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Public Utility Holding Company Act: Major Statutory Provisions and Possible Reform Efforts

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Summary

The Public Utility Holding Company Act of 1935 regulates holding companies which have subsidiaries that are electric utility companies or that are engaged in the retail distribution of natural gas or manufactured gas. Under PUHCA all holding companies which have subsidiaries that are engaged in the electric utility business or in the retail distribution of natural or manufactured gas must register with the Securities and Exchange Commission if they engage in interstate commerce. Several kinds of holding companies are exempt under the Act from the registration and regulation requirements. Holding companies required to register with the Securities and Exchange Commission must disclose information concerning the company's operations and a description of its management structure. The Act also places substantive requirements upon the operations of a covered holding company. Holding companies not exempt from PUHCA coverage have two other requirements–geographical integration and corporate simplification.

For a number of years efforts have occurred to reform PUHCA because of the belief of critics that it has accomplished its goal and that it is no longer warranted. Others maintain that PUHCA still serves a necessary purpose and that to repeal or significantly amend it could lead to abuses in the utility industry which the Act currently prevents. Several bills have been introduced in the 107th Congress to repeal or amend PUHCA. These bills include H.R. 1101, H.R. 2814, H.R. 3406, S. 206, S. 388, S. 389, and S. 1766.

Background

The Public Utility Holding Company Act of 1935[1] (PUHCA or the Act) regulates holding companies which have subsidiaries that are electric utility companies or that are

[1] 15 U.S.C. §§ 79 *et seq.*

engaged in the retail distribution of natural gas or manufactured gas. The Act defines a holding company as:

> (A) any company which directly owns, controls, or holds with power to vote, 10 per centum or more of the outstanding voting securities of a public-utility company or of a company which is a holding company by virtue of this clause or clause (B) of this paragraph, unless the Commission, as hereinafter provided, by order declares such company not to be a holding company; and
>
> (B) any person which the Commission determines, after notice and opportunity for hearing, directly or indirectly to exercise (either alone or pursuant to an arrangement or understanding with one or more other persons) such a controlling influence over the management or policies of any public-utility or holding company as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that such person be subject to the obligations, duties, and liabilities imposed in this chapter upon holding companies.[2]

Passage of PUHCA was premised upon such findings as appear in section 1b of the Act. These findings include concerns of inadequate information provided to investors to appraise the financial position or earning power of the company, issuance of securities without approval of the states having jurisdiction over the subsidiary public utility companies, issuance of securities based upon false information, and the overcapitalization of operating subsidiaries.[3]

Because the Securities Act of 1933[4] and the Securities Exchange Act of 1934[5] were enacted to apply generally to the securities markets, Congress believed that PUHCA was necessary to address the special problems in the area of public utilities. Thus, PUHCA was enacted "to meet the problems and eliminate the evils ... connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce...."[6] According to one commentator, "[t]he fundamental purpose of the Act was to free utility operating companies from the absentee control of holding companies, thus allowing them to be more effectively regulated by the states."[7]

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[2] 15 U.S.C. § 79b(a)(7).

[3] 15 U.S.C. § 79a(b).

[4] 15 U.S.C. §§ 77a *et seq*.

[5] 15 U.S.C. §§ 78a *et seq*.

[6] 15 U.S.C. § 79a(c).

[7] Hazen, THE LAW OF SECURITIES REGULATION § 15.1 (2d ed. 1990).

Major Provisions of PUHCA

Under PUHCA all holding companies which have subsidiaries that are engaged in the electric utility business or in the retail distribution of natural or manufactured gas must register with the Securities and Exchange Commission if they engage in interstate commerce.[8] Several kinds of holding companies are exempt under the Act from the registration and regulation requirements. These exemptions include: (1) a holding company which derives a material part of its income, is predominantly intrastate, and carries on its business substantially in the state in which it and all of its subsidiaries are organized; (2) a holding company which is predominantly a public utility company and whose operations do not extend beyond the state in which it is organized and states contiguous to it; (3) a holding company which is only incidentally a holding company; (4) the holding company is only temporarily a holding company because of acquiring securities for liquidation or distribution; and (5) the holding company does not derive a material part of its income from a subsidiary whose principal business is that of a public utility company.[9]

Holding companies required to register with the Securities and Exchange Commission must disclose information concerning the company's operations and a description of its management structure. Among the items required by the registration statement are the charter or articles of incorporation, bylaws, rights of the different classes of securities, underwriting arrangements under which the securities have been offered, directors and officers, material contracts, balance sheets, and profit and loss statements.[10]

However, PUHCA goes beyond the disclosure-type requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934. The Act also places substantive requirements upon the operations of a covered holding company. Holding companies not exempt from PUHCA coverage have two other requirements–geographical integration and corporate simplification.[11]

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[8] 15 U.S.C. § 79d.

[9] 15 U.S.C. § 79c(a). Apparently, receiving a PUHCA exemption is not unusual. For example, in late 1993 Enron applied to the SEC for a type of exemption. Enron requested on December 28, 1993, that the SEC concur in its opinion that Enron Power Marketing, Inc., would not be an "electric utility company" as defined in 15 U.S.C. section 79b(a)(3) by virtue of entering into described contracts and described transactions because, Enron argued, the activities did not constitute the ownership or operation of "facilities used for the generation, transmission, or distribution of electric energy for sale.." On January 5, 1994, the SEC issued a no-action letter:

> Based on the facts and representations in your letter of December 28, 1993, we would not recommend any enforcement action to the Commission under the Public Utility Holding Company Act of 1935, including section 2(a)(3), against Enron Power Marketing, Inc., in the event that Enron Power enters into contracts for the purchase and resale of electric power and for transmission capacity in connection with power marketing transactions as described in your letter. 1194 SEC No-Act. LEXIS 42.

[10] 15 U.S.C. § 79e(b).

[11] 15 U.S.C. § 79k.

The geographical integration requirement provides that a holding company is limited to a single integrated electric or gas utility system and other businesses which are reasonably incidental or economically necessary or appropriate to the operations of the integrated public utility system. The SEC will permit a registered holding company to continue to control one or more additional public utility systems if it finds that each of the additional systems cannot be operated as an independent system without the loss of "substantial economies"; the additional systems are located in one state, in adjoining states, or in a contiguous foreign country; and the continued combination of the systems is not so large as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.[12]

Corporate simplification under PUHCA requires the elimination of corporate structures or companies which unduly or unnecessarily complicate the structure of a holding company system or which unfairly or inequitably distribute voting power among security holders of a holding company system. Further, the SEC is required to take whatever action necessary to ensure that a holding company ceases to be a holding company concerning each of its subsidiary companies which itself has a subsidiary company which is a holding company.[13]

PUHCA was not intended to eliminate all holding companies and indeed certainly has not done so. Those remaining public utility holding companies, however, must adhere to certain constraints. For example, registered holding companies must obtain SEC approval before it or its subsidiaries acquire any securities, utility assets, or any other interest in any business.[14] SEC approval is also usually required before any person owning 5 percent or more of the voting securities of a public utility or holding company acquires 5 percent or more of any other public utility.[15]

Possible PUHCA Reform

For a number of years there has been discussion to reform PUHCA because of the belief of critics that it has accomplished its goal and that, with changes in the utility industry and with other federal and state statutes, the Act is no longer warranted. Others maintain that PUHCA still serves a necessary purpose and that to repeal or significantly amend it could lead to abuses in the utility industry which the Act currently prevents.

Several bills have been introduced in the 107th Congress to repeal or amend PUHCA. These bills include HR 1101, HR 2814, HR 3406, S 206, S 388, S 389, and S 1766.

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[12] 15 U.S.C. § 79k(b)(1).

[13] 15 U.S.C. § 79k(b)(2).

[14] 15 U.S.C. § 79i(a)(1).

[15] 15 U.S.C. § 79i(a)(2).