

THE ENRON ANTI-DOTE

How the Wisconsin Utility Holding Company Act Protects Wisconsin's Electric Customers

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OVER THE PAST TEN YEARS, the landscape of the electric industry has changed dramatically. In place of the traditional system where each regulated electric utility produced energy to serve its customers, there are now a multitude of producers, energy traders, and holding companies that provide a vast array of unregulated services. In this era of change, there is a corresponding need for close regulatory oversight to ensure that electricity remains affordable and reliable for all Wisconsin customers. The meltdown of California's electric system in the wake of deregulation, the bankruptcy of Enron and the turmoil at unregulated energy companies highlight the importance of strong, stable utility companies that meet their customers' needs. The Wisconsin Utility Holding Company Act (WUHCA) is one of the cornerstones of Wisconsin's ability to maintain this kind of service. WUHCA ensures that the utilities that provide our electric service have a stake in Wisconsin and limits the amount Wisconsin utility holding companies may invest in risky, unregulated ventures. Despite the fundamental consumer, worker and investor protection aspects of WUHCA, efforts are currently underway to overturn the law in court. If this happens, the Wisconsin Legislature will need to move quickly to ensure that these critical protections are maintained.

WUHCA Protects Wisconsin Consumers

In 1985, the Wisconsin Legislature enacted the Wisconsin Utility Holding Company Act.¹ Under the legislation, investor-owned utilities were, for the first time, allowed to create holding companies that could invest in non-utility, non-regulated business ventures. The state's public utilities strongly, and unsurprisingly, supported the enactment of WUHCA and praised its implementation. The utilities' new rights under WUHCA, however, were limited. The carefully crafted legislation balanced the interest of investors, utilities' monopoly customers and the state by permitting *limited* diversification by the holding companies in exchange for *reasonable regulatory controls* to protect consumers. Specifically, WUHCA: (1) capped non-utility investments at 25 percent of the total assets of the utility; (2) required Wisconsin utility holding companies to incorporate in Wisconsin (utilities were already required to be Wisconsin corporations); and (3) require the Public Service Commission of Wisconsin to approve the acquisition of 10 percent or more of the utility holding companies' voting shares. Although the legislature loosened the non-utility investment cap diversification restrictions somewhat in 1999², the basic system of regulation under the

statute remains in place and continues to protect Wisconsin consumers today.

Holding Companies Seeking to Profit from Risky, Unregulated Ventures Want WUHCA Overturned, Regardless of the Harm It Will Cause Consumers

Despite their decades of support and prosperity under WUHCA, some of the large Wisconsin holding companies now want to invest in risky, unregulated investments at levels not allowed by the statute. Little legislative support for further holding company deregulation exists, however, leaving WUHCA's detractors with only one avenue to overturn the statute in court in their quest to shield their activities from Wisconsin's oversight: litigation.

Fortunately for Wisconsin consumers and investors, the attempt to overturn WUHCA thus far has been unsuccessful. In 2000, Alliant Energy Corporation (Alliant) challenged the constitutionality of certain WUHCA provisions in federal court. The holding company sought to eliminate the requirement that utilities and holding companies be Wisconsin corporations, to eliminate the asset cap, and to eliminate PSCW's authority to approve takeovers by foreign corporations. District Judge John Shabaz dismissed the lawsuit on grounds that Alliant failed to demonstrate the WUHCA caused any actual harm to the company; Alliant then appealed the decision to the Seventh Circuit of Appeals. The Court of Appeals reversed the dismissal and remanded the case back to the District Court so that a hearing on the merits could be held. On May 20, 2002, Judge Shabaz once again dismissed Alliant's complaint, holding the regulation of utility ownership and investment for the protection of ratepayers has long been recognized as a compelling state interest. Shabaz explained that "(t)he great potential for abuses by utility holding companies, including acquisition of risky investments and subsidiaries, exaction of unreasonable fees, and issuance of unsound securities...support state restrictions on holding companies."³

If WUHCA Is Overturned, Wisconsin Faces the Real Possibility of California and Enron-Like Disasters

Alliant has now appealed this decision again. While Alliant failed in its first attempt to second-guess the legislature, a serious threat to Wisconsin's electric industry and its customers still exists in the form of the holding company's second appeal in the Seventh Circuit. If Alliant's challenge is successful and WUHCA's most important safeguards are eliminated, the ability of state regulators to protect Wisconsin electric consumers will be limited and the landscape of the state's electric industry will be changed substantially. If this occurs, the legislature must be prepared to revise WUHCA promptly and decisively, in a way which is both constitutionally sound and protective of consumers. Most importantly, any revisions made should strengthen consumer protection, rather than merely preserve WUHCA. To avoid the imminent and serious consequences of deregulation, consequences which have already been felt by utility holding companies and their customers in other states, Wisconsin should enact protections even stronger than those currently in place.

Recent widely-publicized events evidence the dangers that accompany the deregulation and uncontrolled diversification that Alliant now seeks. Failed deregulation in California led to shortages, rolling blackouts, utility company bankruptcy, enormous price increases for ratepayers, market manipulation and profiteering. The dramatic subsequent collapse of Enron, a huge unregulated energy company, has left employees jobless, investors profitless, retirees hopeless, and utility customers unprotected from increased rates. Utility holding companies such as Aquila Corporation, Reliant Energy, CMS Energy Corporation, and Dynergy's unregulated affiliates have crashed and burned, while their regulated utilities try to survive amidst the rubble.⁴ Such damage is likely to occur in Wisconsin if uncontrolled diversification and

further deregulation is permitted.

In fact, Alliant itself is a good example of why Wisconsin customers and investors need WUHCA's regulatory protections to remain in place. In the last three years, the holding company has invested heavily in unregulated ventures all over the world, borrowing extensively to do so.⁵ Alliant is not earning very well on many of these investments and is losing money on others. The company's non-utility business lost \$25.9 million in the third quarter of 2002, contributing to another financial rating downgrade from Standard and Poor's.⁶ Alliant has experienced reduced earnings largely as a result of the poor performance of these risky investments, including a loss of \$19 million on Brazilian hydroelectric plants amid a nationwide drought and losses on loans to a Mexican resort. Continuing involvement in these ventures has resulted in the lowering of Alliant's bond rating, the deterioration of the company's capital structure, falling stock prices, and a major dividend cut.

The Public Service Commission of Wisconsin expressed clear concern over Alliant's business transactions in its June 2002 Audit Report on the company's 2000-2001 operations. The Commission briefed the Legislature on how Alliant's risky ventures will ultimately result in increased cost for consumers:

"The management of [Alliant Energy Corporation]...appear[s] to be making financial decisions that could be to the detriment of the debtholders, preferred stockholders, and ratepayers. Security holders have seen their investments impaired while ratepayers will be affected by the higher interest rates [Alliant's Wisconsin utility] will pay to acquire debt financings."⁷

Another example close to home is Xcel Energy, Inc., the parent holding company of Northern States Power Company-Wisconsin.⁸ One of Xcel's subsidiaries, NRG Energy, Inc., is an unregulated power producer with operations all around the world, but with no generating facilities in Wisconsin. At the end of 2002, NRG

owed debt holder over \$10 billion and has been teetering on the edge of bankruptcy.⁹ As a result of NRG's financial problems, Moody's Investors Services downgraded its debt rating for NSP-Wisconsin and NSP-Minnesota, stating that both utilities have to pitch in to help boost the finances of Xcel.¹⁰ In the third quarter, Xcel wrote off \$2.9 billion dollars for investments in NRG, causing its stock price to tumble.¹¹ The stock price, which had been as high as \$29.77 and fell to a low of \$5.12 in July of this year, currently hovers around \$11.¹²

This huge reversal of fortune has left Minnesota regulators scrambling to gather the information they need to protect customers. Before the near-collapse of NRG, the Minnesota PUC had little information about Xcel's complex financial dealings with its subsidiary, and was therefore at a significant disadvantage in handling the situation. In October 2002, the Minnesota PUC commenced an extensive audit of the company in order to better understand the potential impacts of this staggering failure.¹³ Well after the fact, they are slowly compiling the information and tools they need to try and prevent Minnesota ratepayers from falling prey to this type of situation in the future. As this example clearly shows, it will be next to impossible under a further deregulated Wisconsin system to detect and avoid potentially harmful agreements by and between holding companies and their unregulated subsidiaries until it is too late for ratepayers. If and when WUHCA is revised, the legislature should strengthen the provisions requiring disclosure of such potentially harmful loan or contract provisions to the Commission and, more fundamentally, require the currently exempted Xcel to comply with WUHCA.

WUHCA's Takeover, Diversification And Incorporated Restrictions Are Fundamental Customer Protections That Will Help Wisconsin Avoid Electric Industry Crises.

Included in WUHCA is a provision that the Public Service Commission of Wisconsin must approve any significant change in ownership of Wisconsin holding companies. This fundamental protection ensures that Wisconsin regulators carefully scrutinize any changes in holding company ownership and have the ability to disallow takeovers that would put Wisconsin utility customers at risk. Without this provision, this review would take place only at the federal level, where, as California customers have recently found, local ratepayer concerns are often minimally addressed.

The diversification that holding companies like Alliant now seek seldom, if ever, benefits customers. When diversification is successful, shareholders profit, but the ratepayers do not. When diversification fails, the cost of obtaining capital for the utility goes up, while value goes down. In the end, utility customers are always there to pick up the pieces.

In light of the above, *it is clear that WUHCA is necessary to protect those with the most to lose – customers.* WUHCA's restrictions on diversification prevent holding companies from straying too far from their core business of providing basic utility services to their retail and wholesale customers in Wisconsin. Without such restrictions, holding company management can easily be distracted from its public service duties by the lure of risky ventures and their prospect of greater returns. When the risky ventures go bad, management pays even *less* attention to the core utility business. Holding companies often fund these ventures by diverting retained earnings away from the utility and investing less in infrastructure. Because such "business decisions" place serious risk on the utility and its customers, WUHCA's bar on the kinds of investments that result in harmful business actions is key to protecting Wisconsin ratepayers.

WUHCA's requirement that utilities and holding companies incorporate in Wisconsin is

also a key ingredient of effective regulatory control and consumer protection. If holding companies are permitted to incorporate out-of-state, as Alliant intends to do if WUHCA is overturned, Wisconsin regulators will have increasingly less access to their books and records and control over their regulated diversified activities. For example, if Alliant reincorporates in and moves its headquarters to Delaware, the PSCW's ability to audit the company will decrease in direct proportion to the company's increased remoteness from the Commission, in terms of both geography and regulatory control. The incorporation requirement helps protect Wisconsin customers and workers from takeovers of state utilities by national or international energy conglomerates that have no stake in our state.

The Threat to WUHCA Has Put the Very Nature of Wisconsin's Electric Industry at Stake.

If WUHCA is overturned, the careful steps Wisconsin has taken to sequentially restructure the electric industry will be undermined. We need to make sure that electric customers do not suffer from the financial risks of diversification. We also need to make sure that Wisconsin utilities do not lose their focus on the primary duty they have under their monopoly franchise – devoting their resources and attention to providing low cost, reliable service to Wisconsin customers.

¹ Wis. Stat. sec 196.795

² 1999 Wis. Act 9.

³ Alliant Energy Corp v. Bie, 00-C-611 –S, May 20, 2002 at 7-8 citing North Am. Co. v. Securities and Exchange Commission 327 U.S. 686, 701-02 (1946).

⁴ David Armstrong and Andrew Caffrey, *In Volatile Power Market, Utilities Got Badly Burned*, WALL ST. J. July 24, 2002

⁵ Lee Hawkins, *Standard & Poor's Lowers Alliant Energy Rating*, MILWAUKEE J. SENTINEL, December 7, 2002

⁶ Lee Hawkins, *Non-Utility Business Deal Alliant a Setback*, MILWAUKEE J. SENTINEL, July 27, 2002

⁷ Public Service Commission of Wisconsin, *Audit Report on Alliant Energy Corporation*, June 21, 2002, at 11.

⁸ While Xcel is not subject to WUHCA, its saga illustrates why strong holding company regulations are vital.

⁹ Bloomberg News, *NRG Energy Considers Filing for Chapter 11 As Part of Restructuring*, MILWAUKEE J. SENTINEL, November 10, 2002

¹⁰ David Hanners, *Xcel Gets Hit Again*, ST. PAUL PIONEER PRESS, August 17, 2002

¹¹ *Xcel Writes Off \$2.9 Billion in NRG, Expects Bankruptcy for Unit*, DOW JONES NEWSWIRE, November 19, 2002.

¹² Xcel Energy Stock Quote, accessed online December 18, 2002

¹³ Minnesota Public Utilities Commission, *Docket E,G-002/CI-02-1336, Order Requiring Additional Information and Audit*, October 22, 2002.