retail protections as well in the Act,  
20 and those retail protections do deal with what hopefully  
21 will be a healthy tension between the federal and state  
22 governments.

23 Now, the rulemakings alluded to by the Chairman,  
24 were adopted prior to my tenure on this body, and I had the  
25 opportunity to consider them in my prior position as a state

1 commissioner, as well as currently, and I do have some  
2 observations.

3 First, I want to be very clear that where there  
4 is a regulatory gap in protections with respect to cross-  
5 subsidization, and there is asset impairment, there is an  
6 obligation on this Agency to issue findings, and I think  
7 that is in the public interest, even if it is in the area of  
8 retail customer protections not typically associated with  
9 FERC, but that reflects the clear mandate of Congress.

10 On the other hand, where there are state  
11 proceedings on the narrow, granular issues of asset  
12 impairment and cross-subsidization, is my feeling that the  
13 prior iterations of the regulations, are quite salient in  
14 attempting to avoid conflicting or duplicative adjudications  
15 and respect the state proceedings.

16 There has been some academic commentary, both  
17 prior to repeal of the '35 Act and subsequent, that  
18 suggested there would be a wave of mergers and acquisitions  
19 that would potentially harm the public interest, and that  
20 this tidal wave of proposed mergers would overwhelm the  
21 state commissions and the state commissions would not be  
22 able to adequately protect the retail customers that they  
23 have been charged to protect.

24 And that was a view that I rejected then and I  
25 that I reject now, and I think it's contrary both to

1 history, as well as very current developments in the area of  
2 acquisitions.

3 Not surprisingly, that commentary largely came  
4 from folks inside the Beltway. I have not lived in  
5 Washington that long, so I believe all the wisdom in the  
6 world resides in Washington.

7 I think I know that there are a lot of smart  
8 people who give careful attention to these issues, and,  
9 specifically, careful attention to transactions affecting  
10 their local constituents. I was Chairman of the Arizona  
11 Commission during a very interesting proceeding that lasted  
12 for about a year, where there was quite a bit of pretrial  
13 activity.

14 There were nine days of hearings, thousands of  
15 pages of transcript, witnesses who were cross examined.  
16 There were three days of, I guess I would describe as  
17 tumultuous open meetings in Tucson, Arizona, after which  
18 there was vigorous discussion and ultimate rejection of a  
19 proposed merger, based upon a full an robust factual record.

20 And it seems to me counterintuitive to suggest  
21 that the federal agency ought to somehow duplicate or  
22 complicate a state proceeding. I also paid careful  
23 attention to the proceeding in Oregon, and, Commissioner  
24 Baum, I very much look forward to his comments, as well.

25 I happen to believe that where state authority

1 facilitates review by state commissions, that a granular and  
2 local consideration of state issues, is appropriate, and  
3 beyond the asset impairment and cross-subsidization issues,  
4 I would suggest that there are certain local issues that are  
5 very salient to state officials, such as corporate  
6 headquarters, employment, and the like, that are outside of  
7 the particular mandates and revisions to Section 203 and the  
8 2005 Act, that are, again, relevant, and as a very practical  
9 matter, it's oftentimes difficult for state commissions to  
10 staff proceedings, particularly a merger proceeding that is  
11 coterminous with a telecommunications case or a water case,  
12 or just the ordinary business of conducting state commission  
13 proceedings.

14 And I would be loathe to have a circumstance  
15 where the state commission, in the midst of a merger and  
16 acquisition proceeding, be forced to divert resources to  
17 monitor a federal proceeding, or perhaps to appear at a  
18 federal proceeding.

19 I would like those on the panel to address  
20 essential diversions of resources and maybe some  
21 hypotheticals where an Intervenor or an Applicant would  
22 undertake intervention at FERC, and explain some of the pros  
23 and cons of such simultaneous proceedings at the federal  
24 level and the state level, which would be more than nominal  
25 here at FERC.

1           So, again, my views are largely consistent with  
2 the existing rulemaking. I believe we should be very  
3 deferential to state proceedings. I know from personal  
4 experience, those who intervene at a state commission, as  
5 well as the staff and commissioners, the state regulators,  
6 are very attuned to these issues, and where there is  
7 authority, I think that authority ought to be recognized.

8           I'd be very interested in hearing what type of  
9 generic backstop ring fencing rule, ought to be put in  
10 place.

11           Finally, I think all of us on this Commission,  
12 share the view that we want to be helpful. We certainly do  
13 not want to be contrary to what state commissions are trying  
14 to achieve, and in the area of expertise, particularly on  
15 pricing issues that may implicate wholesale prices, I would  
16 hope that we could find ways to be helpful to the state  
17 commissions and work as partnerships, so that we have a good  
18 result, so that the ultimate, both at the wholesale and  
19 retail levels, is just and reasonable rates and protections  
20 for consumers. Thank you.

21           CHAIRMAN KELLIHER: Thank you. Commissioner  
22 Wellinghoff?

23           COMMISSIONER WELLINGHOFF: Thank you, Mr.  
24 Chairman. I do want to thank my sister state Commissioner,  
25 Ray Baum, for coming, and I thank you, Commissioner Garvin,

1 as well, and all the panelists for being here. I appreciate  
2 it very much.

3 When I was riding on the bus this morning with my  
4 16-year old, going up to the subway station, he asked me, as  
5 he usually does, dad, what are you going to do today? I  
6 said, I'm going to a technical conference on PUHCA.

7 (Laughter.)

8 COMMISSIONER WELLINGHOFF: Did you know that a  
9 pooka is a mythical animal?

10 (Laughter.)

11 I said that this PUHCA has a different meaning;  
12 this has to do with a federal holding company act. He said,  
13 that animal actually is a horse that takes you on a wild  
14 ride.

15 Hopefully, we're not going to be going on that  
16 wild ride.

17 (Laughter.)

18 COMMISSIONER WELLINGHOFF: I think we're actually  
19 in a very good place with the states, and I want to say that  
20 I largely agree with what Commissioner Spitzer has outlined  
21 as his position with respect to our authority and our  
22 responsibilities under the Act.

23 I think that the cross-subsidization issue is  
24 very important and very interesting.

25 I will not be able to participate this afternoon,

1 and I apologize for that. I've got some other things that I  
2 have to go to.

3 But cross-subsidization and ensuring that we can  
4 adequately regulate that, both the states can and FERC can,  
5 is very essential to assuring that we have competitive  
6 markets.

7 That's one area that's important to me. I agree  
8 with Commissioner Spitzer that to the extent there is a  
9 regulatory gap between the states and FERC -- and I think  
10 that some 25 percent of the states haven't given themselves  
11 specific merger oversight authority -- I think that FERC  
12 does have a role to play there, to protect all levels of  
13 consumers, but to the extent those other 75 percent of the  
14 states do have the authority and exercise it, I think that  
15 FERC, rightly, needs to step back and see what they can do  
16 to help coordinate and collaborate with those states, but  
17 not get in the way, not in any way be duplicative, not in  
18 any way be burdensome to the states.

19 I can't see us having parallel proceedings, so  
20 the states should try to have staff at both, and  
21 meaningfully participate.

22 One particular area that I'm most interested in -  
23 - it's fine to have rules, it's fine to have regulations at  
24 the state level, and to have these things in place, but,  
25 ultimately, we have to be sure the rules are being followed.

1 That's where auditing comes in, and auditing is essential  
2 and that's an area where FERC may have more resources than  
3 the states in many instances and it might be one area where  
4 we can actually collaborate with the states.

5 I don't in any way mean to suggest we should step  
6 in and overstep the state's authority, but only where asked,  
7 or only where appropriate, we need to utilize our technical  
8 staff wisely and make sure the rules are being followed.

9 CHAIRMAN KELLIHER: Thank you. Commissioner  
10 Moeller?

11 COMMISSIONER MOELLER: Thank you, Mr. Chairman.  
12 There's been a lot of work put into this conference by the  
13 Staff and also the panelists. I have to also extend a  
14 special welcome to Commissioner Baum and Commissioner  
15 Garvin. Thanks for being here.

16 My main point probably borrows a little bit from  
17 the three of you already, and that is that in the 71 years  
18 since there has been PUHCA legislation on the books, our  
19 authorities are really relatively new in this world in the  
20 last year or year and a half or so.

21 So it's going to take us some time to find our  
22 comfort zone as an agency, and I hope people will be  
23 cognizant of that as we're trying to find our way in this  
24 new world. Thank you.

25 CHAIRMAN KELLIHER: Commissioner Kelly?

1                   COMMISSIONER KELLY: Thank you very much for  
2 being here. I'm pleased that we're able to have this  
3 technical conference.

4                   When we issued our Final Rule in this rulemaking  
5 earlier, there were a lot of details that we just didn't  
6 feel that we had the expertise or the time to consider.

7                   We decided at that time that we would be best  
8 served by having a technical conference, and I thank you all  
9 very much for being willing to give your time and your  
10 effort.

11                  As Commissioner Moeller mentioned, the states, in  
12 a sense, have had more experience on some of these issues  
13 than we have, so we're really in a position of learning from  
14 you. I appreciate that both of you Commissioners,  
15 Commissioner Baum and Commissioner Garvin, are here to share  
16 with us, your experiences.

17                  I know from talking to Commissioner Baum  
18 yesterday, that you've dealt with nine mergers, and that's  
19 extraordinary.

20                  I was also commuting with a family member this  
21 morning, and my sister, who is visiting from Russia, asked  
22 me what I was doing, and I said I'm having a conference on  
23 PUHCA, and she didn't know that a pooka was a mythical  
24 animal. She wanted to know what it was, and I informed her  
25 that it was the Public Utility Holding Company Act, and she

1 said, well, I'm sure you may have a very interesting day.

2 (Laughter.)

3 COMMISSIONER KELLY: And I know we are. Thank  
4 you very much.

5 CHAIRMAN KELLIHER: Thank you. Cindy, are there  
6 any other comments that you wanted to make, or should we go  
7 to the panelists.

8 MS. MARLETTE: Just that we'd like the panelists  
9 to try to keep their remarks to five minutes and that I'm  
10 supposed to be the timekeeper, so if you're getting close to  
11 the end of your five minutes, I will let you know.

12 CHAIRMAN KELLIHER: I have told Cindy to be  
13 gentle with the state commissioners.

14 (Laughter.)

15 MS. MARLETTE: But not anyone else.

16 COMMISSIONER BAUM: Mr. Chairman, I timed mine,  
17 and it's probably going to exceed that by some time.

18 CHAIRMAN KELLIHER: As I said to the state  
19 commissioners, you're under different rules; you're  
20 colleagues. Mike is a former commissioner, and I don't know  
21 whether or not he should be under the same rule. I'm not  
22 sure about that myself.

23 (Laughter.)

24 CHAIRMAN KELLIHER: Maybe less latitude.

25 Why don't we start with Commissioner Baum from

1 the State of Oregon.

2 COMMISSIONER BAUM: Thank you, Mr. Chairman. For  
3 the record, my name is Ray Baum. I'm an Oregon Public  
4 Utilities Commissioner, and I'm here to share with you,  
5 Oregon's perspective on mergers and ring fencing issues.

6 We are very much in agreement with the comments  
7 of members of the Commission today about being deferential  
8 to the states. We believe that FERC's role should be  
9 limited to generic backstop rules to protect ratepayers in  
10 states that have failed to act to protect their own  
11 ratepayers.

12 We proven that states like Wisconsin, Oregon, and  
13 Arizona have adequate authority to effectively deal with  
14 these mergers. We've shown, by actually doing it, that we  
15 can protect our utility customers, and FERC should be  
16 encouraging states to adopt their own rules, and, of course,  
17 in the event that they do not, then you should step in and  
18 provide some pretty high-standard protections.

19 This will encourage states to move ahead and  
20 adopt their own rules and to be concerned about their local  
21 utility mergers, and since every state has a different mix  
22 of conditions and things that would affect a merger, it's  
23 important to have flexibility in those opportunities, and  
24 that when you don't have protections, the Federal Government  
25 could step in to assist and protect those ratepayers.

1           I think you should take the best of the rules of  
2 Wisconsin, Arizona, Oregon, and other states that have  
3 actually had this experience, and pick the best standards  
4 you can pick out of those states, and use those as a federal  
5 backstop.

6           You have a unique opportunity here, because you  
7 set high standards and it will be good for ratepayers and  
8 good for Wall Street and their investors.

9           My outline will take you through a ring fencing  
10 discussion, briefly, including the rating agencies' views,  
11 affiliate transactions, Oregon laws on the subject,  
12 reflections on PUHCA, Oregon's merger experience, and  
13 conclusions.

14           I don't know if you have copies of this outline.

15           What is ring fencing? The purpose of ring  
16 fencing is to isolate the utility from the negative impacts  
17 created by affiliates, to ensure the utility maintains a  
18 strong credit rating and to prevent cross-subsidization, and  
19 to have access to timely and accurate information.

20           Standard Poor's views ring fencing as very  
21 positive, because it isolates the utility from its parent,  
22 and that's good for credit ratings and that's good for Wall  
23 Street.

24           The parent company's nonregulated businesses do  
25 matter, and a parent company risk can be handled by limiting

1 access to dividends, restricting loans to affiliates, and  
2 standards for pricing of transactions with affiliates.

3 S&P looks to the state regulators to maintain the  
4 credit ratings of these utilities.

5 Oregon revised statutes provided detailed  
6 protections for affiliate transactions, require approval  
7 before a utility can guarantee another's company's debt,  
8 another company's indebtedness, and require approval of all  
9 stock and bond issuances.

10 Then we have ring fencing, affiliated interest  
11 statutes, financing statutes, and acquisition statutes, all  
12 of which provide very detailed requirements.

13 Now, I want you to understand that this bill was  
14 passed through the Oregon Legislature in 1980 by the  
15 utilities. Northwest Natural Gas was the major proponent.  
16 They were very concerned about possible takeovers, so they  
17 wanted to make it relatively challenging to be taken over in  
18 the State of Oregon, so this is not a consumer-driven  
19 process; it was -- it ended up being very consumer-  
20 beneficial, but it's not a consumer-driven statute.

21 Current Oregon law requires approval for the  
22 purchase of property, stocks, from one utility by another,  
23 and requires approval for the utility to contract with  
24 affiliated interests, when the utility is a buyer or seller  
25 of the goods, services, and assets.

1           Oregon administrative rules have requirements for  
2 pricing policy. Of course, we also require them to report  
3 all affiliate-related transactions.

4           And under the transfer pricing policy, services  
5 provided by an affiliate, must be the lower of cost and  
6 market, and services provided by the utility to the  
7 affiliate, must be the higher of cost or market, so that the  
8 ratepayer is held harmless either way, and this transfer  
9 policy and pricing is to prevent cross-subsidization and is  
10 stronger than the SEC's cost standard.

11           Oregon's statutes further provide for approval of  
12 all mergers and acquisitions of Oregon energy utilities, and  
13 any acquisition or merger requires: Number one, a net  
14 benefit for to the utility's customers and no harm to Oregon  
15 citizens, as a whole.

16           Oregon's perspective on PUHCA: We regard it as  
17 largely a useless statute, from our perspective. We believe  
18 that was all about shareholder protection and didn't do much  
19 for ratepayers, and so we didn't consider it a factor for  
20 any particular protection for our ratepayers.

21           Under Oregon law, anybody who owns five percent  
22 of a utility and exercises any potential influence over it,  
23 and buys that interest, must pass our merger statute.

24           We believe that the SEC in the federal area, is  
25 the wrong agency to be administering this, and it should be

1       FERC.  If you're going to provide backstop authority, which  
2       the law now currently provides, we believe that we do  
3       adequately protect customers, and where we don't, FERC ought  
4       to step in with some pretty stringent rules.

5               We believe that under the current situation, all  
6       mergers face not only Oregon approval statutes, both our  
7       expressed statutes and the conditions we impose on mergers,  
8       but we have your new FERC authority under the new Energy  
9       Policy Act, Generally Accepted Accounting Principles, SEC  
10      reporting forms -- and you know what those are -- annual  
11      FERC Form 1 reports, additional federal laws, such as  
12      Sarbanes-Oxley, and the findings of external auditors.

13              All those things there would have to be complied  
14      with by mergers today.

15              We have statutes that include extensive  
16      investigatory powers over utility books and records and  
17      related financial and affiliate transactions.

18              We impose conditions on all our mergers, that  
19      require the affiliates and the parent company, when they  
20      deal with the utility, to have their records also subject to  
21      audit and investigation by the Commission.

22              And we annually perform audits of affiliate  
23      interests, report the semiannual operational audits of all  
24      energy utilities, to make sure they are following through on  
25      their merger and refinancing commitments.

1                   Oregon's merger experience: PGE is Oregon's  
2 largest utility, with about 750,000-plus customers. We've  
3 had five opportunities to have that utility sold in the last  
4 decade.

5                   (Laughter.)

6                   COMMISSIONER BAUM: It's really an attractive  
7 piece of assets.

8                   Anyway, the most controversial one was the Enron  
9 merger, and that brought Enron into our state. We really  
10 enjoyed that experience.

11                   (Laughter.)

12                   COMMISSIONER BAUM: And not to be completely  
13 denied, we did deny an acquisition by a high-equity leverage  
14 firm called Texas Pacific Group -- probably not a great name  
15 to bring into the State of Oregon, but we did deny that one,  
16 and we are currently considering a merger now between Dakota  
17 Utilities and Cascade Natural Gas, so the merger activity  
18 never stops in Oregon.

19                   Oregon's statutes and administrative rules enable  
20 effective ring fencing provisions. Portland General, after  
21 Enron filed bankruptcy, was able to keep its investment  
22 grade ratings, because of ten ring fencing conditions that  
23 the Commission put on that merger transaction.

24                   PacifiCorp has similar ring fencing provisions,  
25 except, as we have evolved in this process, their ring

1 fencing provisions are about 40, so as we learn as we go  
2 here, we've developed better and more concise and more  
3 comprehensive ring fencing conditions.

4 Now, some of the ring fencing conditions on Enron  
5 prevented it from being drug into its parent's bankruptcy,  
6 was full access to information requirements and review of  
7 inter-corporate activities.

8 We had two separate entities; we required them to  
9 be separate, so no Federal Judge could look at it and say  
10 you commingled these, and, therefore, they're one company.  
11 We had that all separated out.

12 They maintained separate long-term debt and  
13 preferred stock ratings, and maintained common equity  
14 portions of at least 48 percent, and PGE must notify the  
15 Commission of certain dividends and distributions to Enron.

16 We prohibited all allocations of direct charges  
17 from Enron to PGE without our authorization, we were  
18 properly sharing and allocating general corporate expenses;  
19 restrictions on Enron's access to PGE's power, natural gas  
20 assets, et cetera.

21 And they were not allowed to seek a higher cost  
22 of capital than would have been authorized, absent the  
23 merger.

24 We had the famous golden rule -- Golden Share,  
25 excuse me, and golden rule, too -- Golden Share, where the

1 Commission approved the issuance of a \$1.00 par value junior  
2 and preferred stock; created an independent director, whose  
3 sole purpose was to vote against bankruptcy on a voluntary  
4 basis, if it was not in the interest of the stand-alone  
5 utility, its investors and ratepayers.

6 This prevented Enron from forcing PGE to file  
7 bankruptcy, and this Golden Share was approved by S&P as a  
8 way to be a bankruptcy -- would qualify as a bankruptcy-  
9 remote action. You know what that means.

10 This avoided further downgrades of PGE's bond  
11 ratings, due to Enron's bankruptcy, to maintain its  
12 investment grade status all the way through the process.

13 Then Texas Pacific Group proposed an acquisition  
14 of PGE. That was denied, basically of the harms related to  
15 excessive consolidated debt and risks related to short-term  
16 ownership business plans.

17 We eventually ended up distributing the stock of  
18 PGE and you'll note that the ring fencing provisions  
19 obviously fall away as the company becomes a stand-alone  
20 entity without a parent.

21 Our second largest utility is PacifiCorp. We've  
22 had two mergers involving PacifiCorp. One was Scottish  
23 Power and one was Mid-American Energy Holding Company, which  
24 is owned by Berkshire Hathaway.

25 For PacifiCorp, we adopted the -- Scottish Power,

1 in the first instance, we adopted the requirement that they  
2 maintain separate accounting systems, keep all their books  
3 and records in Portland. Obviously, we had to do that,  
4 because Scottish Power is in England.

5 We required access to Scottish Power records  
6 pertaining to transactions with PacifiCorp and the ability  
7 to audit all unregulated subsidiaries who had those  
8 transactions, and that authority extended to subsidiaries,  
9 even located in England.

10 We required them to maintain a common equity  
11 ratio of 35 percent, and to maintain separate long-term debt  
12 and preferred stock ratings, and PacifiCorp is not allowed  
13 to seek a higher cost of capital than it would have been  
14 authorized to, absent the merger.

15 And we placed a \$200,000,000 ceiling on loans  
16 that PacifiCorp could make to affiliates. Those same ring  
17 fencing provisions were carried over into the merger with  
18 MEHCV, except the increased equity requirements to 48.25  
19 percent.

20 We had the same independent director, which was  
21 analogous to the Golden Share, and we required other  
22 percentage requirements, if they chose to include short-term  
23 debt and capital lease obligations as part of their debt.

24 And they could own -- no non-utility businesses  
25 could be owned by PacifiCorp or its subsidiaries, and that

1 was a new condition.

2 And there was a dividend restriction whereby they  
3 couldn't do any dividends if the unsecured deb rating fell  
4 below BBB or lower as determined by two or more rating  
5 agencies.

6 Okay, by conclusion, affiliated interest  
7 conclusions: Should FERC adopt rules regarding cross-  
8 subsidies and affiliated interest transactions?

9 From Oregon's perspective, this is unnecessary.  
10 Oregon statutes provide adequate authority to protect  
11 customers.

12 For other states that don't have authority, we  
13 encourage you to adopt very stringent, high-quality backstop  
14 standards to afford the best protection for customers.

15 What additional information should FPA Section  
16 203 Applicants file with FERC? Well, look at our ring  
17 fencing, look at our statutes. You can get the information  
18 on what we've got, and you should be getting here at FERC as  
19 part of your investigation and assistance to states.

20 And in the states where you don't have any  
21 authority, then FERC needs to step in and give them  
22 information for those with ratepayers, and protect them in a  
23 full merger process.

24 Ring Fencing Conclusions: We demonstrated  
25 through Oregon's experience, not because Oregon is

1 necessarily brilliant, but we can do a good job, we've done  
2 a good job, and we've passed the test as a laboratory of  
3 democracy, and FERC should not adopt mandatory generic ring  
4 fencing; they just have the backstop effect, as we  
5 previously talked about, and those standards should be  
6 fairly high.

7           Finally, I want to conclude with reading a  
8 statement from S&P: Ring fencing is not a cure for all. In  
9 general, ring fencing will only create a marginal rating  
10 differential between a subsidiary and its parent entity. In  
11 many cases, a distressed parent, or its creditors, will  
12 perceive that significant economic incentives exist to file  
13 a solvent subsidiary into bankruptcy.

14           Those incentives may well give rise to strategies  
15 that can trump the legal structures that may be in place.  
16 Surprise outcomes are not unheard of in the bankruptcy  
17 context. Despite the economic and legal arguments that  
18 support rating levels of the ring-fenced entities well above  
19 those of Edison International and PG&E Corp., Standard and  
20 Poor's cautions that each ring-fencing exercise must be  
21 viewed on its own merits.

22           That was a statement by S&P before Enron filed  
23 bankruptcy. Then we had a test case in Oregon where we  
24 found out whether or not we can avoid legal mechanizations  
25 and still keep utilities separate and profitable, and

1 serving its customers.

2 Oregon passed that test and we believe that FERC  
3 can do the same thing by adopting backstop rules for those  
4 states that don't act. You have a unique opportunity to do  
5 what is good for ratepayers that is also good for Wall  
6 Street, and we urge you to do so. Thank you.

7 CHAIRMAN KELLIHER: Thank you very much. Next,  
8 I'd like to recognize the Honorable Robert Garvin,  
9 Commissioner of the Wisconsin Public Service Commission.

10 COMMISSIONER GARVIN: Thank you, Mr. Chairman and  
11 other members of the Commission. Thank you for giving me  
12 the opportunity to participate in the conference today.

13 My name is Robert Garvin, and I'm a Commissioner  
14 serving on the Public Service Commission of Wisconsin. The  
15 views I am about to provide, are my own and don't  
16 necessarily reflect the views of my colleagues, but, if they  
17 were here, they would agree.

18 (Laughter.)

19 COMMISSIONER GARVIN: The broad scope of the  
20 questions at today's technical conference reflect the broad  
21 and shared concerns that FERC, state regulators, the  
22 consumers we serve, and the companies we regulate, have,  
23 relating to the development of policies to safeguard against  
24 cross-subsidization of non-utility affiliate companies by  
25 an affiliate utility within a utility holding company

1 structure.

2 I want to commend the FERC for its ongoing  
3 efforts to solicit public advice from stakeholders and  
4 regulators like me, in order to see if any additional  
5 safeguards are necessary under Section 203 of the Federal  
6 Power Act and other authorities.

7 The repeal of PUHCA last year, was intended to  
8 end many of the purported restrictions imposed by federal  
9 law on investment diversification by utility holding  
10 companies.

11 The careful balancing act that we, as federal and  
12 state regulators, must now conduct during this transition  
13 period, is to ensure that our statutory obligations to the  
14 consumers we serve -- we fulfill our statutory obligations  
15 to the consumers we serve, with the corresponding duty not  
16 to take regulatory actions that would conflict with the  
17 clear legislative intent behind the law's repeal, which was  
18 fostering a regulatory environment that attracts the  
19 necessary capital to invest in our country's energy  
20 infrastructure.

21 A principal reason, in my view, for the FERC to  
22 exercise caution before promulgating any supplemental  
23 regulations, is that as Ray mentioned, state public utility  
24 commissions are actively and independently carrying out  
25 their statutory responsibilities to protect retail customers

1 from the adverse effects of subsidization by public utility  
2 affiliates within a holding company organization.

3 One need only look at the ongoing regulatory  
4 proceedings in Kansas and New Jersey for some of the most  
5 recent examples, post-PUHCA-repeal, of state PUCs who are  
6 actively examining the books and records of utility  
7 affiliates and non-utility affiliates, and proposing  
8 regulatory safeguards that ensure that the consumers of our  
9 states, those public utility affiliates, are not subsidizing  
10 non-utility affiliates and that we are doing our best to  
11 protect the credit quality of the utilities we regulate.

12 I would concur with those who take -- and Ray  
13 mentioned this earlier and some of the other Commissioners --  
14 - we take the position that supplemental federal regulation  
15 may be required, if there is a demonstrable gap between  
16 federal and state regulation of utility affiliates within a  
17 holding company's structure.

18 I think the adoption of a blanket federal rule,  
19 presumes regulatory failure on the part of state regulators  
20 to protect the consumers in our states, one that simply does  
21 not exist.

22 For this reason, I do not believe that FERC's  
23 adoption of a generic federal ring fencing provision under  
24 Section 203, or other provisions of the Federal Power Act,  
25 is warranted at this time.

1           The authority to review proposed mergers,  
2           corporate dispositions involving public utilities, to impose  
3           cross-subsidization safeguards as a condition of approval,  
4           and rate-related authorities to protect consumers against  
5           inappropriate cross-subsidization, clearly varies from state  
6           to state.

7           In Wisconsin, we already have specific cross-  
8           subsidiization safeguards that demonstrate why, at least in  
9           our perspective, it's not necessary for FERC to adopt  
10          generic safeguards.

11          To protect against cross-subsidization, I just  
12          want to walk through our statues a little bit. Wisconsin  
13          has, really, a three-pronged approach under our law:

14          One is imposing restrictions; two is implementing  
15          reporting requirements; and three is conducting compliance  
16          audits of the holding company's transactions and operations.

17          In some of our orders approving the formation of  
18          energy holding companies in our state, the Commission has  
19          imposed annual reporting requirements, and, in addition, in  
20          approving affiliate interest transactions or agreements,  
21          they many times include annual or periodic reporting  
22          requirements.

23          In addition, the utility's annual report to our  
24          agency, includes a report of any affiliated transactions.

25          I know that many in this room will shudder, but

1 I'm going to briefly describe the Wisconsin Public Utility  
2 Holding Company Act as set forth in Chapter 196.795, because  
3 I think it is a good example of a statutory ring fencing  
4 regime that has successfully protected Wisconsin consumers  
5 from holding company abuses for over 20 years, and, as Ray  
6 mentioned, it was at the behest of the companies at that  
7 time, of the Legislature.

8 The following are some of the statutory  
9 safeguards that are in place in my state:

10 If the Commission finds that the capital of a  
11 public utility is impaired, we can order the public utility  
12 to cease paying dividends until the impairment is removed.

13 We have prior approval authority of all  
14 affiliated interest agreements.

15 We have the authority to approve mergers and  
16 corporate reorganizations involving energy public utilities.

17 We have the authority to approve the formation of  
18 energy holding companies, which includes but is not limited  
19 to some of the following safeguards:

20 We have full access to the records of the holding  
21 company's system that are relevant -- that's a legal term --  
22 to the performance of the Commission's duties.

23 Public utility affiliates can't do any of the  
24 following:

25 They cannot guarantee the obligations of any non-

1 utility affiliate.

2 They can't materially subsidized non-utility  
3 activities of the holding company or any of it's non-utility  
4 affiliates.

5 They cannot be operated in a way which would  
6 materially impair the credit of the public utility or which  
7 impairs the ability of that same utility to provide reliable  
8 service.

9 They also -- the public utility affiliate  
10 employees or resources cannot be used by an affiliate,  
11 without prior Commission approval, and, under this standard,  
12 the public utility is to receive fair market value for the  
13 services provided.

14 Then, lastly, one of the most contentious is the  
15 sum of all assets of non-utility affiliates in a holding  
16 company, cannot exceed 25 percent of the assets of all  
17 public utility affiliates in that system engaged in the  
18 generation, transmission or distribution of power.

19 Now, I would note that in 1999, the Legislature  
20 substantially relaxed that 25 percent in terms of what's in  
21 the numerator and the denominator, so there was substantial  
22 holding company relief. I mean, that's why I put those in  
23 my comments, but I will not read those.

24 I'd also note that our current state law provides  
25 that at least once every three years, our agency will

1 investigate the impact of the operations of every holding  
2 company system, and every public utility affiliate in that  
3 system and determine whether each non-utility affiliate does  
4 or can reasonably be expected to do one of the following  
5 four business lines:

6           One is substantially retain, attract, or promote  
7 business activity or employment within the state; secondly,  
8 increase or promote energy conservation or renewable energy  
9 products; third, conduct a business functionally related to  
10 utility service, or the development of energy resources,  
11 and, lastly, developing or operating commercial or  
12 industrial parks.

13           As you can see from the list I just read, the  
14 Commission already has sufficient regulatory authority to  
15 protect against cross-subsidy. In my view, developing  
16 generic standards and reporting requirements, may be  
17 difficult for FERC to accomplish.

18           I would respectfully suggest that it may be more  
19 productive for FERC to implement any additional safeguards  
20 and reporting requirements on a case-by-case basis. While  
21 the appropriateness of generic action by the FERC largely  
22 depends on state law, I remain concerned that any future  
23 FERC action would have the practical effect of preempting  
24 states.

25           In summary, I believe the adoption of generally-

1 applicable federal regulations, rather than imposing  
2 safeguards on a case-by-case basis, less than one year after  
3 PUHCA's repeal, wrongly assumes regulatory failure on behalf  
4 of the states to aggressively tackle thorny cross-  
5 subsidization issues.

6           It may have the unintended effect of adding  
7 additional regulatory uncertainty at a time when we, as  
8 regulators, utilities, and consumers, need to work together  
9 to find innovative ways to attract the necessary capital to  
10 address the under-investment in transmission facilities and  
11 baseload generation facilities in our country, and, third,  
12 may have the practical effect of preempting states.

13           So, I appreciate the opportunity to participate  
14 in this important dialogue, to hopefully provide some  
15 clarity in our mutual efforts to protect wholesale and  
16 retail customers from affiliate abuse, and I look forward to  
17 any questions. Thank you.

18           CHAIRMAN KELLIHER: Thank you. I would like to  
19 now recognize the Honorable Mike Naeve, former FERC  
20 Commissioner, from Skadden Arps. He's a very experienced  
21 practitioner in this field.

22           We would like to start going on the clock.

23           (Laughter.)

24           CHAIRMAN KELLIHER: Nothing personal.

25           MR. NAEVE: Thank you very much. And I would

1       also add the caveat, as my colleagues have done, that I  
2       don't speak for my colleagues and I don't speak for my  
3       clients. These are my personal views. They are developed  
4       from many years of not only sitting on this Commission, but  
5       practicing before this Commission and working on a number of  
6       merger transactions.

7                   I would agree with the two prior speakers,  
8       Commissioner Baum and Commission Garvin, that the Commission  
9       should act with caution when considering the adoption of  
10      additional generic merger safegaurds.

11                  I also agree with Commissioner Garvin that this  
12      would wrongly assume regulatory failure, not only by state  
13      regulators, but failure of the Commission's existing  
14      protections against cross-subsidization, and failure of the  
15      protections that the Commission has adopted in its most  
16      recent orders that deal with the Energy Policy Act to  
17      prevent cross-subsidization in mergers.

18                  I also think additional burdens could potential  
19      impair or limit efficiency-enhancing transactions, which I  
20      think we don't want to have.

21                  Now, I think there are two basic questions before  
22      you at this stage: One is, should you take additional  
23      steps, and, then, secondly, if so, what should those steps  
24      be?

25                  And as I have just mentioned, I think that at

1       this stage, it's probably not the appropriate time for you  
2       to take additional steps, but I'd actually like to skip over  
3       that issue and come back to it and go to the second  
4       question, and that is, if you do something, what should it  
5       be?

6                   And here's one area where I think I disagree with  
7       my colleagues. I would not act on a case-by-case basis, on  
8       an ad hoc basis; rather, I think you should, if you decide  
9       to act -- and I don't recommend this, necessarily, that you  
10      act -- but if you do decide to act, I think you should set  
11      forth a principal framework for deciding when additional  
12      steps are required, and, then, secondly, what those  
13      additional steps are.

14                   I think there are a number of reasons for  
15      recommending that you set forth this principal framework.  
16      The first is, the vast majority of transactions pose no  
17      threat of cross-subsidization, certainly not threat of  
18      cross-subsidization that can't be addressed by your existing  
19      requirements.

20                   And you don't want to adopt regulations that  
21      would have the effect of imposing burdens on these types of  
22      transactions, so you'd want to provide clear criteria, ahead  
23      of time, so that people know ahead of time, how they're  
24      going to be affected.

25                   You should provide clear criteria to identify

1 safe-harbor-type transactions, so that parties know that  
2 with these types of transactions, there's no threat of  
3 additional restrictions.

4 The definitions for what qualifies for safe  
5 harbor, should be clear and definite, so that parties who  
6 are planning transactions, people who are filing  
7 applications before you, know specifically what's expected  
8 of them and what is not.

9 A second reason you should provide very clear  
10 criteria, both criteria as to when are things required, and,  
11 secondly, criteria as to what is required, is that there is  
12 already far too much uncertainty in the regulatory process  
13 for reviewing transactions.

14 Without clear standards, you'd be adding to the  
15 confusion.

16 When this Agency adopted the Merger Policy  
17 Statement, you made a tremendous step towards reducing  
18 uncertainty. Prior to the Merger Policy Statement, it was  
19 very difficult to prepare an application for a merger and  
20 file it with this Commission.

21 The standards were really quite ambiguous.  
22 Parties could bring up all types of issues in merger cases.  
23 Most mergers were set for hearing, most large mergers, and  
24 many of the issues that were set for hearing, had nothing to  
25 do with the merger. They were just issues that parties

1 would raise in filings, and the Commission would just set  
2 the case for hearing, not specifying what the issues were.

3 The standards weren't clear and it was a very  
4 difficult and time-consuming process.

5 The Merger Policy Statement went a tremendous way  
6 towards adding certainty to the process and clarity to the  
7 process. The Commission clearly identified what are the  
8 issue we're worried about? They identified three specific  
9 issue areas that they were concerned about.

10 They set forth very clear criteria for what  
11 circumstances might cause a potential issue that rises to  
12 the level of concern that we'd be worried about, for each of  
13 these three areas. And then the Commission set forth very  
14 clear recommendations on remedies that could be proposed to  
15 eliminate the need for these hearings in these areas, so the  
16 process became suddenly very clear.

17 The Commission was able to move much more  
18 expeditiously on mergers. A much smaller number of mergers  
19 had to be set for hearing, and one of the reasons was  
20 because Applicants were given guidance on what was expected  
21 of them.

22 They were told, if you identify these problems by  
23 using these criteria, here's what you need to propose to us  
24 to avoid a hearing, so it was very clear and there was no  
25 uncertainty.

1           It also helped Applicants or companies who were  
2           considering transactions, because they knew exactly what  
3           would be expected of them, in trying to evaluate whether a  
4           transaction presented competitive issues or rate issues and  
5           so forth, that might be of concern in this issue.

6           They could run these standard tests that the  
7           Commission had identified. They knew exactly what the  
8           issues would be.

9           It significantly improved the planning process.  
10          Lots of mergers, which might otherwise have been rejected by  
11          this Commission, were never proposed, because people did  
12          test them.

13          And in other mergers, the parties were able to  
14          come in and offer proposed conditions that satisfied the  
15          Commission, without the need for a hearing.

16          MS. MARLETTE: You have one minute.

17          MR. NAEVE: One minute to go?

18          So I think we need to have very clear criteria,  
19          if you do act. I would say, by the way, that another reason  
20          you should do this, is simply because you are required to  
21          under Section 203(a)(5), which tells the Commission, if you  
22          adopt regulations in this area, you need to be very specific  
23          as to the criteria and so forth.

24          Now, I also will tell you that I think you're  
25          going to have a very hard time identifying those criteria,

1 because this is a very slippery slope. When you talk about  
2 ring fencing, there are dozens of potential ring fencing  
3 provisions, many of them seek to accomplish the same thing,  
4 and, you know, it's going to be very hard to establish a  
5 principal for deciding on when and how far you act, what's  
6 the cost of imposing these?

7 I frankly think, at this stage, you know, go get  
8 to the bottom line, I don't think it's time for this  
9 Commission to act. If you do act, though, don't do it as  
10 the other Commissioners recommended, ad hoc, case-by-case,  
11 because then you'll have no standard to decide what we  
12 should be doing.

13 Judges who take these cases on hearing, will have  
14 not standards by which to decide when should we act and how  
15 far should we go? So, I think, if you are going to go into  
16 this area, you should set standards.

17 I frankly think, though, for a variety of  
18 reasons, that because of your existing regulations, because  
19 of the protections you already have to protect against  
20 cross-subsidization, because of the powers that the states  
21 have, you, frankly, should not act at this stage. Thank  
22 you.

23 CHAIRMAN KELLIHER: Thank you, Mike. Now I'd  
24 like to recognize Mr. John Antonuk, who is the President of  
25 Liberty Consulting Group.

1                   MR. ANTONUK: Good morning. I should start by  
2 saying that I have filed testimony before someone to the  
3 right of me, and I've done an affiliates audit of someone to  
4 the left of me, so I think that leaves me "stuck in the  
5 middle with you."

6                   (Laughter.)

7                   MR. ANTONUK: I'm okay with that.

8                   We at Liberty, can't help you much with the nuts  
9 and bolts or the mechanics of federal statutes and  
10 regulations; they are not the tools of our trade.

11                   We work primarily in the state commission arena.  
12 We work now for fully two-thirds of the country's state  
13 commissions, and that includes probably something on the  
14 order of 25 affiliates audits and examinations of ring  
15 fencing, financial insulation, in maybe a dozen cases.

16                   Borrowing from another song, I guess what I'd  
17 like to start by saying, is that I wish they could all be  
18 Oregonian girls.

19                   (Laughter.)

20                   MR. ANTONUK: Because state experience is varied,  
21 in our experience. And I want to talk a little bit about  
22 what some of those experiences tell me in relation to some  
23 of the points for discussion that you set out in your  
24 agenda.

25                   I want to start with the one I thought was the

1 most interesting thing in the bullets that you sent me to  
2 take a look at here, and that's the application of standards  
3 and regulations to existing holding companies, versus newly-  
4 merged entities.

5 I think the potential for and probably even the  
6 likelihood of cross-subsidization and of non-utility  
7 financial risk, except for leveraged buyouts, are not a  
8 function of whether a merger happens to be taking place.

9 If there's reason to be concerned about these  
10 issues in connection with the small number of mergers that  
11 take place, except in Oregon, there's a much greater reason  
12 to be concerned about them for entities already in a  
13 corporate structure that combines utility and non-utility  
14 activities.

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1                   One other issue you've listed with FERC about the  
2 cross-subsidization and ring sensing provisions. I believe  
3 as to the two commissioners who spoke before me, that a  
4 number of states do have authority and use it effectively to  
5 examine cross-subsidization and the potential effect of non-  
6 utility performance on utility access to capital and utility  
7 jeopardy when there's a financial figure of non-utility  
8 affiliates.

9                   Generic safeguards should not supersede effective  
10 state programs. However, the existence of state authority  
11 is not the only criterion that matters before me. Effective  
12 oversight requires three things that many states often find  
13 themselves in short supply of, even when they're long on  
14 authority.

15                   First is the expertise of a multi-discipline  
16 cross-functional set of resources that adequately address  
17 the accounting finance operations and governance risks  
18 involved, whether it's a matter of auditing affiliate  
19 transactions or determining what kind of conditions should  
20 be in place before a merger is approved.

21                   Second is the funding necessary to carry out  
22 effective merger condition drafting, and to perform periodic  
23 post-merger examinations, those being the audits that  
24 Commissioner Wellinghoff I think most appropriately noted in  
25 his comments.

1                   Third, and this I think is particularly  
2                   significant to me because we've dealt with a lot of multi-  
3                   state operations, that's the lack of clear authority in some  
4                   states to gain access to records that link transactions and  
5                   sometimes link financial risks and benefits that involve  
6                   affiliated utilities operating in other jurisdictions, or  
7                   non-utility affiliates operating in any jurisdictions.

8                   One of the biggest areas we have to doing audits  
9                   and examinations for our state is the argument that even  
10                  though common services are provided across several states,  
11                  any particular state doesn't have a right to see the records  
12                  and information that bear upon transactions, even though  
13                  they're linked in other states.

14                  I point that out because your authority with  
15                  respect to access to records obviously doesn't have the same  
16                  territorial limits that apply to many states.

17                  The issue of reporting requirements versus  
18                  restrictions, I see reporting requirements from my  
19                  perspective as helping leverage the power of states to gain  
20                  information about non-utility and out of state utility  
21                  affiliates at a broad level, which relates to the point I  
22                  just made.

23                  But I really think there is only limited value at  
24                  the more detailed level, and that's for two reasons. First,  
25                  I don't think ring fencing helps particularly in addressing

1 ring fencing issues. Those issues are largely a function of  
2 what credit and other documents provide, and how activities  
3 get carried out.

4 After documents and agreements get executed, the  
5 regulatory ability to deal with that circumstance becomes  
6 restricted no matter how much information you have. To the  
7 extent that reporting can help in specific ways, its value  
8 to me lies in the use of information to spot adverse changes  
9 or trends promptly enough to deal with them before financial  
10 circumstances turn seriously south.

11 The question always is who's going to do that.  
12 The utility files the information; the holding company files  
13 the information. I guess what I would always ask is who's  
14 going to look at it, what are they going to do with it and  
15 when are they going to do it?

16 For example, we were involved in a proceeding  
17 where access to utility cash by non-utility affiliates arose  
18 through intercompany loans. The amount owed to the utility  
19 by its underperforming non-utility affiliates moved over  
20 two-thirds of its equity.

21 The accounting for those loans was temporary cash  
22 investments, which served to match the exposure the utility  
23 faced. Your Council opted for the use of that same account.

24 Who will be looking to determine whether growth  
25 over time in that account is actually concealing a transfer

1 of equity from an otherwise healthy utility subsidiary to a  
2 failing non-utility subsidiary? If nobody is doing that and  
3 doing it regularly, reporting information isn't going to  
4 help anybody very much.

5 The last issue I want to address is the  
6 effectiveness of audit and rate proceedings to affect cross-  
7 subsidization. I think hypothetically audits can be  
8 effective, but to be really so, they have to be regular,  
9 indepth and used to recommended where appropriate require  
10 change.

11 They must also not just rely on accounting  
12 experience and standards. Business expertise in all  
13 development areas, for example energy trading, is a common  
14 one where working in is essential. We have not seen  
15 effective use of rate cases to address affiliate issues  
16 because of the litigation context that applies.

17 For rate cases, they're often for schedules and  
18 their need to address other revenue and cost of service  
19 issues. They tend to be seen almost inevitably as more  
20 pressing than affiliate matters.

21 In sort, we do not put much faith in the states'  
22 rate case as an effective context for addressing these  
23 issues.

24 CHAIRMAN KELLIHER: Thank you very much. Now we  
25 recognize Randolph Elliott, Principal with Miller, Balis and

1 O'Neil, on behalf of the American Public Power Association  
2 and the National Rural Electric Cooperative. Mr. Elliott.

3 MR. ELLIOTT: Thank you. I'm Randy Elliott of  
4 the law firm Miller, Balis and O'Neil, on behalf of the  
5 American Public Power Association and the National Rural  
6 Electric Cooperative Association. I appreciate this  
7 opportunity to address the issue of cross-subsidization.

8 In its recent rulemakings and in the notice of  
9 this technical conference, the Commission was asking the  
10 right questions, and we think so far as largely reached the  
11 right answers. But not to this point. We think there's  
12 more to be done.

13 The repeal of the Holding Company Act of 1935, in  
14 our view, increases the likelihood of mergers and  
15 acquisitions being driven by factors other than the  
16 operational efficiencies of the utilities.

17 It increases the chances of regulated utilities  
18 becoming the cash cows for affiliated non-regulated  
19 businesses. We believe the basic principle of the  
20 Commission's response should be to require that the  
21 regulated public utilities and their customers be fully  
22 insulated from the financial risk of their non-regulated  
23 affiliates and parent holding companies of the utilities.

24 Implementing this principle may in some cases  
25 require ring fencing. We've heard about backstop rules when

1 the states clearly have no authority. That's an example of  
2 that, so we believe the Commission should keep those options  
3 in its tool box of prophylactic measures it can apply when  
4 the facts warrant, and when harm is reasonably perceived.

5 Let me turn first to some of the Commission's  
6 questions about Section 203 of the Federal Power Act. The  
7 Commission's regulations, recently promulgated regulations  
8 under Section 203 are silent on what kind of cross-  
9 subsidization safeguards may be necessary.

10 As a result, we feel that the Commission is not  
11 getting sufficient information in the applications to make  
12 the determinations required by the statute. I agree with  
13 Mr. Naeve that a clear policy statement on what's required  
14 helps applicants, intervenors and the Commission, and the  
15 regulations as they exist right now really don't get you  
16 there.

17 We believe the Commission should adopt the  
18 regulations setting forth the minimum cross-subsidization  
19 safeguards that should apply in all cases, and at at least  
20 some minimal level, and then a non-exhaustive menu of  
21 additional cross-subsidization safeguards, such as ring  
22 fencing measures, that the Commission applicants might  
23 propose or that the Commission might impose in appropriate  
24 cases.

25 I'm thinking of the Commission's recent

1 regulations about transmission incentives. They have a list  
2 of things the Commission might do in particular cases when  
3 the facts warrant. We think that the minimum safeguards  
4 that ought to apply in all cases should include  
5 implementation of the Commission's Code of Conduct for all  
6 public utility company subsidiaries of the public company  
7 applicable to both power and non-power goods and services  
8 and transactions between public power authorities and their  
9 non-regulated affiliates, much as the Commission did in the  
10 recent National Grid order.

11 In addition, we believe the Commission's Section  
12 203 regulations should require applicants who are going to  
13 rely on state-proposed cross-subsidization safeguards to  
14 demonstrate the adequacy of those safeguards to protect  
15 wholesale and transmission customers, and to meet the  
16 standards then of Section 203(a)(4) of the Power Act and to  
17 incorporate those as state-incorporated safeguards if that's  
18 what they're going to rely on in their Section 203  
19 application.

20 So the Commission should incorporate those state-  
21 imposed safeguards in its Section 203 orders, acting  
22 independently of the Power Act but not preempting the states  
23 or acting differently.

24 But that gives the Commission the authority then  
25 to enforce audits and oversee the state requirements, and I

1 think it's required really by the clear language of the  
2 statute, Section 203(a)(4), that the Commission make its own  
3 independent finding on whether cross-subsidization issue  
4 problems exist.

5 Let me conclude by turning to the Commission's  
6 authority outside of Section 203. The Commission, I think,  
7 clearly has authority under Section 204, 205 and 206 to  
8 impose generic conditions to prevent cross-subsidizations or  
9 encumbrances of utility assets.

10 The backstop rules that we've discussed so far I  
11 think are an example. Clearly, you have authority to do  
12 that, and again, to reiterate, we think one thing you could  
13 do, even outside the context of the mergers, would be to  
14 codify your code of conduct rules applicable to all public  
15 utilities.

16 With holding company affiliates, we believe the  
17 Commission should also codify its Westar Energy rules under  
18 Section 204, applicable of course only to the utilities that  
19 have to get Section 204 authority for their securities  
20 issuances.

21 At this point, we agree that you should not,  
22 other than perhaps the backstop rules, adopt or preempt the  
23 states with ring fencing requirements, but should act on a  
24 case by case basis.

25 The issue of backstop rules is an exception to

1 that, and I think I would agree with the prior commenters,  
2 that you should look to the best examples of the best  
3 practices, if you will, Oregon, Wisconsin and other states,  
4 and draw from those as you draw up backstop rules.

5 But I think there is in some cases a regulatory  
6 gap that should be plugged, and I think the Commission  
7 should also consider whether to adopt some reporting  
8 thresholds, such as a requirement that a holding company or  
9 public utility holding company system report to the  
10 Commission when the holding company system makes substantive  
11 non-regulated investments.

12 That way, it seems to me to be essential to the  
13 Commission that enforcing and auditing where necessary to  
14 enforce its Federal Power Act authority. With that, I'll  
15 conclude, under time.

16 CHAIRMAN KELLIHER: Thank you, Mr. Elliott. I'd  
17 like to now recognize Joseph Sauvage, Managing Director and  
18 co-head of the Global Power Group of Lehman Brothers.

19 MR. SAUVAGE: Thank you very much. First of all,  
20 I would like to say that what I'm going to speak on today  
21 are my personal views. They don't necessarily represent the  
22 views of Lehman Brothers or our other clients.

23 First of all, I would say that I generally agree  
24 with the comments of the prior speakers. The FERC has a lot  
25 of the tools in its tool kit to address the concerns that

1 are raised today under almost all circumstances with respect  
2 to cross-subsidization.

3 Secondly, it's been stated very eloquently that  
4 the state regulatory commissions in most jurisdictions also  
5 have approvals over corporate mergers and also, very  
6 importantly, have ongoing regulatory approval once a  
7 transaction is consummated. One shouldn't forget the  
8 importance of that on an ongoing basis.

9 The second point I would make is that certainly a  
10 contemplated proposal such as ring fencing are not necessary  
11 cost-free and, as a result, I think they ought to be  
12 implemented, if they're going to be implemented,  
13 judiciously.

14 For example, independent directors. In the  
15 current Sarbanes-Oxley environment, having independent  
16 directors on a subsidiary board can change the corporate  
17 governance dynamics. In addition, as many folks now, it's  
18 getting increasingly difficult to find folks who want to be  
19 independent directors and serve on corporate boards.

20 This is not free, and as a result I think you  
21 have to look at the costs and the benefits out of these  
22 guidelines.

23 Three, I think it's also important to put in  
24 context that there are economic benefits for many of these  
25 proposed business combinations, and these are just bloody,

1 bloody difficult transactions to execute, probably moreso  
2 than any business sector in America.

3 The failure rate for announced utility mergers is  
4 extremely high, as you can tell in the last 12 months, and  
5 approvals are multiple federal level approvals. There's  
6 state level approvals and they can take up to two years.

7 So if you're going to think about implementing  
8 guidelines, and I agree with folks that if you're going to  
9 implement guidelines, I would much rather see guidelines  
10 implemented with safe harbors rather than deal with this  
11 point on an ad hoc basis.

12 I think it's very important for the guidelines to  
13 be clear and straightforward, so that they don't increase  
14 the uncertainty and the risks of these corporate  
15 transactions, because I think it's important to realize that  
16 if you go through a corporate merger or a leveraged buyout,  
17 huge resources are taken by the companies and participants  
18 in the transactions.

19 So that it's not cost-free if the transaction  
20 fails, particularly if it goes on for a year or two years.  
21 People leave, teams have to be replenished.

22 Sometimes that's very challenging for the partner  
23 in the breakup, to in effect put his company back together  
24 very quickly and have to operate in the public service.

25 Finally, I would say that I might have a slightly

1 different perspective than some of the other panelists on  
2 the merits of investment by more non-traditional  
3 participants in the utility industry.

4 My feeling is that if guidelines are adopted,  
5 they shouldn't unduly discourage investment by companies  
6 such as Berkshire Hathaway or General Electric. Yes, even  
7 the private equity firms have infrastructure funds.

8 For example, we were representing DQE in the sale  
9 of a company. One the big negotiating points in that merger  
10 was whether ring fencing was in effect a material adverse  
11 change in the merger. Mike would do a better job of  
12 describing that than I would. But that was in effect a  
13 significant negotiating point.

14 We reached a reasonable compromise, but it was an  
15 important issue to them. I then point out that the McCrory  
16 Investment Group put \$100 million in equity into DQE to fund  
17 a planned acquisition of a power plant, which was promising  
18 to the rating agency, in advance of any certainty of  
19 shareholder approval or regulatory approval of the  
20 transactions.

21 They were very well prepared to submit additional  
22 capital to the business. Also in the current environment,  
23 capital is abundant and it's easy to say we wanted to  
24 discourage some of these folks from participation in the  
25 industry.

1                   But we have to remember, two, three or four years  
2 ago, capital was very reluctant to address in this industry.  
3 In fact, if some of these folks hadn't stepped into that  
4 void, there would have been quite a few other bankruptcies  
5 in this sector. There would have been more severe economic  
6 consequences.

7                   I would just urge if we adopt guidelines, I  
8 understand an advocate's need to protect customer interests  
9 and to protect from cross-subsidization.

10                  But you don't want to construct a framework that  
11 unduly discourages outside of classic utility participants  
12 from becoming involved in the business.

13                  CHAIRMAN KELLIHER: Thank you, Mr. Sauvage. I'd  
14 like to now recognize Brian Little, Controller of AGL  
15 Resources.

16                  MR. LITTLE: Thank you. I appreciate being the  
17 lone industry representative on this panel today. I would  
18 first start out and say that largely I think AGL Resources  
19 is also in agreement with many of the comments by those  
20 preceding me.

21                  AGL Resources believes, generally speaking, that  
22 there are no additional rules necessary at this point in  
23 time, that any additional rules would be essentially  
24 contrary to the repeal of the '35 Act, which was to signify  
25 additional capital investment into utilities also.

1                   It would be counter-intuitive and really preempt  
2 the authorities at the state level as well, and also really  
3 move the utilities down a path, particularly holding  
4 companies like AGL resources, to where you could have  
5 conflicting rules between the FERC and the states.

6                   I will go through a couple of other items. I put  
7 through some information that we provided. I would like to  
8 discuss the at cost rules and also the cost allocation.

9                   Just as a background, who is AGL Resources? I  
10 will say Mr. Antonuk, I think I may have been the first one  
11 who has asked about the audit.

12                   I would say that AGL Resources did not own that  
13 asset at the time the audit was performed, but we do have  
14 many customers from Florida to New Jersey. We were  
15 previously authorized under the '35 Act, and we had to seek  
16 that approval under the '35 Act.

17                   We are currently exempt under the PUHCA 2005 Act.  
18 We do have six facilities and we do have some non-utility  
19 assets, but they're generally related to the gas industry.

20                   When you look at the issues of cross-  
21 subsidization and diversification, again as I mentioned, I  
22 don't think -- we do not believe additional rules are  
23 necessary regarding that.

24                   Mainly again, any additional rules would not be  
25 consistent with repeal of the PUHCA Act, and also that those

1 additional rules would impede economic growth by limiting  
2 capital investment in the utility industry.

3 We also believe that any additional ring fencing  
4 rules are not necessary at this point in time, largely due  
5 to also the rules that exist at the state jurisdictional  
6 levels.

7 If the FERC does decide new rules are necessary,  
8 a forum like this, a technical conference where you have a  
9 lot of different folks, between industry, state jurisdiction  
10 and also the Commission, is the best approach to  
11 establishing those rules.

12 I do want to touch a little bit on the cash  
13 management rules. I know that's the next topic. But we  
14 want to also mention that we do not believe that there are  
15 any additional rules that are necessary with respect to cash  
16 management.

17 Currently today, agreements -- cash management  
18 agreements would be required to be filed with the  
19 Commission, and those agreements would delineate any rules  
20 or the restrictions upon holding company and non-utility  
21 participants in those cash management programs, and also  
22 many utilities like AGL Resources actually have two separate  
23 cash management programs.

24 One in which utility systems are the only ones  
25 who are allowed to participate in that money pool structure,

1 and then you have ones with non-utility participants.

2 Our view of the cost allocations. One thing.  
3 Largely when you look at the PUHCA 2005 Act, it's largely  
4 focused on the electric industry and not so much on the gas  
5 industry.

6 The one area that we would give consideration or  
7 ask the FERC to consider would be that the review of cost  
8 allocations be available to the natural gas utilities as  
9 well, where they're looking for essentially an arbitrator  
10 between when there's issues with the states.

11 This is really particularly very important in the  
12 area where you have local distribution companies in various  
13 states and you can have different cost allocation rules at  
14 each one of the state levels, and the holding company can  
15 have costs trapped and not being recovered through your  
16 ratepayer mechanisms.

17 We also, contrary to comments previously  
18 provided, believe that the at-cost rule that was in the '35  
19 Act is still the best standard for cost allocations, we  
20 believe. That's the fully-loaded cost. It eliminates any  
21 profit motives between subsidiaries and the holding company  
22 structure.

23 It also does not create or lose any value in the  
24 process of reporting those transactions. In fact, the lower  
25 cost of market or the higher cost of market pricing

1 structures, those asymmetrical pricing structures in essence  
2 also are a cross-subsidization issue in themselves.

3 Lastly, from a reporting requirements  
4 perspective, we don't believe there's any additional  
5 reporting requirements necessary, largely due to the  
6 reporting requirements that exist at the state level.

7 Also, holding company reporting under the '33 and  
8 '34 Acts on your 10-Qs, your 10-Ks and your proxies, which  
9 also include things around your control structures that are  
10 publicly filed and available to the FERC staff, and to the  
11 state commissions as well.

12 Also, companies already file FERC Form 22s and  
13 those are largely also provide a lot more detail than what  
14 was provided in the 1360s and in the U-5s that would be  
15 previously filed under the PUHCA Act of 1935. Thank you.

16 CHAIRMAN KELLIHER: Thank you, Mr. Little. The  
17 last panelist on this panel is Ed Comer, Vice President and  
18 General Counsel of the Edison Electric Institute.

19 MR. COMER: Thank you. I'd just like to make a  
20 couple of observations, coming at the end of a very long  
21 panel.

22 My first observation is having lived through the  
23 PUHCA repeal wars, I'm surprised and pleased by how narrow  
24 this discussion is. It's really focused on one very  
25 specific issue.

1           I'd like to start a couple of first principles.  
2 Congress repealed PUHCA. Congress did want to stimulate new  
3 investment in the industry. It did provide more access to  
4 books and records.

5           Regretfully, it only gave this Commission six  
6 months to rule on this, but I think the Commission has done  
7 a really fabulous job in its rules. We are really focused  
8 now on one issue, which is cross-subsidization in large  
9 mergers.

10           It's important to recognize, nobody else has  
11 mentioned it, that the Commission's rules in place already  
12 address cross-subsidization in a huge number of areas. You  
13 have rules in the Edgar standards, the affiliate transaction  
14 rules, transfer pricing rules, the cash management  
15 standards.

16           The standards of conduct are still in place.  
17 They may need revisions but they're still in place for us.  
18 The OATT rules, the anti-market manipulation rule, and then  
19 you have Section 203 authority.

20           The issue of cross-subsidization and the problems  
21 that could arise and that are being discussed here are very  
22 narrow. Congress addressed this issue only in the context  
23 of Section 203. As everybody has discussed here today, the  
24 primary focus is large mergers.

25           There are a huge number of transactions under

1 Section 203 that don't really raise cross-subsidization  
2 issues. Their assets and actual issues where you're going  
3 to need to look at it. There are relatively small asset  
4 transfers. They're not the kind of large mergers that we've  
5 discussed today.

6 It's important for you to recognize that and try  
7 to address and narrow the focus of what we're really talking  
8 about, which I think is the large merger context.

9 Let's switch. We clearly discuss today the  
10 state. Most states have a lot of different ring fencing  
11 type rules in place. It's important to recognize there is a  
12 huge variety and exactly what those rules are state by  
13 state. The variety may depend upon that, the nature of the  
14 companies involved.

15 Given PUHCA, you've got all kinds of historical  
16 factors in place. You have unique issues that may depend  
17 upon the nature of the transaction, who the parties are that  
18 affect exactly what specific rule is in place.

19 There is not a single template in the states,  
20 even for something as simple as the Act's cost standard.  
21 There's a large variety of how that's done in the states.  
22 Dividend restrictions, debt-equity ratios. There's a huge  
23 variety of how the states may address, in a ring fencing  
24 context or cross-subsidization context, the same kinds of  
25 issues.

1           I think, and I go back to the early suggestion,  
2           it makes it very difficult for this Commission to come up  
3           with any generic standards, and I think as you Commissioners  
4           yourselves have suggested, it is important for you to give a  
5           lot of deference and flexibility to the states.

6           Where does that leave you? I think where that  
7           leaves you all is in a situation where you should provide  
8           applicants for large mergers the flexibility to come into  
9           you and explain to you what situations they have, where they  
10          are on ring fencing, what they have done within the context  
11          of their own unique histories, their own state requirements  
12          and everything else.

13          From an applicant's perspective, it would be  
14          useful for them to understand where there are safe harbors.  
15          If you do A, B, C and D or A, B, C or D, you will satisfy  
16          the Commission on the cross-subsidization issue.

17          It won't be a single generic approach. There's  
18          got to be room for a lot of flexibility, because there are a  
19          lot of different ways to assure the Commission, and  
20          especially the state commissions, that companies have  
21          addressed these issues.

22          So in conclusion, I would suggest not a generic  
23          standard but something that works with the states, gives a  
24          lot of deference to the states and a lot of flexibility to  
25          the merger applicants, and that would take off the table a

1 whole host of relatively routine two or three transactions  
2 that don't really need to address these kinds of issues.

3 CHAIRMAN KELLIHER: Thank you, Mr. Comer. I'd  
4 like to make a comment or two and then go to questions and  
5 turn to my colleagues.

6 One comment, one or two of you touched on this,  
7 but particularly when the PUHCA '35 Act was repealed, there  
8 was some commentary that somehow the state roles in  
9 reviewing mergers had been gutted or diminished.

10 It's always puzzled me at the time, and it's  
11 completely unchanged. I think we've seen in the experience  
12 of the last year that that is true. States have the exact  
13 same ability to petition or in fact reject the mergers they  
14 had before the 1935 Act was repealed.

15 So the state role is the same, and that's  
16 certainly clear over the past year.

17 Second, really to get back to the discussion we  
18 had, we use different terms. Let me start off with a  
19 question before I get to this. I think from the panelists,  
20 is it fair to say that none of you support the FERC approach  
21 on cross-subsidization to be mandatory and uniform across  
22 the Board?

23 We've been talking about backstop and gap  
24 filling, default standards, minimum standards. But there's  
25 no support for a preemptive federal approach on cross-

1 subsidization that would be applied without regard to state  
2 policy.

3 Is it fair to say no one supports that?

4 (No response.)

5 CHAIRMAN KELLIHER: How about this? Raise your  
6 hand if you support a mandatory approach that would be  
7 without regard to state law?

8 (No response.)

9 MR. NAEVE: I don't support that. But what I  
10 would point out though is that your current regulations in  
11 effect have that. You have certain requirements you've  
12 adopted that ignore state law. They're mandatory  
13 requirements on parties applying for mergers.

14 They have to come in and provide information and  
15 assurances. The term of art, I believe, is substantial  
16 evidence that they will not -- that a transaction will not  
17 result in encumbrance of utility assets, transfers of  
18 assets.

19 So you do have some existing generic standards  
20 that are Commission-specific standards that are independent  
21 of state requirements, and they're put there to implement  
22 Section 203(a)(4).

23 CHAIRMAN KELLIHER: Mr. Elliott?

24 MR. ELLIOTT: I would agree. In that sense, I  
25 think the statute does require you to reach independent

1 findings in every case, or even jurisdiction in the merger.  
2 So in that sense, it may have some preemptive effect.

3 But we don't believe, at this point, that the  
4 Commission needs to adopt a generic rule that would preempt  
5 the states from acting.

6 CHAIRMAN KELLIHER: Now supposing we take  
7 something like the Oregon approach or the Wisconsin approach  
8 and say this is the federal approach, and everyone has to  
9 comply with it regardless of state law.

10 MR. ELLIOTT: No. The backstop rule would be  
11 preferable.

12 CHAIRMAN KELLIHER: I just want to be more clear  
13 on what we all mean by some of these terms, backstop. If  
14 we're not talking about that kind of mandatory, very  
15 comprehensive federal approach that applies across the board  
16 irregardless of state law.

17 Since we're talking about gap filling, this would  
18 be the two basic approaches. My state colleagues have said  
19 that it is appropriate for FERC to act where states lack  
20 authority to act, to prevent cross-subsidization.

21 But gap-filling would be a different thing from  
22 backstop. It would be a minimum thing from default  
23 standards or minimum standards. A minimum standard gets  
24 into a pretty subjective area, where there's a minimum  
25 federal standard, where state protections are stronger,

1 state cross-subsidization approaches would govern, not the  
2 federal minimum standard.

3 But a different approach, it's very subjective,  
4 and depending on whether a different approach is stronger or  
5 weaker, I think a minimum standard approach is different  
6 from filling a gap. I think it could be clear to identify  
7 where there is a gap.

8 Do you think in practice, though, would that be  
9 difficult if that were the approach that FERC will act on  
10 cross-subsidization to fill a regulatory gap where states  
11 lack authority? How difficult it is to actually identify  
12 that there is a gap that needs to be filled?

13 Would it be if there isn't a law like the Oregon  
14 and Wisconsin law there is deemed to be a gap? Would states  
15 also have a merger review authority without having a full-  
16 blown ring fencing measure in law? The state commission  
17 probably has the authority to impose that as a discretionary  
18 matter.

19 But maybe the question is really to Mike. How  
20 hard is it to identify the gap?

21 MR. NAEVE: I alluded to this, but because of  
22 lack of time I didn't have much opportunity to go into it.  
23 I think it would be extremely difficult, for a couple of  
24 reasons.

25 First of course, is that it would require you to

1 be knowledgeable about each state's authorities, not only  
2 their authorities in the merger context but their  
3 authorities on an ongoing basis.

4 States can review issuances of securities. Some  
5 states cannot. Some states have clear statutes with respect  
6 to affiliate transactions; other states not as clear. So it  
7 would require the Commission on every merger to have  
8 information about the ability of every state to address  
9 cross-subsidization, and I think that would be hard for you  
10 to do it and do it right.

11 There's another piece to this. The second piece  
12 is what the statute says it is you should protect against  
13 mergers causing cross-subsidization. So a second question  
14 you would have to answer is to what extent does this  
15 particular merger cause cross-subsidization?

16 Because regardless of what authorities the state  
17 has, if the merger itself doesn't cause cross-subsidization,  
18 it's not appropriate for you to act. You'd have to then  
19 develop standards.

20 When there is sufficient threat of cross-  
21 subsidization above and beyond what we've already adopted in  
22 implementing Section 203(a)(4), and above and beyond what  
23 our existing powers are, is there something about this  
24 merger that increases cross-subsidization to a level we have  
25 to act.

1           As I said earlier, you'd have to develop  
2 standards to decide that, because most transactions do not  
3 and you wouldn't want to impose those burdens on most  
4 transactions.

5           Indeed, I think it would be very hard to kind of  
6 figure out where you exactly draw the line, when you've  
7 crossed over that standard and have it not be subjective.  
8 But you have to make that attempt, because if you don't,  
9 judges will set it for hearing and judges aren't going to  
10 have any standards to try to decide this issue.

11           You yourselves don't have standards to apply.  
12 You will have to think through that point, when in fact the  
13 statute tells you to develop specific criteria.

14           That's going to be a first test. Then the second  
15 test is well, if we cross over some minimum threshold, and  
16 you have to define the threshold, what do we do?

17           If we're talking about ring fencing, as I  
18 mentioned earlier, there are dozens of things that fall  
19 under the broad rubric of ring fencing. Which of those  
20 individual things, steps will you take?

21           It's going to be very hard for you to say this  
22 particular step or this particular combination of steps for  
23 this level of a problem are the right ones, or for this  
24 level of problem you need to do these steps.

25           Many of the steps, by the way, are substitutes

1 for others. It's going to become very difficult and a very  
2 subjective thing. I think for that reason, that we're  
3 really not dealing with a significant problem, you've  
4 adopted regulations that are, I think, very direct and clear  
5 to understand. You've identified the major areas where  
6 cross-subsidization historically occurs. You have other  
7 tools at your disposal. You also have states review.

8 My information would be because this is so  
9 difficult and is so subjective, you should step back for a  
10 while and see if additional requirements are needed.

11 My judgment is they're probably not. If it turns  
12 out they are, then you can go through this exercise of  
13 deciding what are your criteria, how are you going to decide  
14 these issues, and I think you'll find that a very difficult  
15 exercise.

16 CHAIRMAN KELLIHER: Thank you. I'd like to  
17 follow up with something Commissioner Garvin said, and well,  
18 let me follow up first with Mr. Elliott.

19 At one point I thought you said that a merger  
20 applicant, let's say a merger is a proposed in a state that  
21 has ring fencing provision, an Oregon application or a  
22 Wisconsin application before the Commission, that the  
23 applicant should identify the state ring fencing provisions  
24 and then that we should, in effect, apply state law in our  
25 decision.

1                   That to me raises pretty significant potential  
2                   for conflict, where for applying Oregon law or Wisconsin law  
3                   and we reach a different result, then the Oregon or  
4                   Wisconsin regulators see that we would apply their law and  
5                   in effect have preempted them.

6                   MR. ELLIOTT: Let me be clear what I'm  
7                   suggesting. I heard that the Commission needs to take no  
8                   action because the states are adequately protecting against  
9                   cross-subsidization.

10                   To a large extent, that is true. Certainly in  
11                   protecting the retail ratepayers certainly, and the  
12                   utilities they regulate that would be true.

13                   I think the Commission, though, has some  
14                   obligation to protect wholesale customers, transmission  
15                   customers, and therefore you're going to have to, by  
16                   necessity, make some independent judgment of whether they're  
17                   actually protected or not.

18                   The argument may be made by applicants that the  
19                   cross-subsidization provisions that the state commission is  
20                   going to impose are going to have the necessary spillover  
21                   effect and they will protect adequately wholesale customers  
22                   and transmission customers.

23                   If this Commission is persuaded by that argument,  
24                   I think you could say we don't need to take any further  
25                   action. But I think you will need to adopt those same

1 standards.

2           If it's a ring fencing requirement or something  
3 that the state is adopting, then incorporate them in your  
4 order, so that you can audit and enforce them yourselves to  
5 protect wholesale customers, because the state commission is  
6 naturally -- they would not have the authority, much less  
7 the information, to audit and intervene in order to protect  
8 wholesale or transmission customers.

9           I think the requirements of the 203(a)(4) would  
10 require, I think, the Commission to act independently, not  
11 just to defer to states.

12           CHAIRMAN KELLIHER: Commissioner Garvin raised  
13 the point in his testimony that he sees a part of the  
14 rationale, as an unspoken assumption, that the state  
15 commissions will not discharge their responsibilities?

16           MR. ELLIOTT: Quite to the contrary. I'm saying  
17 you should adopt the same rules, adopt as your own their  
18 protections, if you believe they've got it right, and in  
19 many cases they will.

20           I think the point is that Mr. Antonuk made is  
21 that the state commissions may not have the resources or the  
22 authority in some cases to enforce a lot of these  
23 requirements.

24           One could argue that this Commission, separately  
25 and independently, is exercising its authority to enforce

1 the same requirements. I mean so quite to the contrary, I'm  
2 not saying there's any regulatory failure here. I'm just  
3 recognizing the separate tiers of authority and the --

4 CHAIRMAN KELLIHER: It seems that taking state  
5 law and enforcing it and applying it separate from the  
6 state, why do we apply Oregon law to a merger and reach an  
7 independent judgment, and actually end up conflicting with  
8 Oregon? I'd assume that they're actually not going to  
9 follow through on their responsibilities.

10 MR. ELLIOTT: I'm suggesting that if the argument  
11 is made that the Oregon Commission's order enforcing certain  
12 ring fencing provisions, for instance, in a merger is  
13 adequate, if it were adopted by this Commission, if the  
14 Commission adopted the same substantive rules under the  
15 Federal Power Act that would adequately protect wholesale  
16 customers or transmission customers from cross-  
17 subsidization concerns.

18 Don't reinvent the wheel, but adopt that standard  
19 as your own. I'm not saying apply Oregon law, but I'm  
20 saying adopt the same substantive standard, incorporate it  
21 into your Act. I thought this would be a way of trying to  
22 minimize the complexity if there's a multi-jurisdictional  
23 merger.

24 CHAIRMAN KELLIHER: You're saying take Oregon law  
25 and apply it to the federal standard in every state.

1                   MR. ELLIOTT: In a merger case. That's what I'm  
2 talking about here.

3                   CHAIRMAN KELLIHER: Mr. Comer?

4                   MR. COMER: I guess I would be very troubled by  
5 that. I think that would create a very complex duplication  
6 of regulation. It puts you into a context of if the state  
7 needs to act, changes its positions or its rules, what are  
8 you going to do?

9                   What if there's a need or an emergency and  
10 something needs to be adjusted? Are you going to duplicate  
11 the state process? It doesn't seem to be necessary, and I  
12 remind the Commission that one of your merger criteria is,  
13 you know, whether or not a merger impairs effective  
14 regulation.

15                   I would think the public interest standard under  
16 Section 203 is certainly broad enough to allow you to take  
17 into account the availability of effective regulation at the  
18 state level. I think you do that all the time, and you  
19 should continue in this area.

20                   MR. ELLIOTT: Just quickly. My argument is not  
21 to duplicate it, but to complement it, to try to minimize  
22 the complexity by applying the same rule under the Power  
23 Act, within your sphere of authority, which is different  
24 than the states, and you're protecting different customers.

25                   Another argument would be one of your key

1 interests is protecting wholesale competition. Cross-  
2 subsidization has to effect captive customers. It benefits  
3 the supposedly competitive company with an anti-competitive  
4 benefit.

5 I think this Commission would be uniquely  
6 concerned to enforce cross-subsidization to protect its pro-  
7 wholesale competition policies.

8 CHAIRMAN KELLIHER: I'm not sure that we're not  
9 discussing deferring to states on how to prevent cross-  
10 subsidizations that would affect wholesale power customers.  
11 The only question is who really should we give some  
12 deference to the states on cross-subsidization intended to  
13 protect retail consumers. But I agree.

14 MR. ELLIOTT: I agree within that sphere.

15 CHAIRMAN KELLIHER: John, did you have a  
16 question?

17 COMMISSIONER WELLINGHOFF: I'm trying to  
18 understand Mr. Elliott's example. Maybe I have an example  
19 that might help. As I understand it now, they provide for  
20 us basically, we make these decisions on a case-by-case  
21 basis. I understand Mr. Naeve doesn't think that's a good  
22 idea. Is that basically it?

23 MR. NAEVE: I think you should probably get  
24 specific standards. Obviously, mergers come in on a case-  
25 by-case decisions.

1                   But before you evaluate a particular merger, if  
2                   you're going to go beyond your current standard, you should  
3                   spell out specifically what the standards are, so you can  
4                   give a judgment as to the administrative law judges and the  
5                   applicants, as to how to decide these cases.

6                   COMMISSIONER WELLINGHOFF: That's a direction to  
7                   our auditors.

8                   MR. NAEVE: To prevent arbitrary decision-making.

9                   COMMISSIONER WELLINGHOFF: To go back to Mr.  
10                  Elliott, if you could give us an example. Say we had a  
11                  merger, a multi-state merger in Oregon, Nevada and Idaho,  
12                  okay, states I know a little bit about. Those states all  
13                  approved the merger and we also approved the merger.

14                  What standards would you suggest that FERC  
15                  utilize to audit cross-subsidization with respect to that  
16                  merger, relative to wholesale customers?

17                  MR. ELLIOTT: That's a good question and I don't  
18                  have a quick, easy answer. There you do have some conflict  
19                  of laws. You would have to choose some standard to be your  
20                  own.

21                  COMMISSIONER WELLINGHOFF: Should we choose the  
22                  Oregon standard?

23                  MR. ELLIOTT: Then you would have to make your  
24                  own best judgment as to what the best standard is.

25                  COMMISSIONER WELLINGHOFF: We'll need some rules.

1 Under Mr. Naeve's precept, we need some rules to determine  
2 would best fit when you've got this multi-jurisdictional  
3 situation with different states that have different levels  
4 of standards.

5 I'm not saying we shouldn't do that. Maybe it's  
6 good that they do have it. I'm just trying to figure out  
7 how to do it in a way that's just and reasonable, and that  
8 doesn't fly in the face of due process.

9 MR. ELLIOTT: Well, I think it's unavoidable.  
10 You have to make a choice as to what the best standard would  
11 be. But again --

12 COMMISSIONER WELLINGHOFF: But we should set out  
13 some criteria and rules as to how to make that choice, and  
14 we don't have that right now.

15 MR. ELLIOTT: No, we don't. Whether that's  
16 amending the regulations or amending the merger policy  
17 statement or a separate policy statement, everybody would  
18 benefit by more clarity.

19 COMMISSIONER WELLINGHOFF: Thank you.

20 CHAIRMAN KELLIHER: Let me follow up on that,  
21 John. A hypothetical merger in three hypothetical states,  
22 each of which has rules to prevent cross-subsidization.  
23 That merger in turn comes before the Commission. Do you  
24 think the Commission should not rely on those three state  
25 commission to guard against cross-subsidization that would

1 harm retail consumers?

2 We would certainly act independently to prevent  
3 cross-subsidization of wholesale customers or transmission  
4 customers. Do you think it would be somehow illegitimate  
5 for us to just consider relying upon the state to find three  
6 different cross-subsidization regimes?

7 MR. ELLIOTT: No, I don't. To protect the  
8 consumers that you're charged with protecting, you should  
9 certainly defer to the states and try to minimize the  
10 conflicts here.

11 CHAIRMAN KELLIHER: Two quick questions. I know  
12 I'm taking more than my 20 percent of the time.

13 COMMISSIONER WELLINGHOFF: Could I just follow  
14 up, Mr. Chairman? I'm sorry. Let's take Joe's hypothetical  
15 one step further. You've got three states, only two of  
16 which --

17 CHAIRMAN KELLIHER: I knew you were going to say  
18 that.

19 (Laughter.)

20 COMMISSIONER WELLINGHOFF: Only two of which have  
21 in place provisions to protect retail consumers. Who should  
22 we defer to with respect to the third?

23 MR. ELLIOTT: I think you need some backstop rule  
24 then.

25 COMMISSIONER WELLINGHOFF: And how do we

1 determine the standards for the backstop rule?

2 MR. ELLIOTT: I think you need to look in our  
3 prior comments in the rulemaking. We cited the Oregon  
4 orders in the PBO case as a good set of ring fencing  
5 provisions to look at. The Wisconsin statute, as we  
6 explained here today, is another good place to look about  
7 the best practices.

8 COMMISSIONER WELLINGHOFF: Do any people on the  
9 panel disagree that we should have a backstop rule to  
10 protect consumers?

11 MR. NAEVE: I think I would. I think we're  
12 really talking about different topics here from time to  
13 time. One topic is, and this is almost independent of  
14 mergers.

15 If a state doesn't have adequate rules to protect  
16 customers, retail customers against cross-subsidization,  
17 should FERC somehow step in and develop its own rules and  
18 impose them somehow on that company separate from mergers,  
19 where we think the state has not adopted adequate rules?

20 I don't think you want to put yourself in the  
21 position of second-guessing either what state commissions  
22 have themselves adopted, new rules or should do more, or  
23 whether state legislatures have made bad decisions.

24 So I think you don't want to be in that position.  
25 What we're really talking about here, I think, is do mergers

1 cause cross-subsidies, and you already have adopted rules  
2 that say that companies have to commit, if the merger  
3 doesn't result in new affiliate contracts, they don't result  
4 in encumbering resources, loans or securities issued by the  
5 utilities. You've identified the major areas where cross-  
6 subsidies are likely to occur. So the question is, is there  
7 anything left you need to worry about? I would submit  
8 what's left is not a big area. That is, of course, in the  
9 eyes. That's my view.

10 But I think what's left here is not will the  
11 merger cause direct cross-subsidy right after we close the  
12 merger. It's rather a question of is there a potential in  
13 the future because of the merger that cross-subsidization  
14 may be more likely to occur.

15 I think that's kind of the issue here that we're  
16 probably talking about, not day to day ability of states to  
17 protect against cross-subsidy but rather does this  
18 Commission need to do more, beyond what it's already done,  
19 to not worry about direct cross-subsidization caused by the  
20 mergers?

21 I think you ought to address that. But rather in  
22 the future, is there something about this merger that makes  
23 it more likely in the future that there could be cross-  
24 subsidization, that wouldn't be protected and get by your  
25 existing rules or state rules?

1           I think, with what you've already done, and with  
2 what states have, you picked the bulk of the forbidden fruit  
3 from the cross-subsidy tree. I just don't think that at  
4 this stage there's a sufficient benefit outweighing the  
5 costs, to try to adopt rules to worry about what might  
6 happen in the future with respect to, for example, a  
7 potential bankruptcy of the parent company that might have  
8 an effect on on the subsidiary.

9           That's really kind of, I think, what we're  
10 talking about, and that's what you're worried about when you  
11 talk about ring fencing, and the question is do the states  
12 have the ability to adopt ring fencing, and if they don't,  
13 should you be doing something like that.

14           In my judgment, at this stage, I don't think  
15 there's a sufficient basis to conclude that you should be  
16 worried about imposing ring fencing requirements on mergers  
17 to address something that may happen in the future.

18           There's not a sufficient basis to do it, and if  
19 you were going to do it, then you have to come up with clear  
20 criteria to decide when to react and if we do act, what is  
21 it we're going to do. You'll find it a very difficult line-  
22 drawing exercise.

23           COMMISSIONER KELLY: What I take away from this  
24 is number one, no additional generic rules. Number two,  
25 Congress has focused on cross-subsidization. It's in the

1 statute. Congress has said this is something that we want  
2 you to address.

3 Number three, Congress had put the burden on the  
4 applicant to show the cost of cross-subsidization. In doing  
5 that, we should either provide criteria in advance which  
6 Mike suggests would be very difficult at this point due to  
7 that reinventing, or guidelines.

8 I think maybe Mr. Elliott talked about providing  
9 guidelines. One of you talked about it. Does anybody have  
10 a problem with that?

11 MR. ANTONUK: I just want to say one thing.  
12 Anything that you establish in advance as criteria or  
13 guidelines, if they become lengthy and proscriptive, I think  
14 two potentially unintended consequences happen.

15 One is people at the state level will say this is  
16 all FERC gets. Why do you want more? That's not a good  
17 thing to introduce into state proceedings, this notion  
18 somehow that FERC has already expressed its wisdom on it.

19 So you shouldn't be thinking about going the  
20 extra mile. If you do have standards or guidelines, if you  
21 don't want to control state proceedings, I think you need to  
22 be very careful about how you state what they are and what  
23 they want.

24 The second thing I worry about, and this is a  
25 fuzzy word but a significant one, is that the states we work

1 for are busy. They're resource-constrained. The more you  
2 lay out there as a standard, the more likely I think you're  
3 going to see some, particularly of the smaller states,  
4 backing away from might they might have felt was their job  
5 in the first place.

6 I think you might have the other unintended  
7 consequence of losing the benefits of states considering  
8 these things at the state level, because they figure well,  
9 there's a backstop.

10 That kind of worries me, and it worries me for  
11 this reason. I think Commissioner Spitzer mentioned it  
12 earlier. Ring fencing is important, cross-subsidization is  
13 important, but a merger gets decided, in my experience, on a  
14 more holistic basis.

15 Maybe you don't quite need the ring fencing  
16 standard, but maybe you've made commitments about local  
17 operations or maybe you've made commitments about rate  
18 protection out into the future, that might cause the state  
19 to say you know, I'm going to settle for 90 percent on ring  
20 fencing.

21 If that somehow runs afoul of what you've put out  
22 as a guideline on minimum, do you really want to have to  
23 deal with the fact that you're overriding, in effect, the  
24 FERC's guidelines? A much more complicated and holistic  
25 decision may consider ring fencing perfectly adequate.

1 You'd just put it a little lower on the scale in that  
2 particular case because there were other factors.

3 Both of the points I'm making are that I would be  
4 concerned that you don't do anything that has a chilling  
5 effect on what I think that the states are in general trying  
6 to do in these cases.

7 COMMISSIONER KELLY: I would agree with you. I  
8 also agree with you that it is a holistic decision. It's  
9 not just a decision on whether or not there's ring fencing  
10 or what the ring fencing looks like.

11 However, I do think we need to address ring  
12 fencing, because in particular that was the one subject of  
13 colloquy among the Senators regarding this provision.  
14 Senator Feinstein and Senator Domenici and Senator Bingaman  
15 specifically talked about ring fencing, and that we need to  
16 address ring fencing. It's very important to the states.  
17 It's also important to the financial community.

18 Here's my proposal. What about, what do you  
19 think of using the provision that requires the applicant to  
20 explain why or to show why there's no cross-subsidization,  
21 and announcing a policy but instead of announcing guidelines  
22 or criteria, which have a lot of uncertainties in their  
23 development at this stage, asking the question and putting  
24 the burden on the applicant to tell us, asking the question  
25 does the proposal include ring fencing?

1                   Does it include ring fencing for your utility  
2                   operations for the various states in which you're going to  
3                   operate, and what's your ring fencing proposal? If you  
4                   don't have one, why not? In other words, putting the burden  
5                   on the applicant to explain how ring fencing and any other  
6                   approaches to cross-subsidization, and any other mechanisms  
7                   to avoid cross-subsidization, putting the burden on the  
8                   applicant to explain that it is in the proposal that  
9                   addresses that issue, and if there isn't anything that  
10                  addresses it, why not?

11                  I'm thinking what that would do is announce our  
12                  policy that ring fencing is important, that we defer to the  
13                  states, but it's not abdication to the states. It's  
14                  deference to the states. We'll do our own independent  
15                  review, which I think we're required to do under the  
16                  statute.

17                  We'll act if we need to, although we prefer not  
18                  to. We certainly wouldn't, if it's adequately handled by  
19                  the states. Would an approach like that address the  
20                  problem?

21                  MR. ANTONUK: It does from my perspective. It's  
22                  the "you get to go last approach." Basically what you're  
23                  doing, the applicant's going to tell you what the state did,  
24                  and he's going to tell you everything the state did.

25                  I think under that scenario, you could sit there

1 and say that while the last merger we approved had different  
2 ring fencing and maybe even better ring fencing, on the  
3 whole we're willing to accept that as adequate here because,  
4 on balance, we think all of the important criteria, the  
5 signed paper of approving this merger or not have been made.

6 I think if you do that, you're not so likely to  
7 tell the states don't worry about it; we'll cover it for  
8 you, and you're much less likely to have applicants at the  
9 state level saying "You know, you're treading on what's  
10 really FERC ground here."

11 I really come at this a lot from having done a  
12 lot of work under the FCC competition rules, where the FCC  
13 told the states down to a gnat's eyelash what to do, and it  
14 wasn't from the state perspective a very good experience.

15 It didn't leave them much maneuvering room. It  
16 left them feeling like they had just one more unfunded  
17 mandate, which they did, and it got a lot of them sort of  
18 saying we're walking away from that business, because FCC  
19 wants to tell us everything we've got to do and the way  
20 we've got to do it. We'll just let them do it in the first  
21 place.

22 COMMISSIONER KELLY: It is difficult for  
23 regulators to run the business. On the other hand, the  
24 regulators have the problem of ensuring that the businesses  
25 run right. MR. NAEVE: I look at this from

1 the perspective of somebody trying to advise the client what  
2 might be expected of you, so that you can make a decision.  
3 Do you want to do this transaction or not or what do you  
4 propose?

5 It presents a lot of uncertainty, and one  
6 reaction that immediately comes to mind is -- I wish I knew  
7 the number, but you do process hundreds of two or three  
8 applications, most of them relatively minor.

9 If you put this burden on everybody to file and  
10 explain why they don't need ring fencing or the level of  
11 ring fencing they've engaged in is sufficient, I suspect  
12 you'd be imposing burdens on a lot of people that seem  
13 completely unnecessary.

14 Most transactions present no threat whatsoever of  
15 cross-subsidization and no threat of potential effect to the  
16 financial stability of the utility or any of those things.

17 COMMISSIONER KELLY: Then shouldn't they just  
18 answer it that way, saying we don't propose ring fencing  
19 because no threat of cross-subsidization. If there isn't,  
20 why would that be a problem for us?

21 MR. NAEVE: Again, you don't quite know. Maybe  
22 over time. In numerous cases that go by, at some point  
23 you'll know -- you can get away with that, but you won't  
24 know immediately and you won't know again where you draw the  
25 line, where the Commission's going to draw the line.

1                   These structures are not -- they're a continuum  
2 of potential effects on the utility, and it's not going to  
3 be a clear, bright line. At some point, you're going to  
4 reach a threshold where the Commission's going to decide.  
5 The answer that we're not doing anything isn't good enough.

6                   COMMISSIONER KELLY: Do you think the alternative  
7 to that, of drawing the line is better for the applicant?  
8 It's clearer, but is it going to -- what about where we draw  
9 the criteria? What about the chilling effect on investment?  
10 What if we make the call wrong? Are we in the best place to  
11 make the call?

12                   MR. NAEVE: You have to make the call. You  
13 ultimately make the call no matter what happens.

14                   COMMISSIONER KELLY: But you're saying you want  
15 us to make the call in advance.

16                   MR. NAEVE: I'm saying I'd rather know ahead of  
17 time what you're going to impose on me or my clients, so  
18 they can make the decision do we want to do this  
19 transaction, and what would the cost be.

20                   COMMISSIONER KELLY: If we have a policy that  
21 states what we want, as opposed to a criterion, exact  
22 criterion, than doesn't that put your clients in the best  
23 circumstance, where they know what we want, but we're giving  
24 them the freedom to design their own acquisition to meet the  
25 standard?

1                   MR. NAEVE: I would say this. I think first, you  
2 need to define a class of transactions for which they don't  
3 need to do anything, and you need to let people know when  
4 they're in that class and when they're not in that class, so  
5 they'll know what to propose or not to propose.

6                   Secondly, if you're not in a class where you  
7 don't need to do anything, then that doesn't necessarily  
8 mean you need to adopt every theoretical ring fencing  
9 proposal that could be proposed. They run, again, from  
10 relatively modest to very extensive. So I think they need  
11 guidelines as to how far they go.

12                   I do think you need to identify potential  
13 problems, the criteria for applicants to decide when you  
14 cross the threshold and you now present a potential problem.  
15 For this potential problem, here's the type of ring fencing  
16 provisions that we would expect you to provide.

17                   You could do like you did, for example, with your  
18 current rules and policy statement approach to effect on  
19 rates. You give them three or four options for addressing  
20 this potential type of problem. You offer a rate freeze,  
21 you offer a hold harmless and so forth.

22                   So you might be able to say when you meet these  
23 criteria, here are the potential alternatives that you might  
24 adopt. But absent that, there's no certainty and no  
25 guidelines. If you simply set it for hearing, the judge

1 would have no guidelines and certainty as to how to approach  
2 this.

3 It would be hard to ultimately engage in  
4 principled decision-making without having thought through  
5 what the principles are. It certainly helps parties trying  
6 to decide if we want to invest millions, maybe hundreds of  
7 millions of dollars in a transaction that would take a long  
8 time. We'd like to know ahead of time what will be expected  
9 of us.

10 COMMISSIONER KELLY: If we pursue that approach,  
11 though, we'd have to have -- do we have to have a rulemaking  
12 with a significant record, and how would we know where to  
13 draw the line?

14 MR. NAEVE: That's what you did with the merger  
15 policy statement. You did go out with a merger policy  
16 statement. You solicited comments. You proposed where you  
17 were going to draw the line and when the lines were crossed,  
18 what people should do about it.

19 Parties commented on your proposal and you  
20 adopted a final rule. I must say the merger policy  
21 statement was a tremendous source of clarity for people  
22 attempting transactions, thinking about transactions that  
23 really made the process here at the Commission much better,  
24 and it made it much faster.

25 CHAIRMAN KELLIHER: Commissioner Wellinghoff.

1                   COMMISSIONER WELLINGHOFF: Mr. Naeve, I'm trying  
2 to find out, based upon Commissioner Kelly's proposal and  
3 comments, what is a sufficient level of information. I like  
4 examples. Let me give you an example here.

5                   It's my understanding with respect to the  
6 information regarding cross-subsidization in the now-  
7 withdrawn FPL-Constellation Energy Group merger, that that  
8 information consisted -- the whole information on cross-  
9 subsidization was a hold harmless commitment and a one page  
10 verification by corporate officials of each merging party  
11 that their agreement did not provide for cross-  
12 subsidization. Do you think that information is sufficient?

13                   MR. NAEVE: That's actually an interesting  
14 question. The regs say you have to provide detailed  
15 information that you won't do any of the four things. We  
16 puzzled over that language for a very long time in a number  
17 of our draft applications.

18                   How do you prove a negative? How do you prove  
19 you're not beating your wife? It's extremely hard to do.  
20 How do you provide information that this merger doesn't  
21 provide use of securities? How else do you prove that?

22                   I'm not sure how one could possibly prove it with  
23 detailed information, other than saying we're not doing it.

24                   COMMISSIONER WELLINGHOFF: It's Commissioner  
25 Kelly's suggestion. That's one of the things we're going to

1 do with respect to ring fencing in some detail. Wouldn't  
2 that give the Commission more information as to how there  
3 would not be any cross-subsidization?

4 MR. NAEVE: Two points. Of course, the regs  
5 don't refer to ring fencing. They say why there won't be  
6 encumbrance of assets and so forth. I'm not quite sure how  
7 you provide detailed evidence of that, other than have an  
8 officer say we're not encumbering assets, we're not  
9 transferring any assets and so forth.

10 COMMISSIONER WELLINGHOFF: You're not doing it  
11 today, but we're also talking about the future. How do we  
12 again set standards for auditors and determine, going down  
13 the road, that the effect is not going to be cross-  
14 subsidization?

15 MR. NAEVE: Right. I do think cross-  
16 subsidization is a very important topic, and the Commission  
17 used to have rules and requirements against cross-  
18 subsidization all the times, whether they were mergers or  
19 not mergers. If there's something about the merger that  
20 makes it worse, that's what Congress asked the Commission to  
21 investigate.

22 If no cross-subsidization is theoretically  
23 possible after the merger, I guess it will certainly always  
24 theoretically be possible.

25 COMMISSIONER WELLINGHOFF: Isn't it the intent of

1 Congress that we shouldn't be doing anything after the  
2 merger?

3 MR. NAEVE: Congress says you should investigate  
4 whether the merger causes cross-subsidization?

5 COMMISSIONER WELLINGHOFF: Shouldn't we also, at  
6 least part of that, deal with the issue on an ongoing basis,  
7 so that there are procedures in place to assure that there  
8 won't be cross-subsidization?

9 MR. NAEVE: I think that is a very important part  
10 of your responsibility. You should do it for companies that  
11 merge and companies that don't merge. So I am just not so  
12 sure it should be different for companies that merge and for  
13 companies that don't merge.

14 That's an extremely important part of your  
15 responsibility, and the ring fencing issue goes to  
16 diversification anyhow. Problems arise when companies  
17 diversify and branch out into other businesses.

18 You can diversify through acquisitions into non-  
19 utility businesses, and I would add that when companies do  
20 acquire non-utility businesses, those mergers are not  
21 brought to this Commission. You can do it through mergers  
22 of two utilities, one of which may have more non-utility  
23 business than the other.

24 You know, this Commission has decided there's  
25 something about a particular merger that you've get to look

1 at, because you don't look at all of them. You just look at  
2 the ones where they're acquiring other utilities. Is there  
3 something about that that causes greater concern?

4 In that circumstance, if it causes greater  
5 concern, perhaps you should address it in the context of the  
6 merger. But quite apart from mergers, you have an ongoing  
7 responsibility to adopt adequate rules to protect against  
8 cross-subsidization, and you have a great many rules to do  
9 that.

10 Perhaps you should look to improve those rules,  
11 but nevertheless that's an ongoing issue. Whenever you have  
12 diversification outside of the utility business, this issue  
13 of cross-subsidization arises and you should be addressing  
14 it generically.

15 CHAIRMAN KELLIHER: Mr. Sauvage wanted to be  
16 heard.

17 MR. SAUVAGE: I would say a couple of things,  
18 Commissioner Kelly. One is I think to reach that  
19 conclusion, you have to come to a view that tools in your  
20 current tool kit aren't adequate to address the problem. I  
21 guess as a banker and not a lawyer, I can say it seems like  
22 you have an awful lot of things in the merger approval  
23 process, to make certain transactions are not detrimental to  
24 customers and aren't providing cross-subsidization.

25 But that's a banker's view, not a law school view

1 or a practitioner of regulatory law view. Secondly, that's  
2 almost presuming that ring fencing itself is necessary and  
3 if that isn't a cost to the entities involved, there are  
4 cases where if you look at utility-holding companies, and  
5 you look at the classic distribution entities, say as  
6 compared to large generation businesses, that in fact the  
7 generation businesses are by far the better businesses.  
8 They're producing significantly greater amounts of cash  
9 flow.

10 So if you're going to ring fence, the question is  
11 what problem are you protecting against? The subsidization  
12 of the distribution businesses versus the unregulated  
13 generation companies, when in effect those are probably the  
14 more creditworthy businesses. They're the ones that are  
15 producing the great majority of the cash flow.

16 Are you trying to protect against the cases where  
17 you have a utility holding company, a highly rated utility  
18 and once the unregulated businesses that are merging with  
19 another entity, are you trying to say two utility holding  
20 companies, one rated A plus, one Triple B plus; they merge  
21 and they're rated A.

22 I think while I would be generally a fan if you  
23 conclude that I don't have enough tools in my tool kit, I  
24 would agree with Mike. I would like to have a reasonably  
25 straightforward road map as to what has to be done.

1                   I'm still not convinced, on a personal basis,  
2                   that ring fencing is appropriate or actually the cost  
3                   benefits are perfectly aligned. I think there are different  
4                   questions, where you have a leveraged acquisition of a  
5                   utility company through a holding company.

6                   There, the ring fencing is designed more to  
7                   protect the credit ratings and the integrity of the  
8                   underlying utility assets.

9                   COMMISSIONER KELLY: What about the states that  
10                  do have ring fencing? How would your clients deal with  
11                  those?

12                 MR. SAUVAGE: Clients deal with those. They're  
13                 generally well spelled-out in the statute, and if they  
14                 choose to merge with a company in that state, then they  
15                 understand that they will have to abide by those rules and  
16                 regulations, and they'll go through the state regulatory  
17                 processes.

18                 COMMISSIONER KELLY: So your advice to us would  
19                 be leave it to the states. If the states have ring fencing  
20                 requirements, let the states have them. If they don't,  
21                 don't involve them.

22                 MR. SAUVAGE: With one caveat. If you conclude  
23                 that what you have currently available to you, and I'm going  
24                 to focus on merger approvals, not the rest of the two or  
25                 three transactions.

1                   But if what you conclude that you have currently  
2 available to you gives you adequate sway in terms of the  
3 merger approval to protect the public interest, if you don't  
4 conclude that and you feel you need to do something, then I  
5 would just urge that it be relatively straightforward, so  
6 that companies can look at it and say yes, I can live with  
7 this or no, I can't.

8                   Maybe it's simply saying if you're merging two  
9 companies, the credit ratings of the utility operating  
10 companies are investment grade, and ring fencing isn't  
11 applicable. If they aren't, then you have to go and visit  
12 and discuss it.

13                   COMMISSIONER KELLY: It sounds to me like you  
14 think the same thing as Mike. You want us to decide in  
15 advance, on a case-by-case process, what our criteria will  
16 be?

17                   MR. SAUVAGE: Yes. I would be an advocate of  
18 that. I'd also be an advocate of safe harbors, which would  
19 say if you're in this box, you don't have to worry about  
20 ring fencing, realizing this is all extremely complicated  
21 and it's a lot easier to stay on this panel than it is for  
22 you folks having to implement.

23                   COMMISSIONER KELLY: There are two ways we go  
24 about coming up with criteria, and that is what all agencies  
25 do. One is to have a proceeding in the abstract, a

1 rulemaking where you hash out in the abstract what the  
2 criteria should be.

3 The other is to wait and have experience with  
4 particular cases that raise issues, and have your criteria  
5 evolve from that. I mean I'd be interested. It sounds to  
6 me like you are proposing the first process.

7 MR. SAUVAGE: The first process would mean if  
8 there was another merger to be announced, that there will be  
9 criteria that you can rely on. Obviously, I would say  
10 again, practicing law without a license or regulation  
11 without a license, which I've learned is very dangerous,  
12 presumably those criteria could change over time as you had  
13 more experience with dealing with particular situations.

14 I also think it is important to think about what  
15 you're trying to protect against. What is the issue you're  
16 really trying to protect against? Much of the state ring  
17 fencing is based off of a pretty classic rating agency ring  
18 fencing, and is really designed to protect credit ratings.

19 With that comes a bunch of things about asset use  
20 and those things. But it's really designed to protect  
21 credit ratings, and it has the advantage of being spelled  
22 out by the rating agencies and credit ratings are known and  
23 demonstrable.

24 Mergers, people who have credit ratings pre- and  
25 post-mergers as well. Most folks will go to the rating

1 agencies and get some kind of advance look-see at what the  
2 credit ratings will be if the merger took place.

3 CHAIRMAN KELLIHER: Ed Comer, then Commissioner  
4 Spitzer.

5 MR. COMER: We have thought about this a good  
6 bit. It's somewhat of a troublesome issue. But in response  
7 to your questions, I think from the Commission's perspective  
8 what you should do first is try to define those classes of  
9 transactions that are not at issue. Let's narrow the scope  
10 a little and do that.

11 Two, I personally would be more an advocate at  
12 this stage of kind of a safe harbor approach. Those areas  
13 you would look at those areas where there was a greatest  
14 risk or concern, and within that, where either between what  
15 the rating companies have done or the states have required,  
16 where are you --

17 Do you reasonably feel comfortable that these are  
18 safe harbors and you can give an applicant a clear sense, as  
19 Congress did want to expedite mergers, where you can give an  
20 applicant a clear sense that they can go forward and satisfy  
21 you on a cross-subsidization issue?

22 I think we would all like the Commission to do  
23 that. There are still going to be other areas. We're going  
24 to have to work through some of the other areas, and that  
25 may go more case by case. But the safe harbor gives you

1 that opportunity.

2 I'm a little reluctant, very reluctant go case-  
3 by-case, because there are so few mergers right now. The  
4 uncertainty of not doing it may drag it out more. So I  
5 would take the middle ground between, you know, clear  
6 regulations and guidelines and maybe move to the safe  
7 harbor.

8 I would also keep on talking about ring fencing.  
9 Ring fencing has some very definitive legal context in the  
10 bankruptcy world and other worlds, and I would caution that  
11 Congress asked us to look at cross-subsidization and the  
12 potential for that, and that is what we should be focusing  
13 on.

14 Because if you're asking the question should we  
15 ring fence, in a bankruptcy context that may be the wrong  
16 question to ask in most transactions. That brings us back  
17 to cross-subsidization.

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1                   COMMISSIONER SPITZER: Mr. Chairman, you teed up  
2 an issue that I would like to get some feedback from my  
3 state commission colleagues. We have to have a federal  
4 proceeding. That's the law with respect to cross-  
5 subsidization as it affects retail rate payers.

6                   The question is, as that proceeding unfolds --and  
7 that is my obviously stated preference -- that we fill the  
8 gap as opposed to interfering and having a possibly  
9 burdensome or inconsistent or duplicative federal proceeding  
10 that has already been handled adequately and faithfully by  
11 the state commission.

12                   One idea is that there simply be a gap where  
13 there is no merger authority in a state with respect to  
14 protection of retail rate payers. You have a federal  
15 proceeding. Yes, there is a state proceeding. It means we  
16 don't have potential duplication and inconsistent  
17 adjudication. It means we don't have the potential  
18 duplication or inconsistent adjudication.

19                   On the other hand, if we are going beyond simply  
20 filling a gap where there is an absence of authority,  
21 according to one of minimum standards, the FERC would then  
22 be in a position of -- I won't use the term second-guessing.  
23 That's a little bit derivative.

24                   But reviewing and analyzing what may be an  
25 existing state protection and making a determination of that

1       somehow is inadequate, and somehow fails to meet the minimum  
2       standard.  These cases are extremely complicated and in some  
3       cases you would have a real difficulty making this minimum  
4       standard determination.

5               And then, once you have embarked upon the  
6       standard, per se, you might have a state proceeding and a  
7       federal proceeding simultaneously.  And there are logistical  
8       burdens imposed upon simultaneous federal/state proceedings.

9               What is your reaction to those alternatives?

10              COMMISSIONER BAUM:  Speaking on behalf -- as an  
11       individual Oregon commissioner, I can check this with my  
12       colleagues.  I would suggest you do the stop gap approach,  
13       after listening to this discussion.  The state has no  
14       authority to even step into the field.

15              If you have some minimums that you have people  
16       meet, whether that's to have them maintain investment -- I  
17       mean, just a simple thing like that would trigger most of  
18       the ring fencing protections, because it is about the cost  
19       of capital and maintaining the utilities.

20              Let's not pass through to customers when they  
21       have to get a higher rate of return and all that kind of  
22       stuff because of the borrowing cost of the utility going up.

23              I would suggest that the threshold test be the  
24       complete lack of state authority step in there, and then be  
25       sure that you state that this only applies in the event the

1 state hasn't acted in the area.

2 And then with what you already have in play,  
3 which I have already heard from these other gentlemen, the  
4 cross-subsidization issue seems to be address already, or at  
5 least largely already.

6 I have some problems with the cost rule. I am  
7 not sure exactly how that should go. Obviously, we support  
8 our approach to that. But assuming indeed it goes up a  
9 little on the wholesale side, of course, and on the ongoing  
10 checking of these companies as they go on, the greatest  
11 service you can provide, particularly those states that  
12 don't act, the problem -- if they don't have resources, is  
13 to help them do the investigations, the audits, the follow-  
14 ups -- those states are the smaller states where you don't  
15 have merger authority. They will have to be helped out to  
16 make sure that companies are following through on their  
17 original commitment.

18 COMMISSIONER SPITZER: The commitment you  
19 describe -- we have the overarching concern that the utility  
20 assets not be used to somehow extend credit to non-utility  
21 entities. And that requires some ongoing diligence.

22 What Mr. Antonuk suggested as an example is one  
23 where you had advances by a utility within the corporate  
24 structure that somehow had the economic effect of additional  
25 equity being put in. It sounds like in that case the

1 financials were somewhat opaque.

2 MR. ANTONUK: The utility equity had turned into  
3 a chit from the affiliates. It was an IOU for the amount of  
4 cash that the affiliates had taken out. The accounting  
5 wasn't transparent, and it was only discovered by kind of  
6 getting behind that, and looking at where the money was  
7 coming from.

8 COMMISSIONER SPITZER: That extension of credit  
9 was violative of the state law, but it was not uncovered.

10 MR. ANTONUK: That is correct, which is why  
11 standards ought to start, but they are not the end. They  
12 have to be lived up to. And someone has to look and make  
13 sure they are being lived up to.

14 COMMISSIONER SPITZER: And the source would be  
15 that entity in some cases, that would not supplant, but  
16 would enhance. The State of Texas has an audit function.

17 MR. ANTONUK: I would like the states to do that,  
18 but I would agree if the state doesn't do that, there is  
19 clearly a role that I would hope to see you step in and  
20 fill.

21 COMMISSIONER GARVIN: I have one comment in  
22 response to your question. I agree largely on the  
23 standards. I think the states should be more the gap  
24 filler. But I think you have to look at what the savings  
25 clause of the statute versus the federal telecommunications

1 regime. And that regime, as you pointed out -- you know,  
2 the state is not inconsistent with what the federal  
3 government is doing. It's much more ambiguous.

4 That's why just as a regulator, I would urge  
5 caution on how you construe the statute to say if the states  
6 are tackling cross-subsidy. It better be a specific case  
7 where there isn't anything.

8 Quite frankly, the only reason I was involved  
9 with the big issue on these mergers is synergy savings, not  
10 cross-subsidy at the state level, because I think we take as  
11 a given a lot of states have the issues of cross-subsidy  
12 taken care of.

13 That's why I think, given the savings clause, any  
14 gap should be really narrowly tailored at your level. And I  
15 agree with Mike, that's going to be extremely difficult to  
16 try to do. Plus, if you do it on a prospective basis, I'm  
17 glad I'm on this side of the table.

18 (Laughter.)

19 CHAIRMAN KELLIHER: Commissioner Moeller.

20 COMMISSIONER MOELLER: A very quick question for  
21 Commissioner Baum that may or may not be relevant to our  
22 jurisdictional questions here.

23 Now that you have had a few years to think back  
24 on the Enron PG&E situation that you went through. I went  
25 through your excellent presentation about many factors that

1 you have in the state legislative authority to protect  
2 consumers, but do you have any more observations on what  
3 worked and maybe could also be done to protect rate payers  
4 in that situation?

5 COMMISSIONER BAUM: Well, we have an additional  
6 30 ring fencing provisions that we applied to Berkshire  
7 Hathaway to merge itself with PacifiCorp which we allowed  
8 and granted. That has another 30 ring fencing provisions  
9 that I would be happy to go over with you at your leisure.

10 But we learned a great deal and improved upon  
11 Enron because we felt if they had not been required to be  
12 completely separate companies, and that certainly prohibited  
13 the bankruptcy judge from looking at them as one company.  
14 And agreeing that that is purely a stock ownership issue --  
15 they owned stock in this company. The stock is going to be  
16 liquidated. Not the assets.

17 And that was our key, was to keep focus on the  
18 stock as the asset, which eliminated bankruptcy. We did  
19 that, and we now feel we do a much better job, like we did  
20 with Mid American. And of course the parent itself is very  
21 cooperative in negotiating those ring fencing provisions.  
22 So, we have them here.

23 I would be happy to share them with folks if they  
24 want to see how those should be done. But we learned a  
25 great deal with the ring fencing, too.

1                   CHAIRMAN KELLIHER: Any other questions?

2                   COMMISSIONER WELLINGHOFF: One brief one, the  
3 issue of auditing. The Commission did say there was a type  
4 of periodic audit on cross-subsidization. I was curious to  
5 know whether you thought that the rule for collaborating  
6 with states on those audits.

7                   MR. ANTONUK: Yes, I think that's particularly  
8 true in the case of holding companies, with utility  
9 companies in multiple states. There are document access  
10 questions. There are objections about what a state can see  
11 that involves another state. There are a lot of  
12 efficiencies to be gained by combining state and federal  
13 efforts.

14                   And I think the other issue -- I don't know if  
15 that has been talked about here. It's the question about  
16 the potential for tracked costs. I think it's fair for one  
17 state to have a different view about what is an allowable  
18 recoverable cost, a prudent or an imprudent cost.

19                   But I have trouble when a state says we should  
20 only be picking up 30 percent of the AEG costs and our  
21 fellow states should pick up 70. And then the fellow state  
22 says, no, let's reverse that. Where is the company in that  
23 case?

24                   So, I think coordinating those efforts is good in  
25 terms of moving document access that is material. It is

1 also useful for conflicts and useful for maximizing resource  
2 efficiency.

3 CHAIRMAN KELLIHER: I just had two short  
4 questions. They lend themselves to very short answers.

5 First of all, Mr. Sauvage, I just want to be  
6 clear. Earlier you were talking about the financial sector  
7 entering into the utility business, and it has been  
8 frustrated in Arizona and Oregon, I believe.

9 Do you think ring fencing uniquely discourages  
10 the financial sector from getting into the utility business?

11 MR. SAUVAGE: No, I don't. I was merely urging  
12 if you are going to have safe harbors, principles of  
13 guidelines, that they not be designed to unduly discourage  
14 participation by financial sector investors.

15 CHAIRMAN KELLIHER: I mean Arizona. It wasn't  
16 ring fencing that ended up killing the UniSource  
17 transaction. It was other matters.

18 MR. SAUVAGE: I agree with that completely. I  
19 simply wouldn't want these to be designed to discourage. It  
20 should be a level playing field.

21 CHAIRMAN KELLIHER: We should not assume that the  
22 financial sector is not among potential acquirers.

23 MR. NAEVE: I have been with Joe on several of  
24 these financial transactions. One thing I would just add to  
25 this is, again, the term "ring fencing." It encompasses a

1 great many activities. It's fair to say that many of those  
2 activities would not be problematic for financial investors.

3 That is not to say you can't create so-called  
4 ring fencing conditions that would be problematic. So, one  
5 has to be careful and provide some flexibility in how you do  
6 that. And guidance as to what is acceptable and what is  
7 not.

8 CHAIRMAN KELLIHER: Thank you. Mr. Little, AGL  
9 acquired New Jersey Natural.

10 MR. LITTLE: NEY Corporation.

11 CHAIRMAN KELLIHER: Which in turn owned  
12 Elizabethtown Gas, which was another famously well run gas  
13 utility what was acquired. But was ring fencing a problem  
14 in that acquisition?

15 MR. LITTLE: We had several ring fencing types of  
16 activities that we set up separately.

17 CHAIRMAN KELLIHER: They were imposed by the  
18 State of New Jersey?

19 MR. LITTLE: I don't know if that is actually  
20 state statute, but that is part of the order. It is part of  
21 our financing order with that.

22 But that was a very significant discussion point,  
23 obviously, during the merger approval process, mainly  
24 because of what happened with NEY and Elizabethtown Gas.  
25 And advances from the utility to the holding company.

1                   MR. ANTONUK: We did the work for the board in  
2 that case. Ring fencing was not by statute, and the ring  
3 fencing, I think, resulted from negotiations.

4                   MR. LITTLE: It was.

5                   MR. ANTONUK: It really resulted from what  
6 amounted to a forced sale. NEY was considered by the board  
7 not to be a viable concern anymore. So, the sale really  
8 was, for all intents and purposes, a distress kind of sale.  
9 And the negotiations took place in the context that somebody  
10 was going to have to go to the company.

11                   So, it's not the typical case where you had a  
12 voluntary coming together. It was more, how do we get out  
13 of this difficult situation.

14                   CHAIRMAN KELLIHER: The same thing was proposed  
15 around Elizabethtown. Even though you would not normally  
16 look at it as a potential source, you wouldn't be looking to  
17 Elizabethtown to extract subsidies from. That's not a very  
18 good sentence, but it was, as you said, a utility that was  
19 not viewed as a viable concern.

20                   MR. ANTONUK: The utility was a viable concern.  
21 The problem was the finances had been so compromised by non-  
22 utility activities.

23                   MR. LITTLE: It was the Consolidated NEY  
24 Corporation that was, in essence, troubled. The NEY assets  
25 of the utilities were viable assets.

1                   CHAIRMAN KELLIHER: That's another point Mr.  
2 Antonuk just made, that ring fencing can't be imposed by a  
3 state commission. Even though there is not a dedicated ring  
4 fencing statute per se, they can develop ring fencing  
5 measures on a case-by-case basis, varying from one utility  
6 to the next.

7                   MR. ANTONUK: They can. I think somebody made  
8 the point that ring fencing was a statutory matter  
9 generally, from knocking around a lot of state capitals, my  
10 experience is that it is not. And it is not uncommon to  
11 find in the same state, differing ring fencing conditions  
12 applicable to different holding companies.

13                   Because, as I pointed out before, those ring  
14 fencing provisions came as a result of what is a holistic  
15 decision about a merger. In some cases, ring fencing was a  
16 bigger issue. In some cases, it was a lesser issue. The  
17 same with cost allocation. That's not always consistent  
18 from utility to utility within the same state.

19                   CHAIRMAN KELLIHER: The discretion of commissions  
20 to impose ring fencing, even notwithstanding the absence of  
21 a state ring fencing statute, is relevant to the point of  
22 how do they identify the regulatory -- is the regulatory gap  
23 the absence of a dedicated state ring fencing statute? Or  
24 is it the absence of a state merger authority where ring  
25 fencing can be imposed?

1                   MR. ANTONUK: I would agree with the general  
2                   tenet that it is very difficult in advance to say New Jersey  
3                   is a Category A state, Wyoming is a Category C state. I  
4                   don't see how you could slot them in a way that would be  
5                   useful in advance.

6                   COMMISSIONER KELLY: Are there states that don't  
7                   have the authority to ring fence? Or do you all not know?

8                   CHAIRMAN KELLIHER: There are states that have no  
9                   review authority.

10                  COMMISSIONER GARVIN: I think the point you  
11                  raised, Mr. Chairman, that there are a lot of statutes that,  
12                  even if they are not specific to a rate case, or affiliate  
13                  interest, there are all sorts of statutes that have broad,  
14                  all things necessary and proper, and short of a commerce  
15                  clause or equal production case, I wouldn't litigate that  
16                  case in a regulatory body because we usually win.

17                  COMMISSIONER KELLY: So you take the position  
18                  that --

19                  COMMISSIONER GARVIN: Commissioner Wellinghoff  
20                  mentioned all the states that don't have the oversight, and  
21                  I don't know if that's just a transaction merger thing. I  
22                  just think that most state statutes, there's plenty of  
23                  general authority statutes that give prospective commissions  
24                  as many of these companies that are regulated and their  
25                  lawyers have discovered they have a tremendous amount of

1 authority to structure transactions.

2 COMMISSIONER KELLY: Would you agree, Ray, that  
3 there is no gap?

4 COMMISSIONER BAUM: I think you probably have 10  
5 states or so that are probably without any kind of ability  
6 to do this.

7 COMMISSIONER KELLY: They would have merger  
8 review authority.

9 COMMISSIONER BAUM: I am not sure they even have  
10 merger review authority.

11 CHAIRMAN KELLIHER: I think it is about 10 that  
12 don't have merger review authority.

13 COMMISSIONER BAUM: So, they would be subject to  
14 maybe some back-up support from FERC, but you are going to  
15 cover the cross-subsidy issue already, it seems to me, for  
16 them. The question is, how far do you want to go.

17 You can create safe harbors by doing four things.  
18 One of them is maintain no loans to affiliates. Your  
19 dividends are within the normal range for that company in  
20 that industry. And no securing other assets for affiliates'  
21 debts. Safe harbors, you know. All existing rules that are  
22 out there. That would be something. A quick cut.  
23 Standards, I would say. They are required to be qualified  
24 to go into a more expedited mode, where you don't have  
25 merger authority. It's a stop-gap measure.

1                   MR. LITTLE: The only point I would add -- not  
2 all utilities are going to be rated. In particular, that  
3 was the case with our acquisition of NEY Corporation. But  
4 we do have specific debt to equity percentages that we have  
5 to adhere to.

6                   COMMISSIONER BAUM: Put up those on there too in  
7 certain ranges.

8                   CHAIRMAN KELLIHER: Colleagues, any other  
9 comments?

10                   (No response.)

11                   CHAIRMAN KELLIHER: I want to thank the  
12 panelists. This has been a truly outstanding panel. I want  
13 to thank the "murderers row" of cross-subsidization experts.

14                   (Laughter.)

15                   CHAIRMAN KELLIHER: You have helped us  
16 tremendously. Thank you for your help.

17                   (Whereupon, at 12:15 p.m., the meeting was  
18 adjourned for luncheon, to be reconvened at 1:15 p.m.)

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1 federal regulators stepping on the state regulators' toes,  
2 and we also think it is very necessary in that regard that  
3 it works best to have that coordination to protect both  
4 investors and rate payers.

5 In my written statement, I do remind the  
6 Commission that you do have the authority in this regard.  
7 Because that is always one of the first questions that  
8 arises -- what authority do you have in that regard.

9 Eyesight -- Section 1267 of the Energy Policy Act  
10 of 2005 -- that specifically talks about the fact that the  
11 Commission can take actions necessary or appropriate for the  
12 protection of the customers. That is what I am focusing on  
13 relative to this issue.

14 Basically, I am here to recommend that the  
15 Commission take the next step and put forth guidelines for  
16 further formal comment rather than deciding on the basis of  
17 this panel of whether to do rules or not to do rules or what  
18 those rules should be.

19 I actually have some suggestions for you of what  
20 the rules might contain, a minimum set of rules might  
21 contain.

22 We suggest that you put those out and you seek  
23 the formal comment of the industry of your fellow regulators  
24 at the state level, and of consumer advocates. Specifically  
25 what we are looking at is a minimum set of standards that

1 would then provide a backstop.

2           While I talk in my comments about the gaps that  
3 do occur at the state level, one of those gaps I can give  
4 you from my home state of Wyoming, which is that we have the  
5 ability explicitly in statute to regulate the issuance of  
6 financing. But only if it is long term financing. Anything  
7 that is less than 12 months, or short term financing, is  
8 subjected to specific upfront approval.

9           Much of this cash money pool arrangements we are  
10 talking about are short term financing. Would the  
11 Commission have the ability to use some of its other  
12 regulatory authority to address it? Maybe. But the lawyers  
13 -- and I am not one of them -- but the lawyers tell me that  
14 if there is an explicit statute, it takes the place of a  
15 more general statute. So, there could very clearly be a gap  
16 in our authority in this area.

17           Other states have had similar situations, where  
18 some regulate financing and some do not. So, that is why I  
19 am here, suggesting that the Commission take the next step  
20 to explore the possibility of some minimum standards.

21           The suggested minimum standards that I have in my  
22 comments are the following. These would be a starting  
23 point, clearly, not a final ending point, that I am  
24 suggesting.

25           First of all, looking at a level of percentage of

1 equity, at the holding company level, and thus at the  
2 utility subsidiary or affiliate level, looking at a minimum  
3 percentage of equity basically before they participate in  
4 these pools, or limiting their participation in these pools.  
5 That standard would be to protect the customers against the  
6 forced borrowing by or from unregulated affiliates, the  
7 lending of too much excess cash that might be needed for  
8 capital purposes.

9           The second recommended standard is a prohibition  
10 against internal money management action with affiliates  
11 whose securities are not designated at least as investment  
12 grade level. That would limit the amount of risk of the  
13 utility not being repaid.

14           Third is a prohibition against allowing a  
15 regulated utility to lend asset-secured funds to others  
16 within the holding company or to an unregulated affiliate,  
17 and protecting customer assets from the risk of unsecured,  
18 unregulated transactions.

19           The fourth would be a limit to the amount of  
20 funds that a utility may internally lend an affiliate,  
21 subsidiary or parent, again to protect that the utility  
22 would have the operating funds.

23           The next prohibition against a utility borrowing  
24 from an affiliate if it would not be cost-effective to do  
25 so. And this relates to the interest rate that would be

1 paid to or from the affiliate.

2 Then there would be a complementary one, talking  
3 about the interest rate to be paid and the interest rate to  
4 be received by the utility, depending on which way the  
5 transaction went.

6 Another one might relate to the liquidity ratio,  
7 a requirement that a certain liquidity ratio be maintained  
8 relative to these transactions.

9 And, finally, we are suggesting a mandatory  
10 compliance statement as part of any reporting that these  
11 items are being complied with.

12 Our comments go to the capital-intensive nature  
13 of the utility, to have its cash rated as a utility can be  
14 very problematic in today's time of the utility needing very  
15 much of its cash, both for capital-intensive purposes and  
16 operating purposes. And to put that cash at risk is  
17 somewhat problematic. And we are looking at minimizing that  
18 risk, not eliminating cash management or pooling  
19 arrangements, but to make sure that there is some protection  
20 of the utility's funding.

21 CHAIRMAN KELLIHER: Thank you. I would like now  
22 to recognize Denise Furey, Senior Director of Fitch Ratings.

23 MS. FUREY: I am going to start out with a  
24 description of Fitch. Fitch is a nationally recognized  
25 statistical rating organization. Fitch rates securities of

1 municipal and sovereign governments as well as corporations.

2 The Global Power Group in particular rates fixed  
3 income securities of electric and natural gas utilities as  
4 well as competitive suppliers. Our ratings range from AAA  
5 for the most creditworthy companies to D for issues that are  
6 in default.

7 Today I plan to discuss how Fitch views money  
8 pooling and how cash management practices can affect a  
9 company's ratings. The degree of external constraints  
10 governing cash management practices are two of many factors  
11 in the rating process.

12 Fitch notes in that the groups' use lies a range  
13 of cash management practices -- at one extreme it is all  
14 funding and cash managing is performed by the parent, and so  
15 there is significant commingling of funds. The other  
16 extreme is very discrete issuances and cash accounts are  
17 maintained by each entity within the group.

18 I should note that Fitch has no preference for  
19 any cash management practice, as we simply rate accordingly.  
20 The benefit of a decentralized cash management practice is  
21 that individual members of a group have access to funding  
22 even in the event of financial distress of affiliated  
23 companies. We note also the tight external restrictions  
24 such as regulatory or contractual limits as well as  
25 corporate policies governing shared money promote strong

1 affiliate ring fencing and therefore enable greater  
2 distinction among ratings.

3           We understand the benefit of centralized funding  
4 and cash management. Centralization can be more economical  
5 and less burdensome to administer with discrete treasury  
6 functions in each affiliates and higher treasury structure  
7 when a parent company issues debt and provides all external  
8 capital to the subsidiaries. Subsidiaries are financially  
9 dependent upon the parent for capital, and thus there is  
10 usually virtually no distinction.

11           Fitch would like to note that unlike affiliates  
12 in non-regulated industries, regulated power and natural gas  
13 companies rarely have completely shared external sources of  
14 long and short term funding.

15           However, we have noted the use of shared money  
16 pools as a common cash management technique among affiliated  
17 public utilities. Fitch has noted that money pools vary  
18 greatly within the industry.

19           Some pools include the regulated and competitive  
20 supply entities in one pool. Other company groups have  
21 separate pools for regulated and deregulated subsidiaries.  
22 Some pools have limited on inter-company advanced based upon  
23 either size or credit quality. Others permit the regulated  
24 affiliates to only borrow from the pool, but allow the  
25 competitive suppliers to both borrow and lend.

1           One constant we have seen across the industry is  
2           that the parent companies are allowed to lend into the pool,  
3           but are not allowed to borrow from the pool. We find there  
4           are three main areas in which unrestricted use of money  
5           pools could lead Fitch to determine that there is not  
6           sufficient financing to allow for any differentials among  
7           affiliates.

8           The first relates to the access to short term  
9           funding. If an entity has no independent source of funding  
10          and is solely dependent on its parent or affiliates for  
11          short term financing. And its default probability could be  
12          linked to the parent or affiliates. The range could be very  
13          close to one another.

14          The second relates to short term investments in  
15          entities that will have credit quality. The most prudent  
16          short term investments we would consider to be F-1 rated.  
17          And that is the highest quality of short term instruments.

18          Shared money pools among investment grade  
19          affiliates with excess cash to invest and speculative grade  
20          affiliates with ongoing borrowing increase the risk for the  
21          investment grade entity. If the speculative rate affiliate  
22          were required to enter bankruptcy, the company money pool  
23          related to that affiliate would be unsecured claims,  
24          subsumed in other claims in the bankruptcy.

25          Preferred-1, again, is a somewhat vague, but it

1 is related. We have noted that with cash management  
2 accounts that include the failure to document funds  
3 transferred among affiliated companies could affect a  
4 bankruptcy decision. In particular, we are concerned about  
5 what we call "substantive consolidation."

6 However, we do note that substantive  
7 consolidation usually results from a number of factors, not  
8 just money pools.

9 In summary, while a common practice for the  
10 natural gas and the electric utilities to use money pools as  
11 part of the cash management program, most companies in this  
12 industry have been awarded identical ratings among  
13 affiliates, at least as Fitch rates, because of the  
14 existence of one or more of the following factors of the  
15 groups' cash management program.

16 The first I would note, allowing the parent to  
17 lend but not borrow from the pool. Two, separate pools for  
18 regulated and competitive supply groups. Number three would  
19 be although the group on a day-to-day basis may go to the  
20 money pool to fulfill short term funding needs, committed  
21 bank facilities are in place. Each non-defaulting  
22 subsidiary can continue to borrow, even in the event of  
23 distress on the part of the affiliate or the parent. The  
24 fourth would be credit-metric criteria for money pool  
25 advances. Five, restricting the maximum permitted borrowing

1 from each affiliate to a level commensurate with its  
2 internal cash flow generation and capability. Sixth,  
3 prohibiting financially stronger affiliates from lending the  
4 proceeds from external credit drawings for debt funding to  
5 affiliates Of lesser credit quality. And the last point is  
6 preventing affiliates from providing ongoing long term  
7 funding to one another as a result of perpetual rollovers of  
8 short term money.

9 CHAIRMAN KELLIHER: Thanks very much. I now  
10 recognize Jerry Overman, Director of Cash Management and  
11 Short Term Funding for Dominion Resources.

12 MR. OVERMAN: Thank you. I am here at the  
13 invitation of INGAA, in case it wasn't abundantly clear. I  
14 am a practitioner, not an attorney. So you will have to  
15 bear with me as we go through this.

16 A bit of history. In 2001, 23 merged, or  
17 purchased, Consolidated Natural Gas. We came into the PUHCA  
18 world and, as such, had our money pool under the PUHCA  
19 regulations. Most INGAA companies were not subject to  
20 PUHCA, didn't have the pleasure of the regulation that  
21 existed there.

22 As a prospective, Dominion currently has 28,000  
23 megawatts of electric generation capacity, and 8000 miles of  
24 electric transmission lines. In addition to that, it has  
25 7800 miles of gas transmission pipeline, and a trillion

1 cubic feet of gas storage.

2 We have 4 million franchised gas and electric  
3 delivery customers in five states, and 1.6 million  
4 unregulated retail customers in 11 states.

5 I drill down into the money pool operation and  
6 the purpose. I would state up front that there are many  
7 money pools that are organized differently and managed  
8 differently, as I had learned today at lunch.

9 The purpose behind the money pool is to offer  
10 subsidiaries lower short term borrowing cost due to the  
11 elimination of banking fees, and a mechanism to earn higher  
12 return on interest from surplus funds that are loaned to  
13 other subsidiaries, with the least reliance on external  
14 funding sources.

15 Dominion operates three commercial paper  
16 programs, all rated A2, P2. The current issue rate is  
17 5.36 percent, about two basis points over LIBOR. So, it is  
18 obviously very attractive, both on borrowing as well as  
19 lending.

20 The electric utility has its own CP program, and  
21 does not participate in the Dominion money pool. The  
22 Dominion parent and CNG parent issue commercial paper to  
23 fund the money pool and do not borrow from the money pool.  
24 And the money pool operates at cost. By cost, I mean there  
25 is no staff time allocated to running the money pool, there

1 are no additional rates tacked on to the top of the money  
2 pool in terms of the rates that are charged on investments.  
3 Or on borrowing.

4 The proceeds of short term borrowing may be used  
5 for variety of things, including the internal financing of  
6 construction and capital expenditure programs, working  
7 capital needs, repayment and/or refinancing or debt to meet  
8 unexpected contingencies, payment and timing differences in  
9 cash requirements, to otherwise finance the borrower's own  
10 business and other general lawful purposes.

11 The Dominion money pool currently has 36  
12 participants, and aggregate borrowings of \$5.9 billion.  
13 Operationally, each participant and legal entity has to make  
14 accounts to receive and disburse funds on their own behalf.

15  
16 The cash management is centralized at Dominion  
17 and manages all funding and investment operations and either  
18 sweeps excess funds or injects cash for disbursements.

19 J.P. Morgan Chase is our cash concentration bank.  
20 Most disbursements are made from that bank. So it just  
21 makes sense. Funds are moved to and from bank accounts at  
22 other banks into a general fund account of the participants  
23 at Chase, then moved into a money pool account, a separate  
24 deposit account, where it is accounted for as an  
25 increase/decrease to investment or borrowing for that

1 particular entity.

2 To give you an example to make it a little bit  
3 clearer, FI Transmission Company has received \$1 million in  
4 gas sales proceeds. At Mellon Bank, the \$1 million is  
5 transferred into a general fund account at J.P. Morgan.  
6 Then it is moved into the money pool account. From there,  
7 if there is another participant that needs the \$1 million,  
8 it is transferred to that participant.

9 Both money pools are adjusted, the balances  
10 accordingly in our books. If that is not the case, then  
11 either Dominion or CNG will withdraw from the pool to allow  
12 that. So, each day it's netted out to zero. So, there is  
13 no overlapping of balances.

14 The rates are calculated at the weighted average  
15 borrowing rate for that date and applied equally to all  
16 money pool participants. There is no differentiation among  
17 them. If no borrowings are outstanding on a \$1 million  
18 loan, the rate would be the Federal Funds rate effective, as  
19 quoted by the Fed of New York. Interest is paid and  
20 collected monthly, and physically transferred to and from  
21 each participant, so there is not accrual of a balance, and  
22 it never gets paid out.

23 Participants do not directly lend or borrow from  
24 other participants in the pool. It all goes through the  
25 parent companies. All loans to the money pool are

1 considered notes and all repayments to the money pool are  
2 without premium or penalty. Anytime.

3 The rate paid to the segregation of account,  
4 settling interest monthly eliminates, in my mind, the issue  
5 of cross-subsidization between the entities. We are  
6 satisfied with the regulation that exists today and do not  
7 feel additional terms or filing requirements are necessary.

8 CHAIRMAN KELLIHER: Thank you very much. I will  
9 recognize Kathryn Patton, Deputy General Counsel of  
10 Allegheny Power.

11 MS. PATTON: Good afternoon. I appreciate the  
12 opportunity to appear before you today. Allegheny, like  
13 many holding company systems, for many years has had in  
14 place a money pool. It is three affiliated electric  
15 utilities.

16 Before diving into the Commission's questions, I  
17 thought it would be helpful to describe how the Allegheny  
18 money pool works as a frame of reference.

19 The way the money pool is designed is that the  
20 three utilities can borrow from or loan to the money pool up  
21 to the specified amount.

22 Allegheny's parent company and its unregulated  
23 energy affiliate can loan money but cannot borrow from the  
24 money pool. The utilities do not have external sort term  
25 financing, such as a revolver, in place for short term cash

1 needs.

2           Instead, through the money pool, the cash needed  
3 to fund the day-to-day operations for the utilities is met  
4 through the surplus funds of the utilities or other money  
5 fund participants.

6           To the extent external funds are needed to meet a  
7 utility's cash needs, Allegheny's parent borrows money under  
8 its revolver, and loans to the utilities under the money  
9 pool. Such an arrangement benefits the utilities and the  
10 holding company system by minimizing the need for the  
11 utilities to incur short term debt from outside sources.

12           This reduced the utilities' cost of borrowing, as  
13 well as the administrative burdens and costs to the benefit  
14 of both utility rate payers and shareholders.

15           Allegheny's money pool was approved by three of  
16 its four state commissions, was approved by the FCC under  
17 PUHCA, the information filing at FERC and PUHCA earlier this  
18 year, was approved by FERC under FPA Section 204 and Section  
19 203, before the blanket authorization was granted under  
20 Order 669(A).

21           Turning now to the questions. The Commission has  
22 asked whether its cash management rule requires modification  
23 in light of PUHCA 2005. Allegheny agrees with the  
24 predominant view that there is no need to change the breadth  
25 of measures currently in place to regulate and monitor cash

1 management arrangements, making modification of existing  
2 cash management rules unnecessary.

3 Short term borrowings under money pool  
4 arrangements have been subject to approval by the Commission  
5 under Section 204, or by state utility commissions under  
6 state statutes. Where relevant, as you have noted,  
7 Allegheny is required to get approval from Pennsylvania,  
8 West Virginia and Virginia.

9 Other states with similar requirements include  
10 Illinois and New Jersey and there are many others. Further,  
11 the Commission has found that a public utility lending funds  
12 to an affiliated public utility, is jurisdictional under  
13 Section 203, but has granted blanket authorization for such  
14 transactions.

15 I would also note that we would encourage the  
16 Commission to provide certification between its authority  
17 and of states under Section 204(F). A specific issue arose  
18 when Allegheny was assessing the applicability of Section  
19 204 to its money pool arrangement.

20 Section 204(F) provides that the provisions of  
21 this section shall not extend to a public utility organized  
22 and operating in a state under which the security issues are  
23 regulated by a state commission.

24 Section 204 is really to avoid a regulatory gap.  
25 Commission authorization is required in cases where a state

1 commission does not regulate a particular security  
2 transaction. Thus, the only relevant question for purposes  
3 of assessing the applicability of Section 204(F) should be  
4 where a state commission's authorization is required.

5 For the particular type of security or issue  
6 activity being considered -- a particular issue that was at  
7 issue in Allegheny's application was that we were not  
8 required to get approval from our state under our financing  
9 statutes, but were required to get approval under affiliate  
10 statutes.

11 So, the exemption to 204(F) applies only when it  
12 was approval when it was a financing statute, and so, while  
13 we were getting approval, there was some duplication there  
14 because we did not meet the technical language of that  
15 statute and the Commission should consider clarifying that  
16 Section 204(F) approval is not required for a money pool if  
17 it has been approved by a state commission, whether under  
18 the financial statutes or affiliate regulations.

19 Under the currently effective cash management  
20 rule, utilities must file cash management agreements and  
21 modifications with the Commission.

22 Finally, the Commission has in place extensive  
23 reporting and record-keeping requirements that allow full  
24 review and monitoring of cash management arrangements.  
25 Because the regulations currently in place were sufficient

1 to enable the Commission to regulate cash management  
2 practices, no modifications are necessary to the cash  
3 management rule.

4 Turning to the safeguards, in Order No. 669, the  
5 Commission declined to codify specific safeguards and stated  
6 that it would consider this issue at this Technical  
7 Conference. A safeguard should match the financial  
8 circumstances presented by the company at hand. The  
9 financial circumstances enhance appropriateness of the  
10 specific safeguards varying widely among utility holding  
11 companies.

12 There is no one size fits all approach.  
13 Attempting to codify a single list would likely result in an  
14 overly conservative structure designed to address an array  
15 of financial issues that are not applicable to all holding  
16 company systems.

17 Safeguards that may be appropriate in certain  
18 circumstances may be unnecessary and unnecessarily  
19 restrictive in other cases. For example, following the  
20 bankruptcy of Enron, Allegheny itself was near bankruptcy.  
21 All of Allegheny's utilities were downgraded to the low  
22 investment grade.

23 Had there been a rule in place that would have  
24 prohibited utilities that were below investment grade from  
25 participating in the money pool, who knows what would have

1       happened. This is when the utilities needed the money pool  
2       the most, as their ability to borrow short term funds  
3       externally would have been difficult and costly.

4               Companies have sufficient information at hand to  
5       propose appropriate safeguards for their individual  
6       arrangements. Allegheny supports the Commission's decision  
7       not to impose financial prerequisites for a companies  
8       participating in cash management programs. It may consider  
9       the appropriateness of safeguards when reviewing -- tool for  
10      applications seeking authorization for the cash management  
11      arrangements.

12              Thank you. I look forward to your questions.

13              CHAIRMAN KELLIHER: Thank you very much. I  
14      appreciate that. I just have one or two questions, then I  
15      will turn to my colleagues, and then the Staff.

16              This is an area where I tend not to be an expert.  
17      We saw the NOPR issued in 2002. It might have been issued  
18      in 2001, late '01 earlier to -- actually, it doesn't matter.  
19      But the Commission issued a NOPR at one point, and I just  
20      want to follow up on a couple of questions from Ms. Parrish.

21              First of all, some of the other speakers said  
22      that the companies and consumers can get funds from these  
23      pools. Do you recognize that there are benefits from these  
24      pools subject to some kind of minimum standards?

25              MS. PARRISH: Yes. We are recommending that

1 companies ought to be allowed to participate in the pools.  
2 Participation should be limited to provide some protection.  
3 In doing that, we shouldn't wait until there is a problem  
4 and then address the problem. Many regulations that utility  
5 regulators put in place are to avoid problems in the first  
6 place.

7 CHAIRMAN KELLIHER: You identified in your review  
8 a need for a minimum set of protections. Have you looked at  
9 the NOPR that the Commission issued back in 2002? Are those  
10 some minimum protections that you think are appropriate? Is  
11 there something like that?

12 MS. PARRISH: I did look back at some of the  
13 documents from 2002, 2003. The list I have may be more  
14 extensive than was in the FERC NOPR. I think there is some  
15 crossover between them. But I also took from some of the  
16 practices that have been in effect in some of the states.  
17 For instance, a number of these items came from Ohio or  
18 Illinois that have enacted either rules, or individual  
19 orders on some of these items.

20 So, I think the list I gave you is a little more  
21 extensive than the original NOPR.

22 CHAIRMAN KELLIHER: So it is broader than the  
23 Commission's in scope in, say, 2002.

24 MS. PARRISH: Yes.

25 CHAIRMAN KELLIHER: We did get extensive comments

1 on the proposed rule and a lot of criticism of the proposed  
2 rule.

3 MS. MARLETTE: That is correct. It was 2002.  
4 You are correct. And we did get a lot of pushback on those  
5 types of restrictions.

6 CHAIRMAN KELLIHER: Dominion might have filed  
7 comments. Presumably Allegheny. But what was the nature of  
8 the criticism of the NOPR?

9 MS. NICHOLAS: There was a proposal to require, I  
10 believe, that participants in the money pool had to have  
11 investment grade credit ratings. There were concerns about  
12 the companies might not in fact have the requisite  
13 investment credit rating, and they have to go out and seek  
14 it until they are fully qualified to participate.

15 I think we also had a requirement with respect to  
16 a specific level of equity. I think it was 30 percent. And  
17 there were significant objections to that particular  
18 requirement.

19 Again, it was overly prescriptive. It wasn't  
20 necessarily the right answer. Ultimately, we backed off  
21 from both of those particular requirements. It was a  
22 different kind of a regime. Kind of to provide transparent  
23 with respect to those arrangements.

24 But Cindy's right. We had significant pushback  
25 with respect to prescriptive requirements for participation

1 in those cash management arrangements.

2 CHAIRMAN KELLIHER: Allegheny -- you provided an  
3 anecdote in Allegheny's experience. Did Allegheny meet  
4 those minimum standards that were in the proposed rule? MS.

5 PATTON: We would not have met the investment grade  
6 requirement. I believe we would have met the minimum  
7 capitalization requirement. That was my concern about the  
8 kind of the one size fits all. You get very prescriptive  
9 rules. While we may have met one but not the other, someone  
10 else could have been at a different situation.

11 Particularly, some utilities have -- they are service  
12 companies participating in the money pool. That service  
13 company may not have any assets because all the assets are  
14 owned down at the utility level. And so there could be  
15 issues. Not a particular issue for Allegheny, because our  
16 service corps doesn't participate, but kind of from the  
17 other utilities' perspective, that could be a concern.

18 CHAIRMAN KELLIHER: Just one other question for  
19 Ms. Parrish. Mr. Overman outlined Dominion's cash program.  
20 I just wonder if, again -- what was your reaction to their  
21 program?

22 MS. PARRISH: I think the two programs we heard  
23 described here today do have a lot of protection already  
24 built into them because of the parent not being able to  
25 participate as a borrower. A lot of the protections we are

1 concerned need to be in place relate not so much from the  
2 utility being able to borrow effectively and cost-  
3 effectively but being raided as the cash cow.

4 And so, those are the protections that we would  
5 worry about particularly in this era of being bought by a  
6 lot of non-regulated companies. That might be looking at  
7 utilizing that cash for non-regulated services and so, the  
8 protection we are really concerned about is what is  
9 happening to the cash of the utility going back and forth,  
10 not so much as to where their getting their cash. Although  
11 we have suggested something relative to interest rates to  
12 make sure that we don't run into a situation as we saw back  
13 in the '90s, and again, this may be more of a phone example  
14 rather than an energy example, where service companies were  
15 being set up where formerly regulated services were being  
16 provided by unregulated companies had a higher rate of  
17 return.

18 We don't want to get into a situation where  
19 unregulated companies can earn a higher return by lending to  
20 a regulated company at a higher rate than that company would  
21 otherwise pay to a third party.

22 It's that sort of protection we are worried  
23 about, looking at the impact on the utility itself. Not so  
24 much -- we don't care what happens with the holding company.

25 CHAIRMAN KELLIHER: Colleagues, any questions?

1 Phil? Cindy?

2 MS. MARLETTE: I guess I will start. Can I ask a  
3 question, Kathy? I know you said previously Allegheny's  
4 cash management program had been approved by the SEC.

5 And you, Jerry, said that also. Did the SEC put  
6 on the types of restrictions that Denise talked about, on  
7 the cash management program?

8 MS. PATTON: My understanding -- the only  
9 requirement was perhaps the 30 percent capitalization  
10 requirement before they had an increased level of scrutiny  
11 over the company. I think the company as a whole -- we were  
12 in that situation so they were very closely scrutinizing  
13 everything that we did for awhile.

14 But they didn't stop the money pool between the  
15 utilities.

16 MS. MARLETTE: If the Commission decided not to  
17 add additional safeguards of the type that Denise mentioned  
18 -- and if you don't know the answer now, maybe you can think  
19 about it and then put it in the record. Are there  
20 additional reporting or transparency requirements that we  
21 missed when we did the first rule that would be useful? I  
22 don't know if anyone has any thoughts on that.

23 As Janice Nicholas said, it is basically a rule  
24 that requires the cash management plan to be in writing, to  
25 be on file with certain information and it's mainly a

1 monitoring tool for the Commission.

2 Are there thoughts that you all have as to  
3 whether any additional reporting requirements would be  
4 helpful? I would appreciate that.

5 MS. PATTON: I can't imagine any. I think there  
6 are already a lot of reporting requirements in place. In  
7 fact, the Commission actually stopped one. I think it was  
8 669(A), where we used to have to report when we fell below a  
9 certain capitalization level, and the Commission said that  
10 they already had that information, they didn't need it from  
11 us.

12 I think between what we file at FERC and what we  
13 file in all of our states, I think our books are pretty  
14 transparent for the Commission and the states to see what is  
15 happening.

16 CHAIRMAN KELLIHER: Any questions from the right  
17 hand side?

18 MR. MOSIER: Mrs. Parrish, I would like to ask  
19 you, I guess, about a second element. You heard the  
20 discussion about being able to obtain an investment grade  
21 rating in the first place. My question is a little bit  
22 different.

23 It goes to what happens -- and now perhaps where  
24 it has been downgraded, what in particular are we trying to  
25 achieve with this element, given that Ms. Patton's testimony

1 is that you will have situations eventually where companies  
2 are in straits and may be downgraded, perhaps below  
3 investment grade, which necessarily doesn't mean that the  
4 amount will not be repaid. Doesn't even mean that there is  
5 a problem. It means there is a greater chance than there  
6 has been before, but that could be relatively small.

7 What are you trying to protect by focusing on the  
8 investment?

9 MS. PARRISH: The protection that we were looking  
10 at, again, was from the vantage point of if the utility is  
11 lending to a non-regulated affiliate that might be a risky  
12 affiliate, what is the risk of nonpayment of debt.

13 If we look back from the panel from this morning,  
14 when Commission Baum was talking about their situation,,  
15 having an Enron-owned regulated company, if the utility had  
16 been able to rate it by some of the unregulated Enron  
17 companies, that would have been of concern, and there would  
18 have been a risk of not having those funds repaid. That's  
19 the sort of thing that we are concerned about in terms of  
20 where is the utility's cash going.

21 MR. MOSIER: So, if there is no particular value  
22 the investment rating itself, it sounds like you are more  
23 concerned with the totality of the facts and circumstances  
24 in making a specific assessment of what the chances are for  
25 the utility to recoup its funds --

1                   MS. PARRISH: Absolutely. The investment grade  
2 is just, I guess, a shorthand, easy measure of what is that  
3 risk and where does that risk become more or less  
4 acceptable.

5                   If there is another way to measure that risk, we  
6 certainly would entertain discussion of that, or would like  
7 to be a part of the discussion on that.

8                   It's one of those shorthand, easy measures that  
9 identifies -- an easy measure everybody identifies level of  
10 risk.

11                   MR. MOSIER: Mr. Overman, you gave a very  
12 detailed description of the mechanics of your money pool and  
13 how it operates. I am wondering where did the development  
14 of that structure come from. Is this the product of  
15 regulation? Of law?

16                   MR. OVERMAN: Part of it is circumstantial, as to  
17 the individual companies along the way. Part of it is  
18 certainly regulatory in the context of the PUHCA regulation  
19 and the structure it generated.

20                   I would like to comment just briefly on the issue  
21 of having enlistment grades on each of the participants.  
22 Obviously, that's not just something off the cuff. In order  
23 to establish that, it is a very expensive process. The fees  
24 involved and the rating agencies are as such.

25                   (Laughter.)

1                   MR. OVERMAN: As well as the need for having  
2 external financing ability and the banking fees that would  
3 be involved in establishing that would be extremely  
4 expensive, to have all of the participants investment grade.  
5 I realize that on a shorthand basis, that would be very  
6 convenient to look at. But on the maintenance and  
7 administration and the actual establishment of those  
8 ratings, it would be extremely expensive.

9                   MR. MOSIER: I have another question. In the  
10 NOPR that led to Order 667, Dominion and EEI filed comments,  
11 bringing to FERC's attention that they were going to be in a  
12 situation with their financing efforts where orders from the  
13 SEC were going to be expiring, not just Dominion's but all  
14 the other formerly registered holding companies, knowing  
15 that this was going to create either a wave of filings at  
16 FERC -- well, that it would create that. Both for the  
17 companies and the Commission at that time.

18                   It suggested that the Commission extend the  
19 effectiveness of the SEC financing orders in Order 667. That  
20 effectiveness runs to the end of 2007, and in some cases,  
21 into 2008.

22                   I am wondering if the clock is ticking on this,  
23 and, by the way, about two dozen companies took advantage of  
24 that. Subsequently, several companies have notified FERC  
25 that they no longer belong on that. But there are still a

1 substantial number that do.

2 Assuming that they all don't come in, and none  
3 rely on their SEC orders, are the elements of those orders  
4 as they concern money pools, perhaps, an efficacious place  
5 for the Commission to start if it does decide it needs to  
6 modify its cash management rules.

7 MR. OVERMAN: To the effect of what is required  
8 under PUHCA regulations for filing financial reports and  
9 other things, I am not familiar with that process. Our  
10 accounting department takes care of that. And our legal  
11 department takes care of the legal part.

12 So, I am not really that familiar with it  
13 exactly. I don't think there would be any structural  
14 changes within our money pool, under either case. I don't  
15 pretend that Dominion's is a model money pool. However, I  
16 think that it is one that protects all the participants  
17 equally. So, I don't know we would necessarily change  
18 anything or advocate changing anything within our pool  
19 structure under either scenario.

20 MR. MOSIER: Ms. Patton?

21 MS. PATTON: Allegheny was one of the companies  
22 that gave back our SEC authority and offered to come into  
23 the Commission and request approval of our money pool. I  
24 think we were probably one of the first in the post-PUHCA  
25 world. The Commission reviewed it, the Commission approved

1           it, and had the rules in place to look at that. So I am not  
2           sure any other rules are needed. They were already there,  
3           under 204 for them to do that.

4                       MR. MOSIER: As far as you know, is there a  
5           significant change in the PUHCA 2005 act? Money pool rules  
6           that were approved by the FERC?

7                       MS. PATTON: Not what I am aware of. As you  
8           know, there were a lot of unwritten rules that they used in  
9           reviewing things, and we filed the exact same money pool.  
10          It hadn't been changed. So, I guess to kind of answer your  
11          question, I am not aware that there was any difference in  
12          the review that took place within the scope of the authority  
13          the Commission had, over what the scope of authority of that  
14          was under PUHCA.

15                      MR. MOSIER: Thank you.

16                      CHAIRMAN KELLIHER: Steve?

17                      MR. RODGERS: I just had one or two questions for  
18          Ms. Parrish. In your testimony, you stated that you thought  
19          it would be appropriate for the FERC to have mandatory money  
20          pool standards right in the guidelines, and they should not  
21          -- a state should not be credited for imposing different  
22          standards if it so chooses.

23                      Later on, you said that FERC standards would  
24          simply be in place to help customers in regulatory areas  
25          where no state standards exist to protect customers.

1                   Did you mean that FERC's minimum standard would  
2                   only apply in cases where there was effectively a regulatory  
3                   gap, or did you contemplate that there might be situations  
4                   where there would be overlapping state standards?

5                   MS. PARRISH: I anticipated this question in  
6                   light of this mornings discussion and so I got to thinking  
7                   about it. And I think I am really proposing minimum  
8                   standards more than filling in the gap. But it would  
9                   actually do both. Because even though a state may be able  
10                  to have some oversight over a piece of it, with most holding  
11                  companies the problem with state regulation is at end at the  
12                  state border. And the holding company activity does not.

13                  So, there is rarely going to not be some sort of  
14                  a gap relative to this money that is moving around, not  
15                  usually. There will be something that FERC would be able to  
16                  have jurisdiction over that a state would not relative to  
17                  that.

18                  I think that's part of filling the gap. But in  
19                  terms of the minimum standards, having been in state  
20                  regulation a long time, most state regulators, in my view,  
21                  would not oppose having a set of standards that would  
22                  protect customers at a minimum level, as long as they were  
23                  not prohibited from doing more than that if they though FERC  
24                  had not gone far enough.

25                  Some of the states have very restrictive rules in

1 terms of utilities can only borrow from each other. They  
2 can't borrow from any unregulated entity within the holding  
3 company.

4 FERC may not want to put that sort of standard in  
5 a minimum, but leave that to the state if they feel like it  
6 needs to go further based on the circumstance.

7 That would be what I would anticipate relative to  
8 the minimum standard. Now most state regulators would  
9 welcome some level as long as they still had the ability to  
10 have the flexibility over and above that minimum to address  
11 any unique circumstances.

12 And I think you could look at the situation  
13 again, going back to this morning's panel, where Oregon does  
14 more than Wyoming, but Wyoming wouldn't object to a certain  
15 level. Oregon wouldn't object to a certain level, as long  
16 as they could do more than that.

17 That is what I am thinking of in that regard.

18 MR. RODGERS: Would that put FERC in the position  
19 of having to judge the adequacy of state standards? And if  
20 it held that they were not adequate in the circumstances to  
21 go ahead and impose our standards?

22 MS. PARRISH: What I would anticipate is that you  
23 would impose your standard and that would become the minimum  
24 for state and federal level in some way, by having those  
25 standards out there once the company had met your standard.

1 It would meet it at the state level as well. If there were  
2 really an unusual circumstance, I would hope there would be  
3 a situation where the state could come in to FERC and say,  
4 look, this is just so off the board from anything any of us  
5 anticipated, could we please have an exemption or could we  
6 look at something different in this one case. A sort of  
7 exemption in that regard for something so unusual that it is  
8 not anticipated.

9 Otherwise, just have this minimum that would  
10 apply across the board with the states being able to go  
11 beyond that if they felt the need.

12 MR. RODGERS: Thank you. I wanted to ask Mr.  
13 Overman and Ms. Patton if they could comment on what was  
14 just discussed in terms of what they thought FERC minimum  
15 standards and possibly complementing the state standards  
16 would cause regulatory uncertainty or confusion or  
17 difficulties otherwise.

18 MS. PATTON: I mean, we already have to go to the  
19 three states and in effect negotiate with them as to what  
20 the terms of our money pools are going to be. To add  
21 another dimension with another approval that takes place on  
22 top of that creates uncertainty and a burden.

23 What I would like to see kind of going the other  
24 direction is, if we got our states approving the money pool,  
25 whether it be under a financial statute or under an

1 affiliate statute, they are approving it, then to deter to  
2 the states for that approval, and not require additional  
3 approval for that.

4 MR. OVERMAN: We feel the rules are sufficient as  
5 they now exist. We filed our money pool with you. You have  
6 audited us. There are opportunities, I think, to explore  
7 any deficiencies that you would find in the process with the  
8 existing rules.

9 MR. RODGERS: Thank you.

10 CHAIRMAN KELLIHER: Yes.

11 MS. NICHOLAS: My question is for  
12 the panel in general. Should the Commission consider  
13 adopting any rule with respect to limitations on  
14 participation that is not characterized correctly?  
15 Limitations on holding company activities with respect to  
16 money pools, I think that Dominion and Allegheny -- and this  
17 is consistent, I believe, with SEC policy, at least prohibit  
18 borrowing by the holding company from the money pool.

19 My experience is that is not an unusual  
20 prohibition with respect to a money pool. I am wondering if  
21 that is the kind of requirement, as least as one example, of  
22 something that would be reasonable for us to consider as a  
23 requirement with respect to a money pool arrangement.

24 MS. PARRISH: Yes.

25 (Laughter.)

1 MS. PARRISH: I think one of the difficulties I  
2 am having with some of my fellow panelists' answers is that  
3 this assumption that the states are approving. I am been in  
4 Wyoming 15 years and have never seen a pool approval come  
5 across my desk. So, I don't think that is true in all the  
6 states. That is where I'm talking about that FERC needs to  
7 step in, because of situations like that.

8 MS. PATTON: I guess your question -- it's not an  
9 option for Allegheny at this point, because I don't foresee  
10 our state's approving our parent company participating as a  
11 borrower under the money pool. So, I will reserve for the  
12 other utilities to comment on that in their comments.

13 We really don't have an opinion on that.

14 MR. OVERMAN: The way we are structured, though,  
15 the holcos can only be the ones generating commercial paper,  
16 borrowing to fund the pools. There would not be the  
17 opportunity to borrow from the pool because the funds are  
18 raised at the affiliate level.

19 And since our electric utility doesn't  
20 participate in the pool, that would be the major source, if  
21 it were not for the holding company borrowing.

22 MS. FUREY: We did some research approximately  
23 three years ago on the money pools. One thing we did note  
24 and did speak on to the SEC, is that we did not see one  
25 money pool that a parent had borrowed from the pool.

1                   And we are not endorsing any type of money pool  
2 structures. However, we would note in our research whether  
3 the parent company had any ability to borrow, we have not  
4 seen that.

5                   CHAIRMAN KELLIHER: Any other questions?

6                   (No response.)

7                   CHAIRMAN KELLIHER: If not, I want to thank the  
8 panelists for helping us today. I would like to inquire  
9 whether the panelists for panel three are here. One, two --  
10 raise your hands if you are a panelist on panel three.

11                   (Show of hands.)

12                   CHAIRMAN KELLIHER: For anyone who is not here --  
13 I'm sorry, but who is not here, and whoever arrives can be  
14 on the other panel.

15                   Welcome, panel three.

16                   (Pause.)

17                   CHAIRMAN KELLIHER: Mr. Fetter, a very honorable  
18 member of this panel.

19                   MR. FETTER: I remember when they called me  
20 "honorable" before. I have been down-rated.

21                   (Laughter.)

22                   CHAIRMAN KELLIHER: I apologize.

23                   MR. FETTER: Sitting regulators know that this  
24 could someday be you.

25                   (Laughter.)

1                   CHAIRMAN KELLIHER: I thank the panel for being  
2 here today. The focus of this panel is to discuss  
3 exemptions, waivers, and blanket authorizations set forth in  
4 Order No. 667 et al. and 669 et al.

5                   I want to start with Steven Fetter, President of  
6 Regulation Unfettered.

7                   MR. FETTER: Thank you, Mr. Chairman, Members of  
8 the Commission and Commission Staff. I will offer my views  
9 today, not only from my official line as an energy advisor  
10 and consultant, but also from my previous service as  
11 chairman of the Michigan Public Service Commission, and as  
12 head of the utility rating practice.

13                   In addition to the topics noticed for this panel,  
14 FERC staff has asked that I offer my thoughts with regard to  
15 ring fencing, the topic of the first panel today. I welcome  
16 that opportunity because I have talked about that topic for  
17 many years, and my views match well with the approach the  
18 Commission has taken with regard to exemptions, waivers and  
19 blanket authorizations.

20                   On this topic, I highlight my long-stated belief  
21 that the best consumer and investor protection is open,  
22 frank communication between regulators and utility  
23 management. Such a course is far superior to trying to put  
24 in place statutory or regulatory policies and limitations  
25 aimed at dealing with future unknowns.

1                   I call this the regulators' cardinal rule. I  
2 believe this outlook should guide and inform the  
3 Commission's consideration of the policy issues under  
4 discussion within this technical conference.

5                   Whether the issues are ring fencing in the  
6 context of cross-subsidization, structures allowing holding  
7 company leverage if finances for greater efficiencies, or  
8 the use of exemptions, waivers and blanket authorizations,  
9 to facilitate movement away from the prior PUHCA environment  
10 to a new one that provides flexibility for further industry  
11 innovation, the key is that the safeguards necessary to  
12 protect consumers and other industry stakeholders from  
13 anticompetitive behavior accompany these productivity  
14 advances.

15                  This technical conference is an excellent vehicle  
16 for open communication among stakeholders. I view  
17 positively this Commission's actions with regard to  
18 exemptions, waivers and blanket authorizations under Order  
19 667 and 669. You have provided leeway to allow utilities  
20 and holding companies to take structural steps that hold out  
21 the potential to be beneficial for both customers and  
22 investors through more efficient processes. A technical  
23 conference such as this one serves as a midterm check as to  
24 whether the process deserves to be further refined and  
25 streamlined, or whether shadows of potential abuse have

1 started to appear.

2 I have participated in other affiliate-related  
3 discussions elsewhere that have caused me a certain amount  
4 of unease. Rather than identification of actual problems,  
5 requiring specific ameliorative actions, the focus has been  
6 on shutting down potential strategic paths for fear that  
7 some abuse could conceivably occur sometime in the future.

8 In an industry where high hopes for significant  
9 gains from competitive structuring have not yet borne fruit,  
10 I believe a lockdown on innovation is precisely the wrong  
11 path for regulators to take. I am happy that this has not  
12 been the path that the FERC has taken in its initial  
13 implementation of the Energy Policy Act of 2005 in the post-  
14 PUHCA environment.

15 It is far better that identification of real  
16 potential problems result in transactions between regulators  
17 and competitive affiliates be raised in a setting such as  
18 this one through communication among all stakeholders in  
19 order to give regulators the opportunity to remedy those  
20 problems prospectively through collaboration and compromise.

21 Consumers, regulators and utility management and  
22 investors all win under such an approach.

23 As a former regulator, a former bond rater, and  
24 now a consultant in the service of companies, commissions  
25 and consumers, I have seen the dangers that overbroad

1 activity limitations can cause, most especially the  
2 inefficient skewing of hoped-for competitive markets.

3 I firmly believe that where consumers have  
4 regulated services do not subsidize unregulated competitive  
5 initiatives by an affiliate, the efficiency gains can come  
6 from appropriate transactions inured to the consumers on  
7 both sides of those activities.

8 The rule necessary to implement appropriate  
9 affiliate transactions are best received through  
10 collaboration with regulators and compromise among  
11 stakeholders following open communication.

12 I am sure this Commission will benefit from the  
13 views expressed across the entire spectrum making ultimate  
14 judgments more clear, better supported and more easily  
15 understood. The once seemingly inexorable march toward  
16 wholesale/retail competition that began in the early to mid-  
17 1990s did not anticipate that regulators would erect rigid  
18 barriers between corporately separate entities providing  
19 regulated and competitive services.

20 Legitimate cost-sharing and appropriate  
21 allocation of management expertise between both the  
22 regulated and competitive sides of the entity can give rise  
23 to immediate consumer benefits, cost reductions and the  
24 cultivation of an environment that fosters new ideas as to  
25 how to provide not only very old and essential regulated

1 services, but also pioneering concepts within the  
2 competitive sphere as well.

3 As I wrote in Public Utilities Fortnightly two  
4 years ago, hard and fast statutes and rules are not the best  
5 means to maintain order within the partially unregulated  
6 utility sector.

7 Utility regulators should hesitate before putting  
8 policies in place today that limit managerial discretion in  
9 the future, based upon the regulators belief that they can  
10 predict the future. You have not done that and I believe  
11 this Commission is on the right path.

12 Thank you for inviting me to participate.

13 CHAIRMAN KELLIHER: Thank you very much. I would  
14 now like to recognize Walt Burkley, Vice President and  
15 Counsel, Capital Research and Management Company.

16 MR. BURKLEY: Thank you for having me here today.  
17 I wanted to talk briefly about our status as a passive  
18 investor on some of the relief you provided us this year,  
19 both in the PUHCA context and in the Power Act context.

20 I am with Capital Research and Management  
21 Company. We are a mutual fund family called the Americas  
22 Fund, approximately 30 funds with about \$800 million under  
23 management. So, a significant investor in the mutual fund  
24 area.

25 Like a lot of companies in our industry, we were

1 very excited about the potential for repeal of PUHCA because  
2 for a number of years, that has very much limited our  
3 utility analysts in their ability to invest in the companies  
4 that they have found interesting.

5 One of the things we quickly realized when we  
6 found ourselves able to take advantage of the exemption for  
7 passive investors was provided in PUHCA 2005 was that life  
8 in a world where you had to worry about regulation as a  
9 holding company is different than the previous world where  
10 you just worried about holding company status.

11 It is in that context that we started to look at  
12 Section 203 and realized that actually the kind of  
13 flexibility that we could get under PUHCA 2005, we really  
14 wouldn't be able to take advantage, because of the passive  
15 investor exemptions. They weren't really applicable to  
16 Section 203.

17 That led us in the spring to start a dialogue  
18 with staff that I think was really productive. That was for  
19 a blanket authorization that was ultimately granted in  
20 September.

21 Before getting into that, I want to back up for a  
22 second and just sort describe to you why these limits sort  
23 of posed an issue for us.

24 As I mentioned before, we manage a mutual fund  
25 family. These mutual funds are all standalone entities.

1 They are either corporations or trusts. They all have their  
2 own investment limits. None of them can individually decide  
3 10 percent of the voting securities because, in connection  
4 with the services we provide, we as an investment advisor  
5 have the authority to vote the securities held by the mutual  
6 fund.

7 So, you can see if the mutual fund holdings  
8 aggregate to up over 10 percent, Capital Research and  
9 Management Company as an advisor would be deemed to be a  
10 holding company. And that is not something that prior to  
11 this year we wanted to do.

12 Now, this year, we have to figure out what that  
13 means because there was no passive investor exemption to  
14 Section 203. We realized we needed to do something if we  
15 were to take advantage of the flexibility under PUHCA 2005.

16 When we started conversations with staff, what we  
17 suggested to them was that the recognition that they gave to  
18 past investors is not implicated in the same kinds of  
19 control issues in PUHCA. It was also something that could  
20 be applied in the 203 sphere.

21 As a result, we were able to get an exemption  
22 that allows us to go up to 20 percent collectively for all  
23 of the funds that we manage under, I think, some very  
24 important conditions. One, that the funds individually can  
25 exceed 10 percent. Two, all the funds need to maintain

1 investment restrictions that they currently have preventing  
2 them from investing for control. And, I think most  
3 importantly -- and this will get to my next point -- that we  
4 maintain our status as 13(g) filers under the rules of the  
5 Securities and Exchange Commission.

6 Schedule 13(g), as you may be aware, is a form  
7 that is available for institutional investors under the  
8 Securities and Exchange Commission reporting regime. Under  
9 that regime, anyone who holds more than 5 percent of the  
10 voting securities of an issuer needs to file reports with  
11 the SEC.

12 It can be a long form report or, if you are not a  
13 controlling investor, you are entitled to use 13(g). That I  
14 think is an important the Commission can rely on when it is  
15 thinking about rulemaking in this area.

16 And I think something that was important in the  
17 blanket authorization received for us. To maintain 13(g)  
18 status, we need in essence to represent that we are not  
19 investing for control and that is something in turn that you  
20 all can look at.

21 One of the conditions to the blanket  
22 authorization was that we maintain that status and that we  
23 also provide copies of those reports to you. I think that  
24 that's going to be a very workable model for us.

25 The term of -- the authorization was for three

1 years, but that is the sort of thing that the Commission can  
2 look at and think about providing on a broader basis to the  
3 industry because with the uncertainty around Section 203,  
4 not just (A)(2), but also (A)(1) -- it's hard for  
5 institutional investors to really put the kind of capital  
6 into the industry that I think you are trying to look for.

7 Those are my remarks, and I thank you again for  
8 your time this year.

9 CHAIRMAN KELLIHER: Thank you very much. I would  
10 like to now recognize Steven Bunkin, managing director and  
11 associate general counsel of Goldman Sachs.

12 MR. BUNKIN: Thank you, Mr. Chairman.  
13 Commissioners, Staff members. I am pleased to be here this  
14 afternoon to share with the Commission and staff the  
15 perspective of one financial institution that plays multiple  
16 roles in the power markets with respect to the actions that  
17 the Commission has taken since the adoption of the Energy  
18 Policy Act of 2005.

19 We believe that the Commission provided needed  
20 clarity with respect to the rules under the revised Power  
21 Act of 2005 through the adoption of its blanket  
22 authorizations.

23 We encourage the Commission to take certain  
24 additional steps, which I will outline today. In  
25 particular, we urge the Commission to issue a blanket

1 authorization under Section 203(A)(1), along the lines of  
2 what it has done under Section 203(A)(2).

3 I thought what I would do would be to take a  
4 moment to describe the business of Goldman Sachs in the  
5 power arena to provide some context as to our position on  
6 these issues. Goldman Sachs is an investment bank which is  
7 involved in a number of different ways with the power  
8 industry. It is an advisor on utility merger and  
9 acquisition transactions. It is an underwriter of debt and  
10 equity securities of utilities, both in the context of  
11 merger and acquisitions and also in the context of normal  
12 capital raising activities.

13 Goldman is a significant participant in the  
14 financing markets for utility entities, acting as a lender  
15 and arranger of loan facilities. Goldman also acts as a  
16 broker, market-making dealer and investor in a range of  
17 power-related securities, and through its asset management  
18 and merchant banking activities, Goldman invests in the  
19 utility sector on behalf of its clients.

20 Goldman's wholly owned subsidiary, J. Aron, is a  
21 power marketer with based at the Commission. Goldman has  
22 invested in a number of power-generating assets and  
23 currently owns interests in approximately 20 QFs, EWGs, and  
24 PUHCAs, through its Congentric subsidiary, its horizon, of  
25 which Goldman itself is a holding company within the meaning

1 of the Energy Policy Act of 2005.

2 The various roles we play in the power market  
3 enable us to be more responsive to our clients and to allow  
4 us to provide liquidity in debt, equity, credit and  
5 commodity markets which are vital to the electricity sector.

6 Goldman Sachs supports each of the authorizations  
7 that the Commission has provided through its Order 667, as  
8 amended. These orders provided greater certainty and  
9 clarify with respect to the treatment of particular  
10 transactions in the post-PUHCA 2005 world.

11 Of particular importance are the exemptions that  
12 are granted under 203(A)(2) in relation to the acquisition  
13 of securities of utilities and holding companies. There  
14 are, however, ways in which the Commission can provide  
15 greater clarity to the marketplace and therefore promote  
16 liquidity.

17 The ability to provide liquidity plays an  
18 important role in creating financing and underwriting  
19 opportunities that will benefit the electricity sector.  
20 Investors generally expect that a firm that is underwriting  
21 or arranging their financing will stand ready to repurchase  
22 securities at a moment's notice at prevailing market rates.

23 It is important to emphasize that market-making  
24 capabilities require the ability to quickly in response to  
25 client demand. That is why in this type of situation it's

1 not practical for a market maker to obtain prior Commission  
2 approval before it reacquires securities.

3 A reduction in market-making capabilities would  
4 likely reduce liquidity and limit options of utility and  
5 holding companies and their capital-raising activities.

6 Therefore, we encourage the Commission to promote  
7 liquidity and investment in utility sector by making  
8 permanent or extending blanket authorizations provided under  
9 203(A)(2). We believe the Commission should codify a  
10 blanket authorization for acquisition of voting securities  
11 by firms such as Goldman Sachs when acting in a fiduciary  
12 capacity.

13 This would include situations where the firm does  
14 not itself have beneficial interest ownership in the  
15 securities that it is acquiring and where the firm owes a  
16 fiduciary duty on behalf of its underlying client.

17 The Commission has codified fiduciary exclusion  
18 for commercial banks, noting that regulatory oversight  
19 toward such institutions is subject generally. Goldman  
20 Sachs and institutions like it are also subject to  
21 comprehensive regulatory supervision by the Securities and  
22 Exchange Commission under its consolidated supervised entity  
23 regime.

24 This supervision is similar to the type of  
25 supervision to which banks are subject under the Board of

1       Governors of the Federal Reserve System, and the Comptroller  
2       of the Currency.

3               We encourage the Commission to consider the  
4       relevance of these different but significant regulatory  
5       controls on non-bank fiduciaries. We strongly urge the  
6       Commission to grant a blanket authorization under 203(A)(1)  
7       that would, at the very least, parallel the existing  
8       authorization under (A)(2).

9               We believe there is a lack of clarify with  
10       respect to the application of (A)(1) to various transactions  
11       and that this creates uncertainty among market participants.

12               As you know, 203(A)(1) requires Commission  
13       approval for a public utility to dispose of facilities that  
14       are subject to the Commission's jurisdiction that have a  
15       value in excess of \$10 million or more.

16               On its face, 203(A)(1) would not appear to apply  
17       to transactions in the ordinary course of secondary market  
18       trading of securities issued by utilities, IPPs, or the  
19       holding companies.

20               However, the Commission's approach to (A)(1)  
21       raises a few concerns. First, the Commission considers  
22       changes in control over jurisdictional assets to be  
23       dispositions for purposes of (A)(1). Second, the Commission  
24       analyzes the change of control on an indirect as well as  
25       direct basis.

1           Because the Commission has elected to address  
2 changes of control on a case-by-case basis, market prices  
3 have been left with uncertainty as to whether a particular  
4 transaction in the secondary market would require prior  
5 Commission approval.

6           The Commission has indicated that its approach in  
7 this area is guided by a concern with respect to control  
8 markets and the protection of captive customers or customers  
9 receiving transmission services.

10           While we appreciate the Commission's focus on  
11 these issues, we believe that it is unlikely that these  
12 concerns would be implicated in relation to an acquisition  
13 of less than 10 percent of the voting securities and that  
14 entity owns a jurisdictional asset.

15           Moreover, we believe that providing the blanket  
16 authorization in this area will promote another objective of  
17 the Commission, which is to promote investment in the power  
18 and utility sector. We believe that this blanket  
19 authorization will promote liquidity and/or thereby reduce  
20 financing costs and encourage infrastructure investment and  
21 ultimately benefit customers.

22           As my fellow panelists pointed out, we also  
23 believe that the Commission should consider providing  
24 greater clarity as to what constitutes a passive investment,  
25 for which no Commission authorization is required. For

1 example, the Commission may conclude that where an entity  
2 that is not a traditional public utility owns less than  
3 20 percent of the public utility securities and does not  
4 exercise day-to-day management and control over that entity,  
5 as evidenced perhaps by a 13(g) filing, that should  
6 constitute passive investor status.

7 This would simply and facilitate decision-making  
8 on the part of investors in the market. In sum, we  
9 appreciate the work that the Commission and staff have done  
10 in formulating the guidelines in the post-PUHCA 2005 world.  
11 We believe that what the Commission has done has promoted  
12 growth, and created investment opportunities and we  
13 encourage the Commission to take the additional steps I have  
14 described.

15 CHAIRMAN KELLIHER: Thank you, Mr. Bunkin. We  
16 will now recognize Deborah Bolton, vice president and  
17 assistant general counsel of Mirant.

18 MS. BOLTON: Thank you, Commissioners, for the  
19 opportunity to speak. We were hoping that EAct would  
20 provide some clarity and eliminate the need for providing  
21 unnecessary two or three filings, but this hasn't been shown  
22 to be the case.

23 Mirant has affiliated public utilities, and as a  
24 holding company under Section 203, so we face 203 issues  
25 when we do anything with our assets or securities, and

1       apparently when third parties do something with Mirant  
2       stock, the basic guidance we usually get after looking into  
3       it, is to just make a 203 filing to be on the safe side.  
4       But this isn't really guidance, and there are real costs  
5       associated with a filing obligation.

6               Let me identify three problems. One has been  
7       discussed at length by Mr. Bunkin. It is basically what  
8       constitutes control for a Section 203 purposes under  
9       203(A)(1).

10              There is no statutory or regulatory percentage,  
11       so the industry has basically created this folklore of a  
12       5 percent test. The 5 percent -- we looked and it isn't  
13       written anywhere. It seems overly conservative, especially  
14       in light of the 10 percent test that is now being used under  
15       Section 203(A)(2).

16              Using the 5 percent test under 203(A)(1) for  
17       Mirant essentially eliminates the 10 percent threshold under  
18       203(A)(2), which makes little sense. We request that the  
19       Commission clarify that the 10 percent would be a basic  
20       threshold for a transfer of control for all of 203. Or, at  
21       the very least, consider establishing that there is a  
22       presumption of no control under 10 percent, and the burden  
23       would be showing that there was control.

24              The second issue is under old Section 203, FERC  
25       required a public utility to make a 203 filing when a

1 controlling interest of the upstream stock was transferred.  
2 This, however, creates an obligation that would be  
3 impossible for Mirant's public utilities to perform.  
4 Mirant's stock is publicly traded in the market in huge  
5 volumes between third party arm's-length investors.

6 We receive notice of transfers about 5 percent  
7 under the SEC regulations. But this is after the fact  
8 notice. We have no control over it and usually no notice of  
9 such transfers. Basically, there is no way, no reason to  
10 require a public utility to file for upstream stock  
11 transfers under 203(A)(1). Such transfers are already  
12 captured by the filing made by the acquiring party under  
13 Section 203(A)(2).

14 Section 203(A)(1) should apply according to the  
15 clear language of the statute to the transfer of assets by  
16 the public utility. And 203(A)(2) should capture the  
17 upstream and secondary market transfers of control by having  
18 the acquiring party make the 203 filing.

19 The party that acquires the stock has knowledge  
20 that it is going to make the acquisition and can make the  
21 filing. The public utility does not. At a minimum, a  
22 public utility with stock traded publicly in the market  
23 should not be required to make a 203 filing for transfers of  
24 upstream stock.

25 According to FERC, the disposition of assets

1 under \$10 million is exempt under Section 203(A)(1)(a), but  
2 not under (A)(1)(b). Since many transactions, as  
3 dispositions under (A)(1)(a), they would also be interpreted  
4 as mergers or consolidations under (A)(1)(b). Under one  
5 interpretation, you need to make a filing, under the other  
6 one, you don't. Again, just to be fair, if you make a  
7 filing for something that is less than \$10 million.

8 Even more confusing is FERC's interpretation that  
9 Section 203(A)(1)(a) that the \$10 million threshold applies  
10 for public utility that is transferring part of its assets,  
11 not if it is transferring the whole of its assets. Due to  
12 the placement of a comma, transferring the whole of your  
13 assets of less than \$10 million requires a filing, but  
14 transferring a part of your assets less than \$10 million  
15 doesn't.

16 That seems like a nonsensical result, and would  
17 be very creative in people partially out their sales to  
18 avoid a 203 filing. It seems like the clear intent was  
19 transactions less than \$10 million to take place without the  
20 cost and transactional delay of a 203 filing.

21 FERC should make this clear through a blanket  
22 waiver or claim of lack of jurisdiction over transfers of  
23 less than \$10 million. In short, I am here to say, from a  
24 company perspective, there is a real and significant cost to  
25 requiring 203 filings to be made to be on the safe side.

1                   These are real costs that are borne by companies,  
2 both monetary and transactional delay costs. The filing  
3 requirements need to be clear so we can follow them without  
4 having excess debates with various outside counsel about  
5 what is and isn't required.

6                   We should be secure that we are in compliance  
7 without always have to make a 203 filing to be on the safe  
8 side.

9                   Thank you for allowing me to speak today.

10                  CHAIRMAN KELLIHER: Thank you. I would like to  
11 now recognize Ike Gibbs, vice president and compliance  
12 director and assistant general counsel with J.P. Morgan.

13                  MR. GIBBS: Mr. Chairman, thank you. I  
14 appreciate the opportunity to participate in today's  
15 technical conference to discuss issues related to the  
16 implementation of PUHCA 2005 and the changes to Section 203  
17 of the Federal Power Act that were enacted by the Energy  
18 Policy Act.

19                  I am especially appreciative that you and your  
20 fellow commissioners and the Commission staff have committed  
21 a portion of our time today to discuss the exemptions,  
22 waivers and blanket authorizations set forth in Orders 667  
23 and 669.

24                  J.P. Morgan did not participate in the PUHCA 2005  
25 rulemaking. However, we find the existing settlement

1 strikes a fairly reasonable balance between the protective  
2 goals of PUHCA 2005 and Congress' goal of avoiding negative  
3 impacts on the traditional roles played by financial  
4 institutions.

5 With that said, we believe the Commission should  
6 consider a new exemption that embodies characteristics of  
7 the statutory exemption that applies for holdings of EWGs,  
8 QFs, PUHCOs, and the regulatory exemption for passive  
9 investors.

10 J.P. Morgan encourages the Commission to consider  
11 modifying the passive investor objection to limit the  
12 requirement to entities claiming the exemption to filing a  
13 FERC 65 and 65(A). In crafting such a modification, the  
14 Commission could consider the strict bank regulatory  
15 oversight that many financial institutions are subject to.

16 I will now briefly mention a few comments about  
17 the Section 203 blanket authorizations. J.P. Morgan has two  
18 public utility entities. One of those is J.P. Morgan Chase  
19 Bank, National Association, for which the Commission granted  
20 various blanket authorizations in the bank's market-based  
21 rate authorization order.

22 Additionally, the bank participated in the FPA  
23 203 rulemaking earlier this year. The Commission included  
24 several of the bank's recommendations in the final rule.

25 In the agenda for today's conference, a question

1 was asked about a 203(A)(1) blanket authorization for  
2 acquisitions of public utility voting securities subject to  
3 a 10 percent threshold. J.P. Morgan supports a blanket  
4 authorization for financial institutions under 203(A)(1).

5 J.P. Morgan has not considered whether such an  
6 authorization needs to be codified. However, if the  
7 Commission goes that route, we would suggest tweaking the  
8 Federal Reserve, OCC and the underwriting hedging blanket  
9 authorizations that are currently available to holding  
10 companies under 203(A)(2), so that they also apply to public  
11 utilities under 203(A)(1).

12 Thank you.

13 CHAIRMAN KELLIHER: Thank you very much. I now  
14 recognize Andrew MacDonald of Thelen Reid Brown Raysman &  
15 Steiner, on behalf of Edison Electric Institute.

16 MR. MacDONALD: Thank you. As you  
17 note, I am appearing today -- I was asked to appear today on  
18 behalf of Edison Electric. I do have clients with other  
19 interests in this whole topic, but for today's purposes, I  
20 am here for EEI. Anything I say should be understood that  
21 way.

22 EEI, as you know -- the members of the EEI are  
23 predominately the traditional investor-owned electric  
24 utilities, many of which are in holding company systems,  
25 possibly even most are in holding company systems today.

1       EEI's members strongly supported the repeal of PUHCA and  
2       generally have been supportive of the Commission's  
3       rulemaking procedures.

4               EEI has participated in all the Commission's  
5       proposals, including not only those leading to 667 and 669,  
6       but in the cash management NOPRs and the recent accounting  
7       NOPR in Order 684.

8               EEI appreciates the extensive work and the  
9       careful work the Commission has done in implementing PUHCA  
10       2005 and amended Section 203, and Orders 667 and 669, along  
11       with the cash management rules and the accounting rules,  
12       collectively, which provide adequate protection for the  
13       utilities and their customers.

14               So, in short, EEI does not believe that there is  
15       any major substantive change that needs to be made at this  
16       time to Order 667 and 669.

17               And, indeed, while it is off the subject, to the  
18       cash management rules, either. I would add that the cash  
19       management rules are part of this.

20               We encourage the Commission to retain the  
21       exemptions, waivers and blanket authorizations provided by  
22       Order 667. They have been carefully crafted. There has  
23       been a lot of input from all affected parties, and the  
24       Commission has balanced the interests of the consumers on  
25       the one hand, protecting utilities, and on the other hand,

1 the Congressional directive to eliminate unnecessary federal  
2 regulation of holding companies, by repealing PUHCA 1935.

3 The members of EEI came to this process with  
4 really two distinct perspectives. We had holding companies,  
5 we have many members of EEI who are exempt holding companies  
6 under the 1935 Act, generally as intrastate or one-state  
7 holding companies. These companies were generally concerned  
8 with the implications of the rules that would have extended  
9 to them greater regulation under PUHCA 2005 than they had  
10 ever encountered under PUHCA 1935.

11 On the flip side of the equation, many of our  
12 members were previously in registered holding company  
13 systems. The registered holding companies, of course,  
14 supported repeal of PUHCA. Lessening regulation at the  
15 federal level was a congressional mandate, but curiously,  
16 many of the registered holding companies were also very  
17 interested in preserving the structural and financial  
18 benefits that had evolved over the years under SEC  
19 regulatory practice, particularly in regard to the  
20 continuing use of centralized service company structures,  
21 money pools and other forms of interest system financing  
22 techniques that enabled holding companies to achieve  
23 significant efficiencies and economies for rate payers and  
24 investors.

25 EEI believes that from the perspective of its

1 members the Commission has struck an appropriate balance in  
2 Orders 667 and 669 protecting consumer interests while at  
3 the same time carrying out the mandate of Congress to reduce  
4 unnecessary regulation of holding company systems, except  
5 for two suggestions that we would make on Order 669 dealing  
6 with blanket authorizations under Section 203, we see no  
7 reason for the Commission to make any major changes to these  
8 rules, and again, I am speaking only from the perspective of  
9 the members of Edison Electric. There are others on this  
10 panel who have different interests that are not at odds with  
11 Edison Electric's view.

12 We know that there have been a lot of questions  
13 about the single state holding company system waiver. We  
14 know that controversy is ongoing.

15 We believe that the Commission, in Order 667(A)  
16 and 667(B), has interpreted the statute and the Commission's  
17 mandate correctly and has, by implementing a rule that in  
18 effect mirrors the policies of the SEC under Section  
19 3(A)(1), and this has given the former exempt holding  
20 companies a great deal of assurance that at least for the  
21 vast majority of them, I suppose, they were exempt under the  
22 old PUHCA, and they will continue to enjoy at least a  
23 limited waiver under the new law.

24 Obviously, we also feel that the Commission has  
25 handled the exemptions under 667(A) for EWG, PUHCO and QF

1 parents correctly and there is a lot of back and forth on  
2 that.

3 I am going to just skip to Order 669. The only  
4 real two changes that we were propose on the rule, a blanket  
5 authorization under Section 203, deal first with the mirror  
6 image or parallel exemption under Section 203(A)(1) for the  
7 blanket authorization under 203(A)(2) for up to 10 percent  
8 acquisitions and voting securities.

9 Several other panelists have already spoken about  
10 that. I won't dwell on it. We do think it makes sense and  
11 would add a great deal of certainty in that area.

12 The other blanket authorization -- probably this  
13 is more of a fix than a new blanket authorization. Maybe  
14 it's just my own reading of the statute and the rules in the  
15 preamble, but this relates to the blanket authorizations for  
16 internal corporate reorganizations. Again, which works to  
17 be, I believe, a blanket authorization under both 203(A)(1)  
18 as well as 203(A)(2).

19 But as I understand the rule and the preamble,  
20 that blanket authorization would not apply to a case where  
21 there is a direct transfer on an asset from one  
22 nontraditional utility subsidiary to another nontraditional  
23 utility subsidiary.

24 For an example, an attempt to transfer an asset  
25 from one EWG subsidiary to another is not apparently covered

1 by the internal reorganization blanket authorization, we  
2 would encourage the Commission as it considers potential  
3 changes to that rule, to consider that possibility as well.

4 Thank you.

5 CHAIRMAN KELLIHER: Thank you. I would like to  
6 now recognize Kara da Silva, senior vice president, Radian  
7 Asset Assurance. She is our last speaker of the day. Bear  
8 in mind that the last shall be first. You are actually in a  
9 great position to end our day. You shouldn't feel bad about  
10 it. We look forward to your comments.

11 MS. Da SILVA: Thank you very much. Good  
12 afternoon, commissioners and staff. I come from Radian  
13 Asset Assurance. What we do is provide a rating which  
14 enables qualified issuers to borrow money in the public  
15 market at the lowest interest rates.

16 Once these debt obligations are sold, Radian  
17 guarantees both unconditionally and irrevocably a timely  
18 payment of principal and interest to bondholders. We step  
19 into the shoes of bondholders, and therefore represent their  
20 interests in the capital markets if something goes wrong.

21 I manage the public finance portfolio. I am a  
22 risk officer. My views are colored by the fact that I am a  
23 risk officer. But also, because what we do is monitored  
24 industries and portfolios, we are usually out front in being  
25 able to identify risk. We have also clearly watched the

1 profound changes in the industry over the past, I would say  
2 decade, but more clearly in the past five years. It brought  
3 a lot of risk into the portfolios for those who had provided  
4 bond issues or who had purchased in the capital markets.

5 We feel that with the repeal of PUHCA and PUHCA  
6 2005 and the FPA 203, that more change is going to come.  
7 What the Commission had set forth already, in terms of the  
8 exemptions, waivers and blanket authorizations, is  
9 sufficient to enable some of that change to occur.

10 Taking any further steps until seeing what that  
11 change -- or actually it is probably not the right step to  
12 take. The market likes to understand the rules. When they  
13 understand the rules, they can establish a game plan.

14 The first panel today spoke about cross-  
15 subsidization and the possibility of ring fencing. When you  
16 put those rules in place, then you can better understand  
17 where the market plays out. But until we see what happens,  
18 based on these changes, the profound changes to date, and  
19 what is likely to happen in terms of where the Commission is  
20 going to go, we have cross-subsidization rules and ring  
21 fencing. We would recommend that the Commission wait until  
22 it has more experience before making any further changes.

23 Thank you.

24 CHAIRMAN KELLIHER: Thank you very much. I will  
25 have to rely on staff to ask questions. I would like to see

1 if Cindy or the left hand or the right hand have some  
2 questions of the panel.

3 MS. MARLETTE: I'll start with a few. The first  
4 one is a clarification. Mr. Burkley, you talked about the  
5 blanket authorization the Commission gave for passive  
6 investors. We granted it for three years. You recommended  
7 that we provide an exemption on a broader basis. By that  
8 you mean, when you say a "broader" exemption, you do it  
9 case-by-case for a three-year period?

10 MR. BURKLEY: I think what I was suggesting was  
11 that the policy basis that undergirded the blanket  
12 authorization would be taking something that you could apply  
13 to other, similarly situated parties. Others in the mutual  
14 fund industry, other types of passive investors, if you are  
15 trying to encourage more capital to come into the industry,  
16 that would be an appropriate thing to do.

17 So, I wasn't relating it to our circumstances.

18 MS. MARLETTE: But granting the Commission has to  
19 grapple with the rules, obviously, how much do we grant by  
20 blanket authorization versus how much should the Commission  
21 do on a case-by-case basis, subject to renewal, to try to  
22 monitor what is going on in the industry, and not be too  
23 hasty in granting too many blankets?

24 Do you see the case-by-case authorizations, such  
25 as the one you got, being problematic for doing business for

1 investing? I guess I am asking if the Commission waits for  
2 a period of time until it gets more experience with the  
3 individuals before widening some of the blankets. Is that  
4 going to affect your business?

5 MR. BURKLEY: We took a look at this, and we  
6 realized we would need flexibility and it would be hard for  
7 us to operate if we didn't get it. That caused us to come  
8 forward. I am sure there are others who are doing a similar  
9 review, and so, you could wait for people to do that on a  
10 case-by-case basis and see how that shakes out.

11 I guess the point I was making is, because it  
12 seems that there is a recognition that investors of this  
13 type do pose a very low concern for control issues, that  
14 that's something you could think about, but obviously, if  
15 you wait for others to come forward, that would be  
16 appropriate as well.

17 MS. MARLETTE: I appreciate it. Next, I think we  
18 heard this from a couple of people, about what constitutes a  
19 change in control and lack of clarity. I hear you. I  
20 understand that that's an issue.

21 The second aspect of that, I think I heard, and  
22 it was an issue raised in the rulemakings previously  
23 -- it's the mismatch between the 203(A) acquisitions, and  
24 not granting, if at the same time you get two or three  
25 (A)(1)'s and you don't get a blanket, you kind of nullify

1 the 203(A)(2).

2 I take it most of you think that the Commission  
3 should go ahead and have a parallel 203(A)(1) authorization.  
4 I take it that the lack of that 203(A)(1) blanket could be  
5 impeding the ability to transact.

6 (Pause.)

7 CHAIRMAN KELLIHER: All right. Andrew?

8 MR. MOSIER: This is a question for the panel.  
9 It concerns the companies with the more diversified -- more  
10 than one line of business activities.

11 The Commission, as Mr. Burkley pointed out,  
12 granted an authorization for their asset management  
13 activities that did rely on some SEC instruments in part.  
14 That perhaps was a relatively easy thing to do because it  
15 was only one line of business involved, which is not true of  
16 some of the other companies, some of the other financial  
17 houses.

18 I am wondering to what would you point the  
19 Commission on the assumption that the financial houses will  
20 all look for these authorizations for at least their asset  
21 management activities and perhaps other activities. That  
22 would help the Commission, one, deal with the full issues,  
23 but also for those companies who are active in the markets,  
24 are active asset owners, the issue of market manipulation.  
25 I open that to you and look for your guidance.

1                   MR. BUNKIN: We actually filed an application  
2 following the adoption of the EPA to clarify the activities  
3 that the non-asset-owning parts of Goldman Sachs would be  
4 able to engage in, following PUHCA 2005.

5                   The Commission were very helpful in working with  
6 us to craft something that took into account the nature of  
7 our organization and the fact that while we are an active  
8 market maker through our broker-dealer subsidiary, we do own  
9 assets through separate parts of Goldman Sachs.

10                  If those parts of the organization are acquiring  
11 new assets, then the approval process that would be  
12 appropriate for those activities would be entirely different  
13 than the blanket authorization that would be granted to the  
14 normal trading activities that go on in our broker-dealer.

15                  I think that the Commission and the staff have  
16 recognized that although these organizations, large  
17 financial institutions, are engaged in a number of different  
18 activities in the power industry. Those are distinct  
19 activities. They can be looked at on a standalone basis for  
20 purposes of these authorizations.

21                  With respect to the question of market  
22 manipulation, I think that -- it strikes me that the fact  
23 that one part of the organization is engaged in the trading  
24 or investing in activities and securities of the utility  
25 companies, in a way that is, by definition, not gaining

1 control over those organizations because they are within the  
2 percentage parameters that are allowed.

3 There is no benefit that is being derived from an  
4 informational perspective that would cause that activity to  
5 result in manipulation-type concerns.

6 MR. GIBBS: I'll just add to that. My  
7 organization is a little bit different from Steve's, in that  
8 we are regulated by both the Federal Reserve and the Office  
9 of the Comptroller of the Currency, which is a fact that the  
10 Commission has recognized. Over the past years, as we have  
11 been going through the rulemaking process, there is an  
12 element of bank regulatory oversight. That's an area where  
13 we will be different from some of the other financial  
14 institutions that you will see, which appears in the  
15 industry.

16 On the issue of market manipulation, the question  
17 sounds very similar to one that myself and others from the  
18 financial community answered when we were here a few weeks  
19 ago as part one of our trade association outreach efforts,  
20 to talk about the role of financial institutions in the  
21 energy industry.

22 And, at the time, our comments really focused on  
23 the fact that the financial community has very strong  
24 information barriers between the various lines of business  
25 that sit under the umbrella organization.

1                   From a reputational perspective, those  
2 information barriers are deemed to be a highly valuable  
3 commodity, if you will, within our business. And I think  
4 that's probably the strongest defense that we have against  
5 the sharing of information between the lines of business  
6 that you have referenced.

7                   MR. RODGERS: Can I jump in with a follow-up on  
8 that? It is correct, though, that those informational  
9 barriers are self-policed. They are not imposed by any  
10 regulatory authority.

11                  MR. GIBBS: I am not aware of any information  
12 barriers that are mandatory information barriers.

13                  MR. BUNKIN: They are mandatory in the sense that  
14 in order for our organizations to be engaged on the one hand  
15 and advising clients on activities that involve material  
16 nonpublic information about transactions on the one hand,  
17 and be an active participant in trading securities, we have  
18 to make sure that in order to comply with the SEC rules that  
19 we have information barriers that meet the standards of the  
20 SEC, and 10(B)(5) and related interpretations.

21                  I don't think they are regulatorily mandated per  
22 se, but by default, it is essential to have these  
23 information barriers, and that they be robust and stand up  
24 to scrutiny through regulatory audits, which the SEC will  
25 conduct, as with other regulatory bodies in different

1 jurisdictions.

2 MR. RODGERS: Could I ask Steve and Ike, do your  
3 companies have energy management service businesses?

4 MR. BUNKIN: Not specific. We are not in that  
5 line of business specifically. However, in the normal  
6 course of our power trading activities, we may enter into  
7 petroleum agreements or contracts of that sort, which were  
8 involved in our essentially managing a power plant. That  
9 would be subject to a change of status filing with the  
10 Commission. So, all those types of contracts would be on  
11 notice to you.

12 MR. RODGERS: Could some of those arrangements  
13 involve a manner or measure of control that your company  
14 would have over those assets for some period of time?

15 MR. BUNKIN: I think a tolling agreement could  
16 involve a level of control over the management of a power  
17 plan insofar as the dispatch would be part of that  
18 arrangement, yes.

19 MR. RODGERS: So there could be situations where,  
20 through those arrangements, you would actually be perhaps  
21 not passive in your involvement in the market because you  
22 actually have control of generating assets?

23 MR. BUNKIN: Right. I am not sure that that  
24 activity -- if you are saying that entering into a tolling  
25 agreement would be the disposition of a jurisdictional

1       asset. I don't see where this goes, in terms of the  
2       framework that exists within the rules that are currently in  
3       place.

4                I think we have been talking more about acquiring  
5       assets or securities of public utilities and holding  
6       companies, and not about a contractual arrangement which  
7       would give one party a dimension of control over an asset.

8                I am not sure that would be covered by the rules,  
9       other than the change in status rules.

10               MR. RODGERS: I had a question for Ms. Bolton. I  
11       appreciate the dilemma in which you find yourself when your  
12       securities are being traded publicly in ways that you are  
13       not aware of, and essentially exposing your company to two  
14       or three filing obligations that you may not be aware of  
15       until after the fact.

16               MS. BOLTON: That's right.

17               MR. RODGERS: Is there something that the  
18       Commission could do to address that situation other than  
19       just providing a blanket authorization that entities with  
20       publicly traded securities have a blanket authorization?

21               MS. BOLTON: Well, a blanket waiver, you mean?

22               MR. RODGERS: Yes.

23               MS. BOLTON: I think that would do it. But as I  
24       was saying, I also think that just a rereading of 203 in  
25       light of EPAct might answer that for you. The old 203 just

1 basically had (A)(1), so you had to cover upstream  
2 securities and sale of assets, and transfer of physical  
3 assets in the same paragraph.

4 Now you've got two arms. You've got the public  
5 utility trading its assets and you've got the holding  
6 company acquiring assets. If you handle the upstream  
7 transfer of securities through 203(A)(2), you have them  
8 covered, for the most part.

9 The one you don't have covered is if it's  
10 purchased by a public utility that is not a holding company.  
11 But then that is covered under 203(A)(1). And so, there  
12 isn't really a transaction in the upstream market that would  
13 slip by. But it would be able to have the onus be on the  
14 person who is acquiring the assets rather than the  
15 downstream public utility that really has no idea.

16 I would even prefer someone saying, if you are  
17 publicly traded, you aren't subject to that. It's just  
18 being out there with the Commission's new penalty authority,  
19 and being very unclear if somebody trades above 6 percent  
20 and you don't know about it, whether you had a before the  
21 fact filing obligation.

22 MR. RODGERS: Thank you very much.

23 MR. BUNKIN: Mr. Rodgers, let me separate it. It  
24 occurred to me with respect to your question, one other fact  
25 which is important to consider is that in filing other 203

1 applications that are made we would reference whatever  
2 control arrangements would be conferred through tolling  
3 agreements that we would be party to.

4 That would be something that the Commission would  
5 see and be able to take into account for purposes of a  
6 market power analysis with respect to other applications  
7 that were filed after that tolling agreement is introduced.

8 MR. RODGERS: Thank you.

9 CHAIRMAN KELLIHER: I have a question for Ms.  
10 Bolton about the comma. You referred to a comma?

11 MS. BOLTON: Yes, sir.

12 CHAIRMAN KELLIHER: Where is the comma?

13 MS. BOLTON: If you look at 203(A)(1)(a), that  
14 says that no public utility shall sell, lease, or otherwise  
15 dispose of the whole of its facilities subject to the  
16 jurisdiction of the Commission -- comma -- or any part  
17 thereof. There should be a comma there.

18 CHAIRMAN KELLIHER: A missing comma?

19 MS. BOLTON: Either take the first comma out or  
20 add another one in, yes.

21 CHAIRMAN KELLIHER: In fact, we know that we  
22 don't have the freedom to do that.

23 MS. BOLTON: There's a lot of typos and things  
24 wrong with EPAct.

25 (Laughter.)

1                   CHAIRMAN KELLIHER: As we interpret the statute,  
2 we have to assume that the choice is deliberate, and the  
3 choice of grammar is deliberate. There have been Supreme  
4 Court cases on commas.

5                   MS. BOLTON: I agree with that.

6                   CHAIRMAN KELLIHER: I agree the meaning is  
7 different with or without the comma. I'm just not sure we  
8 can freely change the meaning by inserting or removing  
9 punctuation.

10                  MS. BOLTON: No, but you might be able to  
11 consider some kind of a waiver to say that the intent, or  
12 the way they are going to enforce it under \$10 million is  
13 something that you don't see as an issue. You might not  
14 have to go back to the statutory issue there.

15                  MS. MARLETTE: I guess an option would be to  
16 grant a blanket --

17                  MS. BOLTON: Right. Just say \$10 million is not  
18 an issue for us. We understand what they did here.

19                  CHAIRMAN KELLIHER: I have been moderating for  
20 the past hour. I am sorry.

21                  (Laughter.)

22                  MS. BOLTON: If it will be of any help, it was a  
23 shocker to me, so I appreciate it.

24                  CHAIRMAN KELLIHER: Any other questions?

25                  MS. MARLETTE: No. I would just urge the

1 panelists and others to comment by January if there are  
2 issues on which they need clarification. We heard a lot  
3 about the desire for additional blanket authorizations, but  
4 please put those in the record. And be as specific as you  
5 can. That would be helpful.

6 And if you have ideas on how to interpret or  
7 change control, let us hear that, too.

8 CHAIRMAN KELLIHER: Thank you. I want to thank  
9 all of the panelists. This has been a very good panel, for  
10 me in particular. I can't say I am an expert on the  
11 exemptions, waivers and blanket authorizations for the past  
12 year, but we have had a lot of interesting orders in this  
13 area. So, we appreciate all your help.

14 As I said in the beginning, the record will be  
15 open until January 26th. Once the record is closed, the  
16 Commission will deliberate and see what steps, if any, we  
17 should take in the future.

18 Thank you for your help today. With that, this  
19 meeting is closed.

20 (Whereupon, at 3:15 p.m., the meeting was  
21 concluded.)

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24  
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