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June 9, 2009

The Honorable Jon Wellinghoff
Chairman
Federal Energy Regulatory Commission
888 1st St, NE
Washington, DC 20426

Dear Chairman Wellinghoff:

In the context of the Subcommittee on Energy and Environment's review of our nation's transmission policies, I request information on the nature and extent of any increased investment in wholesale transmission lines that is attributable to Congress' decision, in the Energy Policy Act of 2005, to repeal of the Public Utility Holding Company Act of 1935 (PUHCA). As you know, PUHCA was enacted to protect utility ratepayers and investors from the risks associated with complex utility holding company structures, risky diversification, and unsound financing structures.

Those favoring a repeal of PUHCA argued that one of the principal results of such repeal would be to facilitate increased investment in transmission by removing PUHCA's restrictions on ownership of utility assets outside of a single, geographically contiguous region, as well as the Act's myriad restrictions on utility ownership and diversification. Repeal of these restrictions, it was argued, would facilitate the entry of merchant transmission providers into the market, providing additional options to get necessary transmission built.

The link between repealing PUHCA and increasing deployment of transmission was explicitly made in the House Energy and Commerce Committee report on an early version of what would subsequently become the Energy Policy Act of 2005. The report claimed:

> Investment in electric transmission expansion has not kept pace with electricity demand. Moreover, transmission system reliability is suspect as demonstrated by the blackout that hit the Northeast and Midwest in August of 2003. Legislation is needed to address the issues of transmission capacity, operation, and reliability. In addition, state regulatory approval delays siting of new transmission lines by many years. Even if a project is completed, there is uncertainty as to whether utilities will be able to

> recover all of their investment, which hinders new transmission construction. ***Measures proposed, such as repealing the Public Utility Holding Company Act, would facilitate needed investment in the transmission sector."*** (Emphasis added)[1]

In my opinion, the repeal of PUHCA was unwise, because it removed many longstanding consumer and investor protections which had been on the books since 1935. Many in Congress, including myself, opposed repealing PUHCA, fearing that it would increase incentives to exercise market power, create situations where the incentives to exercise market power are impossible to detect and mitigate, and lead to utilities taking on increased risks or creating complex financing structures at the expense of utility consumers and investors.[2]

Recently, the Government Accountability Office (GAO) raised a number of concerns about FERC's failure to take actions to improve its oversight of utility mergers and acquisitions following PUHCA's repeal.[3] Specifically, the GAO has found that:

> FERC has made few substantive changes to either its merger review process or its post merger oversight since EPAct and, as a result, does not have a strong basis for ensuring that harmful cross-subsidization does not occur. With regard to its review of mergers and acquisitions, FERC officials told us that they do not intend to make changes to their process other than to require companies to disclose any existing or planned cross-subsidization and explain why it is in the public interest, and to certify in writing that they will not engage in harmful cross-subsidization. With this disclosure and company attestation, FERC officials review organizational and financial information provided by the companies at the time of the

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[1] See page 171 of the Energy and Commerce Committee report on Energy Policy Act 2005 (H.R. 1640), House Report 109-215.

[2] "Among other objectionable features of Title XII is the outright repeal of the Public Utility Holding Company Act of 1935 (PUHCA), which is administered by the SEC. This law has operated for years to protect consumers and investors. Title XII fails to include appropriate compensatory protections to ensure that investors and consumers are not at the mercy of unconstrained market power. Its few ''reforms'' barely scratch the surface of what is needed to prevent the recurrence of market abuses that cost consumers billions of dollars in electricity overcharges and compromised the reliability of a system that once was without peer." Dissenting Views on Electricity and Hydropower Relicensing by Representatives John D. Dingell, Edward J. Markey, Sherrod Brown, Frank Pallone, Jr., Hilda L. Solis, Eliot L. Engel, Diana DeGette, Lois Capps, Bart Stupak, Anna G. Eshoo, Tammy Baldwin, Tom Allen, Jim Davis, Jay Inslee, Jan Schakowsky, Henry A. Waxman, Rick Boucher. H.R. 1640, Energy Policy Act of 2005, at page 494.

[3] See Government Accountability Office, "Utility Oversight: Recent Changes in Law Call for Improved Vigilance by FERC" GAO-08-289, February 25, 2008; and Government Accountability Office, "Utility Regulation: Opportunities Exist to Improve Oversight" GAO-08-752T, May 1, 2008 .

> proposed merger and do not take further steps to independently verify such information. With regard to postmerger oversight, including its oversight of already existing companies previously regulated by SEC or FERC, FERC intends to continue to rely on its existing enforcement mechanisms to detect potential cross-subsidies—primarily companies self-reporting noncompliance and a limited number of compliance audits. FERC officials told us that they believe the threat of large fines, as allowed by EPAct, will encourage companies to investigate and self-report noncompliance that they discover. To augment self-reporting, FERC officials told us that they are using an informal plan to reallocate their limited audit staff to conduct affiliate transaction audits of 3 companies in 2008 (of the 36 holding companies it regulates). FERC officials told us that it relies on informal discussions between senior FERC managers and staffs to plan its audits each year, but does not formally consider the risks posed by various companies. A risk assessment, for example, could include developing a risk profile for companies by using data on a company's financial condition and by collaborating with states to consider a company's history of compliance. In contrast to FERC's approach for selecting companies for compliance audits, financial auditors and other experts told us that such a risk-based audit approach is an important consideration in allocating resources to detect noncompliance. Finally, we found that where affiliate transactions were audited, the resulting audit reports often lacked a clear description of the audit objectives, scope, methodology, and findings—thus preventing them from being useful to FERC staff to build better audit practices or to improve transparency to states and companies policing these transactions or the public more generally.

In order to more fully evaluate the impact of the policies established in recent years to facilitate the deployment of additional transmission capacity, I request that the Commission provide the Subcommittee with information regarding both the impact of PUHCA's repeal on the nation's transmission system and FERC's oversight of utility mergers and acquisitions. Such information is needed in order to allow the Subcommittee an opportunity to more fully analyze the costs and benefits associated with this prior Congressional action. Specifically, I request that the Commission provide answers to the following questions:

1. How many merchant transmission projects, encompassing how many total miles of transmission lines, has FERC approved since PUHCA's repeal in 2005? What is the percentage of total transmission investment resulting from these merchant lines?

2. Could these transmission lines have been built even without PUHCA's repeal? Are there other quantifiable benefits in terms of increased transmission investments that have been demonstrated from the restrictions on the PUHCA 1935 being eliminated?

3. How many utility mergers have taken place as a result of PUHCA's repeal that would not have been permissible had PUHCA remained in place?

4. What changes in utility market share has resulted from these approved mergers?

5. Please respond to the following questions regarding the concerns raised by the GAO report cited above:

   a.) Why has the FERC failed to beef up its oversight of utility mergers and acquisitions following PUHCA's repeal?

   b.) Why has FERC chosen to rely largely on utility self-reporting of post-merger cross-subsidization rather than step up its oversight or auditing activities to ensure that such cross-subsidization does not occur?

   c.) Why has FERC chosen not to undertake a risk assessment for companies it regulates in order to better focus its audit and oversight activities on those companies whose consumers might be most at risk of being harmed as a result of cross-subsidies or other anti-competitive actions by the utility?

   d.) In the absence of strong protections against cross-subsidization, how can the Subcommittee be assured that the higher "incentive" rates the Commission has been approving for utility investments in transmission actually go for that purpose, rather than subsidizing other utility expenses or even being diverted to non-utility affiliates of a utility holding company?

6. On the day that the Energy Policy Act of 2005 was signed into law, Representative Dingell and I wrote to then-Chairman Kelliher and other federal agencies regarding needed compensatory measures to be undertaken following PUHCA's repeal in order to spare utility consumers and investors from a repetition of the types of abuses that led to PUHCA's enactment in the first place. In that letter, we requested, among other things, that "FERC use its existing legal authority under the Federal Power Act, which section 1267(a) of EPACT expressly preserves, to adopt such general rules" as the Commission determines necessary to protect against mergers that result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company."[4] To my knowledge, the Commission never did so. Would the Commission now be willing to consider taking such action? If not, how can the Subcommittee be assured that utility consumers are not having their rates raised to pay for transmission assets that are not being used for their designated purpose, but are

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[4] See letter from Representatives Dingell and Markey to GAO, FERC, SEC, and FTC, August 8, 2005, at http://markey.house.gov/docs/energy_environment/iss_energy_ltr050808.pdf

instead being used to cross-subsidize some other activity or are being used to overpay a non-utility affiliate for products or services relating to such transmission construction?

7. In 2001, MidAmerican CEO David Sokol argued that PUHCA prevented companies like MidAmerican from investing in building new electricity infrastructure in California and the West that might have averted the electricity crisis that afflicted that region at the time.[5] Mr. Sokol also testified before the House Energy and Commerce Committee that "MidAmerican's largest investor, Warren Buffett, has publicly announced his intention to invest as much as $15 billion in the industry once PUHCA is repealed....[but] PUHCA's barriers to entry prevent him from making these investments, particularly in transmission and distribution assets."[6]

a. How many miles of transmission has MidAmerican built in California and the West since PUHCA's repeal?
b. How much additional transmission has it built in regions outside of its pre-PUHCA-repeal service territory?
c. Has Mr. Buffet actually invested the $15 billion in transmission and distribution assets that Mr. Sokol predicted would occur?

8. I am also concerned that the repeal of PUHCA has also freed large multi-state public utility companies to diversify into other potentially risky businesses, to the potential detriment of utility investors and consumers. For example, MidAmerican Holdings has acquired the second largest real estate brokerage company in the country, HomeServices. According to the companies' 2008 annual report, "Net income was unfavorably impacted by lower earnings at HomeServices due to the continuing weak United States housing market..."[7] MidAmerican's annual report goes on to indicate that HomeServices':

> "Operating revenue decreased $367 million for 2008 compared to 2007. Brokerage transactions declined by 20% and the average home sales price declined by 8% reflecting the continuing weak United States housing market. HomeServices had an operating loss of $58 million in 2008, a $91 million decrease compared to 2007 due to the lower revenue and $39 million of expenses

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[5] See Prepared Testimony of Mr. David L. Sokol, Chairman and CEO, MidAmerican Energy Holdings Company, Subcommittee on Securities and Investment, Senate Banking Committee, March 29, 2001.

[6] See Prepared Testimony of Mr. David L. Sokol, Chairman and CEO, MidAmerican Energy Holdings on "Developments Relating to Enron Corp" Before the Full Committee on Energy and Commerce, February 6, 2002.

[7] See page 55 of MidAmerican Holdings 2008 Annual Report, http://www.sec.gov/Archives/edgar/data/1081316/000108131609000010/mehc10k_123108.htm#item1a_risk_factors

> taken in 2008 related to office closures, partially offset by lower commissions and operating expenses.'[8]

While these losses may not currently threaten the financial or operating condition of MidAmerican Holdings, they do underscore the risks inherent in utility holding company diversifications, including the risk that utility ratepayers might be exposed to losses resulting from non-utility business ventures. What protections have been put in place to prevent utility shareholders, such as those of MidAmerican Holdings' regulated utilities, to prevent them from rate increases, higher costs for borrowing, or other risks which might be associated with unsuccessful or failed diversifications?

Thank you for your assistance and cooperation in responding to this request. In order to better inform the Subcommittee's deliberation on this matter, I request that a response be provided no later than the close of business on Thursday, June 11, 2009. Should you have any questions, please contact Joel Beauvais of the Subcommittee staff at 202-225-4407.

Sincerely,

Edward J. Markey

Edward J. Markey
Chair
Subcommittee on Energy and Environment

cc: Mr. Fred Upton, Ranking Member

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[8] See *Page 59* of MidAmerican Holdings 2008 Annual Report, http://www.sec.gov/Archives/edgar/data/1081316/000108131609000010/mehc10k_123108.htm#item1a_risk_factors