BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1209

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In the Matter of	)
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MIDAMERICAN ENERGY HOLDINGS	)
COMPANY & PACIFICORP,	)
	)
Application for Authorization to Acquire	)
Pacific Power & Light, dba PacifiCorp	)
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COMMENTS OF THE

CITIZENS' UTILITY BOARD OF OREGON

PART I

October 14, 2005

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In the Matter of MIDAMERICAN ENERGY HOLDINGS COMPANY & PACIFICORP, Application for Authorization to Acquire Pacific Power & Light, dba PacifiCorp	COMMENTS OF THE CITIZENS' UTILITY BOARD OF OREGON

I. Introduction

The Citizens' Utility Board offers these comments on the proposed purchase of PacifiCorp by MidAmerican Energy Holdings Company (MidAmerican). Our comments are a rather informal analysis of the risks of the transaction based on MidAmerican's Application and an initial look at discovery responses.

Part I of our comments covers a number of risks and uncertainties. While the comment stage is, we believe, intended to give parties the opportunity to make observations and arguments that cannot otherwise be "proved," we believe that testimony in this case will still require the Commission to draw rational inferences from a base of factual information, because no party will be able to prove a harm from an action not yet taken. CUB will not, for example, be able to "prove" how Berkshire Hathaway will utilize its electric utility holdings after PUHCA repeal, when PUHCA repeal does not go into effect until after the record closes in this case and Berkshire Hathaway does not yet own PacifiCorp. That does not mean that the Commission should ignore the dangers of life after PUHCA or ownership by layers of corporate structure. That also does not mean the dangers are not real and factually supported.

Speaking of PUHCA repeal, CUB offers in Part II of its comments, the insight of Lynn Hargis, a nationally recognized utility consumer advocate, who focuses on what the loss of PUHCA means to this Commission generally and to this transaction specifically. Ms. Hargis surveys the history of PUHCA, identifies the lost consumer protections as a result of its repeal, and describes the issues the Commission must grapple with in a post-PUHCA world.

Finally, before we begin, we reiterate our concern that the schedule for this docket is too short to allow adequate discovery, vetting of concerns, settlement, and, should it become necessary, litigation. The issues in this case are different from those in the Texas Pacific case, but they are no less difficult to wrestle with.

II. MidAmerican's Business Plan

A. PacifiCorp As An Investment Vehicle: Build Rate Base & Profits

Just as someone wearing yellow-tinted glasses sees the world in yellow, MidAmerican's fixation on system investment, as emphasized in its Application and Direct Testimony, reveals its business plan. In identifying its strengths as a company, its past investment strategy, and even in the benefits it provides PacifiCorp customers through this transaction, MidAmerican tells us it will invest as much as it can in the system. No mention is made of the massive increase in PacifiCorp's rate base that will result from this investment, jacking up rates and increasing the profits collected by the Company.

Arguably, this may be a tactical reaction to the Texas Pacific application, where the risk of under-investment was an issue, and we certainly encourage utilities to make prudent investments in the system infrastructure. However, there must be a balance between system investment and affordable rates. The direct testimony of witnesses Abel and Gale is remarkable in that, even as it heavily emphasizes over a billion dollars in investments, there is, without exaggeration, not a single direct reference to the affordability or reasonableness of rates for PacifiCorp customers under MidAmerican ownership.

The thrust of the testimony and indeed the benefits of the transaction are that “MEHC is poised to deploy significant amounts of capital” and “MEHC is committing investment dollars” toward PacifiCorp’s infrastructure. PPL/100/Abel/3. Again, this is not bad, unless the balance between investment and affordable rates is lost, and given what we have seen so far on the record, MidAmerican has lost it.

In the 15 bulleted benefits on pages 4 to 6 of witness Abel’s testimony, ten of them deal with investments that would or could go into rate base to earn a return for MidAmerican, three deal with some cost or bill reduction, and two are neutral. On a dollar basis, the balance is even more skewed. MidAmerican’s benefits consist of over $1.3 billion in investments and $36.3 million of potential cost reductions (although even $30 million of this cost reduction, the corporate overhead costs, is based on a comparison to a ScottishPower forecast).

The $1.3 billion in investments that MidAmerican identifies does not include any of the gas or coal generation facilities that PacifiCorp assumes in its 2005 IRP. Indeed, MidAmerican tells us that this $1.3 billion is a drop in the bucket. We are repeatedly told that PacifiCorp needs $1 billion of investment every year for the next five years. At this point, as far as we can calculate, MidAmerican is piling on an additional $400 million in investment on top of the PacifiCorp budget that already anticipates rates rising annually "by over 4% for the foreseeable future." PPL/200/Johansen/7. That's a lot of rate cases and a lot of rate increases. But never mind all of that, because customers are getting a benefit here. As MidAmerican repeatedly says, it has a "long-term ability and willingness to invest in energy infrastructure." PPL/100/Abel/23. As rate base rises, with little apparent concern for the effect that that has on rates, customers will begin to realize that MidAmerican's benefits for the customers somehow feel more like benefits for shareholders.

A case in miniature is MidAmerican's benefit to include an own & operate option in its renewable RFPs. This seems to fit a pattern, a business model, if you will, that MidAmerican wants to own whenever it can because it will increase rate base and thus earnings. MidAmerican says this option "will enable comparison and evaluation of that option against other alternatives." PPL/100/Abel/16. This is an interesting argument for improvement in the RFP process, when the Commission is currently engaged in Docket UM 1182 to determine precisely how to eliminate the self-build bias in the RFP process. Apart from whether or not renewable developers have any more interest in developing turn-key proposals or whether a prudent utility should be examining this option anyway, it is not immediately clear who this proposal is intended to benefit.

Even beyond the immediate issue of investment versus rates, all that available capital for investment has another side to it. The access to capital which is the source of the benefit that MidAmerican offers in the form of investment in PacifiCorp's infrastructure is also the same access to capital that MidAmerican and/or Berkshire Hathaway may use to collect other electricity companies across the country. In the second part of CUB's comments, Lynn Hargis of Public Citizen expresses the concerns many in the industry have concerning the concentration of the energy sector in only a few owners.

B. Affordable Rates

i. PacifiCorp Forecasts Annual 4% Rate Increases For The Foreseeable Future

By adding additional investment, and bringing some capital investments forward in time, MidAmerican creates additional rate increases. Yet, their filing is virtually silent on the issue of rates. MidAmerican has not provided, and has not even done, an analysis of how its investment plan will affect rates. Without knowing the impact on rates, it is difficult to agree that investment for investment's sake is a benefit. We do know, however, that a business plan built around rate base additions and the associated return on investment will push rates higher.

Additions to rate base increase rates. This is a simple fact of the regulatory structure. Even if an investment is cost-effective over its life, and on its face a prudent investment, it pushes rates higher. This is the reason CUB has argued that the prudence of investments must be evaluated in the context of their rate impacts and the rate environment in which the investments are made. Timing investments in a manner so as to minimize rate shock should be a regulatory goal. However, in this case, MidAmerican is claiming that the additional investments they propose to make, and the investments they propose to make earlier than PacifiCorp had planned, represent clear benefits to customers, yet they readily admit in response to CUB data request 6 that they have not looked at the rate impact of these investments.

We must consider the rate effects of increasing rate base. Sometimes, it may make sense to delay a cost-effective investment that is discretionary because of the additive effect that it has on rates, and the subsequent rate shock that can wreak havoc on individuals as well as on the economy. Though this docket is not a rate case, the importance of balancing capital investment with rate increases is pertinent in understanding MidAmerican's approach to utility investment, as well as in framing MidAmerican's expectations should this acquisition be approved.

When weighing the benefits associated with a business plan based on increasing rate base, we have to consider the rate impact of that business plan. Unfortunately, MidAmerican has not provided any analysis of the rate effects of their plan. We know that PacifiCorp projected 4% annual increases for the foreseeable future. We do not know how much MidAmerican's proposed additional investment will add to this. We do not know how much moving forward some investments will add to it. We do not know whether this business plan, that MidAmerican argues is a net benefit, will create unacceptable rate shock.

ii. Lack Of Concern For Cost Reduction & Operational Efficiency

In recent years, we have seen quite a number of 511 filings: Enron, ScottishPower, Sierra Pacific, NW Natural, Texas Pacific, and MidAmerican. MidAmerican's application differs from all the past applications in that MidAmerican does not claim that its expertise, experience, and plans will improve the efficiency of PacifiCorp and lead to lower costs. With the exception of a small savings in cost of capital, which will be offset by additional capital investment, MidAmerican does not argue that it will reduce PacifiCorp's costs or even keep rates at a manageable level.

This is surprising, since MidAmerican already operates a utility, MidAmerican Energy. It would be expected that there are some things that MidAmerican Energy does better than PacifiCorp and through cross-pollination would lead to lower costs at PacifiCorp. It would be expected that there are some things that PacifiCorp does better than MidAmerican Energy and would lead to lower costs at MidAmerican Energy.

But MidAmerican's filing does not offer these kinds of savings. We must believe that their examination of PacifiCorp has not identified the potential for savings. There is nothing that they found that could be done more efficiently. ScottishPower, right or wrong, has shown an interest in efficiencies and cost-cutting. MidAmerican has not, and this may prove to be of considerable harm to customers over the long run.

iii. Lack Of A Rate Credit.

Of course, there is another answer. MidAmerican does not want to discuss improving the utility and making it more efficient, because that could be the basis for customers to ask for rate credits. If improved efficiency is part of the business plan, then customers might want these benefits guaranteed upfront in the form of a rate credit.

Such a request is not unreasonable in this case. MidAmerican's business plan is based on adding capital investment to PacifiCorp's already-considerable capital investment plan, and thereby pushing up rates and increasing profits. Offsetting some of this rate increase with a proposal from MidAmerican to find efficiencies in the operation of PacifiCorp would help counter the potential rate shock associated with MidAmerican's business plan.

Under MidAmerican's business plan, a rate credit is also important to create an incentive for identifying efficiencies. Under traditional regulation, a utility has an incentive to identify efficiencies because the savings from those efficiencies accrue to the utility between rate cases. A business plan that is based on increasing rate base, however, creates the need for frequent rate cases in order to add the capital investment to rates as soon as it becomes used and useful. This investment pattern would therefore require rate cases every year or two for the foreseeable future, which reduces the traditional incentive to find savings because those savings will only accrue to the utility very briefly. A rate credit is a way to reestablish the incentive to streamline a utility's operations, which is associated with traditional regulation. If MidAmerican provided a rate credit to guarantee its ability to create a certain level of efficiency, then MidAmerican and PacifiCorp would have an incentive to find those efficiencies.

C. What Rate Of Return Does Buffett Expect?

What are Buffett's and MidAmerican's expectations for their return on their investment in PacifiCorp? Buffett's reputation is not that of a modest investor, and Texas Pacific's application also demonstrated that more aggressive investors are becoming interested in utilities.

i. How Holding Companies Use Utilities

In our UM 1121 testimony about Texas Pacific's proposed purchase of PGE, we spoke of a new paradigm in public utility ownership. We described a shift from utility owner-operators to utility buyers and traders. In the spectrum of possible investments, public utilities have traditionally been seen as a low-risk, but moderate-return investment. Why then, one might ask, has there been a growing interest of equity firms and mega-corporations in public utilities? Since when have the likes of Texas Pacific and Warren Buffet been interested in 10% returns?

Simply put: they're not.

Texas Pacific and Warren Buffett are interested in public utilities, not because of the regulated rate of return, but because they can use public utilities within a holding-company structure to earn a far greater rate of return than that authorized by the Public Utility Commission. The two most egregious examples of this are the use of double leverage and customer tax payments.

ii. Double Leverage

Investors have learned to use holding company structures to take advantage of regulatory treatments of debt and equity at a utility. This is, in fact, not new knowledge, but is coming back into prominence as PUHCA protections have faded and, more recently, been outright repealed. The spread between authorized rates of return and debt interests rates allows a holding company to put equity into a utility, support that equity with debt somewhere else in the holding company structure, and profit from the difference between the cost of that debt and the rate of return which has been beefed up by the infusion of capital into the utility. A simplified example would be infusing $10 million of equity into a utility, and storing $10 million in debt at the holding company. The investors then receive a higher rate of return from the utility customers because of the increased level of equity at the utility, while paying a lower interest rate on the debt stored elsewhere. The difference between the utility's rate of return and the holding company's cost of debt is free money. No matter where it is located in a holding company, debt is debt.

This isn't how the system is supposed to work. At its most basic level, the regulatory compact exchanges a regulated rate of return for investment in a utility's infrastructure on behalf of customers. Double leverage is not investment in a utility's infrastructure on behalf of customers; it is an accounting chess game where customers are played as pawns. Customers should not be paying for this, and investors should not be profiting from it.

iii.   IRS Allies

We have seen how corporations such as Texas Pacific have figured out how to use the tax code to squeeze additional profits from their captive utility customers. In the past, the rates customers paid included the taxes the utility would pay if it were a stand-alone entity. Stand-alone utilities seem to be increasingly less-common, and there is a good reason for this shift. Holding companies can keep customers' tax payments for themselves, while off-setting the company's consolidated tax payments with debt interest deductions and subsidiary losses.

Oregonians and the Legislature have spoken very clearly on this matter, and we are all in the process of putting an end to this tax game. The battle is far from over, however, and it is important to account for these tax shenanigans in evaluating Buffett-Berkshire-MidAmerican's proposed acquisition. While a holding company may claim that its presence should make no difference to customers, as they would pay the same amount in taxes if the utility were actually a stand-alone, it in fact makes an enormous difference.

Residential customers pay taxes, as do commercial and industrial customers. Those taxes go to support the government, society's infrastructure, schools, etc. When holding companies are enriched by customer overpayment of taxes, not only are they earning more than their regulated rate of return, but the services supported by taxes lose funding and/or customers must pay additional taxes to support those services. Tax payments from customers should be used for the benefit of the community, not the personal enrichment of individuals.

iv. Expectations For Return On Equity

It is not clear how much MidAmerican's business plan of increasing rate base will cost customers because such an analysis has not been presented. It is also not clear what return on that rate base is expected by MidAmerican.

In Iowa, MidAmerican Energy's rate of return in recent years far exceeds the authorized rate of return in Oregon, and the Alternative Form of Regulation adopted there ensures that the Iowa ROE for MidAmerican Energy will likely remain above levels that would typically be approved in Oregon. The Iowa AFOR requires a good faith attempt at adjustment within 30 days if the annual ROE falls below 10%, or allows the utility to file for a general rate case. On the other end of the scale, if the earnings are above 11.75% a share of the over-earning is used to reduce the rate base of the utility, but there is no cap above which a general rate case would be triggered to reduce rates. In addition, the utility won agreement that established the ratemaking principles in advance for its $335 investment in new wind generation and associated transmission. Under that agreement the utility is guaranteed recovery "without the need to establish prudence or reasonableness," with an ROE of 12.2%. MidAmerican has suggested that its management believes there is a relationship between a utility's return on equity and the level of risk a utility accepts, but it is not clear what the level of risk is of a wind facility with pre-approval and guaranteed recovery.

This is an important issue. MidAmerican has not stated whether it thinks the ROE established by stipulation among all parties in the recent UE 170 rate case is reasonable. It is certainly below what MidAmerican is accustomed to in its home state. The capital investments proposed by PacifiCorp put significant upward pressure on rates, including increasing the total amount that customers are charged for return on rate base. If MidAmerican also plans to raise the rate of the ROE, then the risk of significant rate shock to customers will likely become a reality.

v. The Value Of A Utility As A Stand-Alone vs. Its Value To A Holding Company

We can think of no reason that it would be in customers' interest to regulate utilities such that they are more valuable to a holding company than they would be to investors of a stand-alone utility. Between profit from double leverage and profit from customer tax overpayment, it stands to reason that utilities are, indeed, more valuable to holding companies than they are on their own. Texas Pacific's, Buffett's, and MidAmerican's interest in our utilities would seem to support this conclusion.

In the next section, we explore the risks, difficulties, and complications that accompany a public utility when it becomes subsumed in a larger holding company. These problems are not insignificant, and to encourage the promulgation of these larger holding companies through additional profits for holding company investors is irrational. In fact, it stands to reason that customers should be compensated for bearing the risks and complications associated with regulating a utility within a mega-corporation.

III. Risks Of PacifiCorp Joining Berkshire & MidAmerican

A. Buffett's Energy Empire

In the second part of CUB's comments, Lynn Hargis will describe the protections provided by PUHCA which kept utility holding companies from growing unchecked and swallowing utilities and captive customers in their drive for expansion. With the repeal of PUHCA, holding companies are now free to do just that. We emphasize, below, a few concerns we have about what it might mean to be part of a post-PUHCA conglomerate.

i. Do We Want PacifiCorp To Be No. 2 In Buffett's Expanding Energy Empire?

It has been reported in the media that Berkshire has $40 billion to spend in the electric industry. PacifiCorp is the current acquisition target, but it certainly is not the last. We need to consider what the implications are for customers as part of a much larger holding company. Oregon may have a say in whether PacifiCorp is to be the second utility acquired by Berkshire Hathaway, but we won't have a say in the third, fourth, or eleventh acquisitions. Buffett and MidAmerican did not dedicate their resources to repealing PUHCA simply to acquire PacifiCorp. Indeed, Buffett has publicly declared his intent to grow his energy empire; what we don't know is how much he intends to expand it.

ii. Market Power

Market power is a concern of any economic concentration. When a market participant has market power, it is able to use that power to artificially increase prices, decrease competition, or both. The reason we regulate the retail prices of electric utilities is that on the retail level, as a monopoly, the utility has tremendous market power. However, a utility participates in more than just the retail market. Utilities buy and sell wholesale power, and own and operate transmission systems. MidAmerican also owns natural gas pipelines that provide fuel to electric operations. Finally, utilities buy equipment that is needed in the production, transmission and distribution of electricity.

If MidAmerican, at its current level or at some point in the future, as it acquires more utilities, pipelines and related assets, begins to exercise its growing market power, then retail customers will likely bear higher costs. Exercising market power in the transmission and wholesale electric markets will decrease competition and increase prices. CUB argued in the PGE wholesale trading investigations, that because customers are highly dependent on the market for energy, and because markets only reach the optimal prices if they are competitive and transparent, that utility employees have a responsibility to monitor those markets and ensure that they function properly. While PacifiCorp purchases less base load energy on the market than PGE, PacifiCorp customers are no less dependent on the market for daily and hourly trading to balance systems. It is in the economic interest of PacifiCorp customers to ensure that energy related markets for power, transmission and equipment are robust, competitive and transparent. Because Oregon does not have a say on that eleventh utility joining MidAmerican, we have to determine whether the potential for market power abuses in this expanding empire are threats, and whether they can be mitigated with conditions.

iii. Political, Policy, & Regulatory Power

The political and regulatory muscle wielded by Buffett, Berkshire, MidAmerican, and the extensive Berkshire family is considerable, and cannot be expected to decrease as the corporate Goliath grows. We should remember the lessons learned from the conglomeration of the cable television industry.

In the early days of cable, there were a great many small local and regional cable companies. The business model of cable was to ask communities to grant the cable company a monopoly local franchise to provide cable services utilizing the local government's public rights-of-way. In exchange for the monopoly, local license, the cable companies agree to allow for local rate regulation by the local community. After getting most communities around the country to join in this licensing, we saw a wave of cable television mergers in the 1980s and 1990s.

Today there are less than a handful of large national cable companies, with a scattering of a few remaining local, small companies. As the cable companies grew into national powerhouses, they turned on the local communities, and began an expensive lobbying campaign that successfully got the federal government to take away the rate-setting rights of local government. It was a raw exercise of political power, financed by obscene amounts of campaign contributions. Local governments could not match that political power.

MidAmerican and Berkshire Hathaway are not strangers to the use of political power. They did not like the SEC exercising their authority derived from PUHCA, so they were heavily involved in the push to repeal PUHCA. According to the Center For Responsive Politics, MidAmerican is a significant contributor to federal election campaigns. They lobbied for state preemption on a variety of issues such as transmission siting and pipeline siting. They opposed the McCain-Lieberman global warming bill, even though it was a modest beginning to carbon regulation. MidAmerican's willingness to use legislation to preempt regulation is extremely troubling, and the fact that it has the political muscle to be successful in the legislative arena has dangerous implications for PacifiCorp ratepayers.

iv. The Geographic And Practical Limits Of Regulation

The complications of regulating multi-state PacifiCorp, as opposed to Oregon-only PGE, provides a microcosm of the complications of regulating an enormous, diversified, and complex holding company. Clearly, from the perspective of affiliate relationships, tax relationships, and debt relationships, the Commission cannot simply pretend the utility exists in a vacuum. That being said, when potentially useful information – that the parties may or may not even know exists – is buried at various companies' headquarters in various states, and the trail of interconnections is as tortuous as a labyrinth, the Commission's and intervenors' resources can quickly be stretched to their limits. As Buffett's energy empire grows, our knowledge of its intricacies can only decrease, and our ability to understand how the empire is shaping our utility and our ability to protect our utility will be increasingly constricted.

B. The Buffett Persona

MidAmerican is not just another utility holding company. MidAmerican is a privately held company, owned by Berkshire Hathaway, which is itself controlled by Warren Buffett. However, it isn't just control that is a concern; we have never seen a utility parent company that is so tied to a single individual. While it is difficult for us to know how much of the Warren Buffet mystique is real, we do know that few utilities are part of a holding company that is so dependent on a single individual.

Warren Buffett's desire to add utilities to his empire gave rise to his drive to repeal PUHCA, MidAmerican's efforts to lobby for PUCHA repeal, and their combined proposal to purchase PacifiCorp. The proposed acquisition is being financed by Berkshire Hathaway, which we assume means that Warren Buffett himself is an advocate of the deal. To help promote MidAmerican's purchase of PacifiCorp, Warren Buffett spoke at the Western Conference of Public Service Commissioners' annual meeting in Boise in June. While the application in this docket proposes MidAmerican as the purchaser of PacifiCorp, everyone knows that, behind the curtain, it is really Warren Buffett who is buying our utility.

Books have been written about Warren Buffett and his investment theories and practices. Clearly, we should be familiar with those theories and practices before turning PacifiCorp over to him. However we are also concerned with the uncertainty of what happens after Warren Buffett no longer controls his energy empire. We regulate utilities for the long-term, and the end of Buffett's reign at Berkshire Hathaway lies in the not-too-distant future. The PUC agreed with CUB that Texas Pacific's short-term ownership created risks for the utility, and was a concern in a utility-acquisition proceeding. The dependency of Berkshire Hathaway and MidAmerican on a single individual is also of considerable concern to PacifiCorp's customers.

What will happen to PacifiCorp in the post-Buffett world of Berkshire Hathaway? Who will then control Berkshire Hathaway? What will be their views of utilities as investments? What kind of influence will they wield over PacifiCorp? How will they exercise their political and economic power? What risks will they take, and what might be the consequence of these risks for PacifiCorp? MidAmerican's and Berkshire's dependence on the influence of one person, requires a serious examination of what may happen in the absence of that individual. Unfortunately, MidAmerican's application is as silent on this issue, as it is on the rate impacts of its business plan.

C. Access To Information

As PacifiCorp becomes part of a bigger enterprise such as Berkshire Hathaway, it is critical that access to information be protected. Oregon parties and this Commission will be required to review the prudence of decisions affecting PacifiCorp. Such decisions must be well-recorded, transparent, and accessible to all parties. Without a clear history of the rationale and thought-process behind decisions, there is no way for the Commission to evaluate the prudence of Berkshire's, MidAmerican's, or PacifiCorp's actions or investments.

Unfortunately, this transaction creates enormous uncertainty not only about decision-making, but also the ability to trace the history of decisions. What decisions will be influenced or made in Portland? What decisions will be influenced or made in Salt Lake City or Des Moines or Omaha? How will the recommendations, suggestions, guidance, and influence, as well as the decision, be recorded? The comments of Lynn Hargis, which follow, starkly describe PUHCA's lost protections for information documentation, retention, and accessibility, and why those protections were originally implemented.

It is being suggested that most decision-making will remain at PacifiCorp, but we know there are real limits to this. Corporate parents are like real parents. Parents may let their daughter decide what clothes she is going to wear, but they don't let her wear shorts and sandals in a snowstorm. There are limits to what is delegated. In addition, to the degree that PacifiCorp investments are made using Berkshire Hathaway's capital, it must be assumed that Berkshire has some control over those investment decisions.

In its response to CUB data request 2, MidAmerican only offered to provide access to records related to affiliate transactions. While it is critical to ensure that affiliate transactions do not overcharge customers, it is not nearly enough. Access to information concerning all decisions that affect the utility must be guaranteed.

D. Regulating Affiliates

The Berkshire Hathaway corporate family is quite extensive, and should PacifiCorp join it, PacifiCorp will have affiliates in an array of businesses all over the country. As Berkshire makes more investments, especially in the energy sector, the indirect and direct interactions between PacifiCorp and its affiliates will grow.

While affiliates' transactions are monitored through a master services agreement and affiliate reports, there will always be the potential for affiliate abuses. It is hard to imagine that there isn't a cozy relationship between all of Berkshire Hathaway's subsidiaries. Representatives of both Kern River and MidAmerican Energy have put a great deal of effort into this proposed acquisition, and have made a number of visits to Oregon to promote this deal. What difference does MidAmerican's purchase of PacifiCorp make to Kern River or MidAmerican Energy? Yet they are members of the MidAmerican corporate family, and as such are expected to help. Will PacifiCorp be expected to promote Buffett's next energy acquisition?

IV. PacifiCorp In A Post-PUHCA World

The comments of Lynn Hargis, in Part II, list and describe the utility and customer protections that were provided by the Public Utility Holding Company Act of

1935 (PUHCA), and that are now lost with the President's signing of the Energy Policy Act of 2005 (2005 EPAct). These protections were considerable, and, like a snail out of its shell, utility customers are now exposed to massive holding companies seeking to increase profit by any means. We had hoped to ask the Commission to open a docket specifically to look at the repeal of PUHCA, and to define what the Commission's role would be in replacing the protections of PUHCA at the state level, but this proposed acquisition came first.

This docket, therefore, must stand as the first attempt at rebuilding the consumer protections lost by the repeal of PUHCA, and evaluating what it means for another company to acquire an Oregon utility now that PUHCA, after safeguarding utilities for seventy years, is gone. This is an enormously important issue to us, as we strive to protect utility customers and keep Oregon's utilities focused on serving Oregon customers in a post-PUHCA world. This issue is also of national interest. MidAmerican's proposal is the first major acquisition to be evaluated after PUHCA's repeal. The nation is watching to see how this proposed acquisition is evaluated, what risks and concerns take the spotlight, and what protections are provided for PacifiCorp customers.

V. Losing Local Control, Local Influence, Local Anything

This application presents two types of loss of local control and input: loss eastward toward Salt Lake City, Des Moines, and Omaha, and loss upward to increasingly larger and more distant corporate layers.

The promise MidAmerican made to Utah to move PacifiCorp executives eastward may or may not result in a significant loss of jobs in Portland. However, it could signify a shift of decision-making and company vision to Utah. As we see it, the west and east sides of PacifiCorp territory are increasingly divided on issues of resource choice, environmental concern, and using market options. We are concerned that PacifiCorp's policy development will naturally drift eastward under the MidAmerican umbrella until it merges with the MidAmerican Energy decision-making process, and the policies become indistinguishable.

Just as troubling is the loss of local concern by a detached and disinterested corporate behemoth. PacifiCorp may well become one utility in a national stable. It is so much easier to develop utility policy once and apply it to all your utility holdings, than to develop a different policy for each. One need only look at the telecom industry to find an example of an industry tired of local affairs, local concerns, and individual state regulation, so much so that it convinced Congress and federal regulators to ignore local concerns and set uniform national policy in order to preempt state regulation.

These risks are real and possible, if not probable, but it will be difficult to demonstrate them in testimony, because PUHCA repeal is so fresh and we therefore have no recent examples draw from. Establishing conditions to ensure that local concerns and local input are not a thing of the past will be difficult. Without those assurances, however, this transaction is a problem for Oregon.

VI. Why Aren't Buffett & Berkshire Applicants?

We are not clear why Berkshire Hathaway and Warren Buffett are not applicants in this case. Berkshire Hathaway owns 83.75% of MidAmerican. Warren Buffett owns 30% of Berkshire Hathaway. The Oregon Revised Statutes state:

> (1) No person, directly or indirectly, shall acquire the power to exercise any substantial influence over the policies and actions of a public utility which provides heat, light or power without first securing from the Public Utility Commission, upon application, an order authorizing such acquisition if such person is, or by such acquisition would become, an affiliated interest with such public utility as defined in ORS 757.015 (1), (2) or (3).

ORS 757.511(1).

> As used in ORS 757.105 (1) and in ORS 757.495, "affiliated interest" with a public utility means:
>
> (1) Every corporation and person owning or holding directly or indirectly five percent or more of the voting securities of such public utility.
>
> (2) Every corporation and person in any chain of successive ownership of five percent or more of voting securities of such public utility.
>
> (3) Every corporation five percent or more of whose voting securities are owned by any person or corporation owning five percent or more of the voting securities of such public utility or by any person or corporation in any chain of successive ownership of five percent or more of voting securities of such public utility.

ORS 757.015 (1 to 3).

These comments are not testimony, much less a legal brief, so we will not make a full scale argument why Berkshire Hathaway and Warren Buffett should both be applicants. But this issue is salient for this and future ORS 757.511 applications. We think that the percentage ownership in the "chain of successive ownership" dictates that Berkshire Hathaway and Warren Buffet should be applicants.

Beyond the statutory and legal arguments are the policy arguments that underlie the statute. If Berkshire Hathaway and Warren Buffett do have substantial influence over PacifiCorp "directly or indirectly", as ORS 757.511(1) says, then they should be part of this investigation. Furthermore, if they are not applicants, then the relationship between the Commission and the non-applicants is more tenuous, and it is more difficult to negotiate conditions with the non-applicants, much less require certain conditions of the non-applicants. For example, if it is useful or necessary to require access to Berkshire Hathaway documents that relate to PacifiCorp, it is "helpful" to actually be able to apply that condition if Berkshire comes under the Commission's jurisdiction.

It seems clear to us, that by choosing not to be applicants, Berkshire Hathaway and Warren Buffett are signaling that they do not recognize that the Commission's authority reaches up to them. In the order in the Texas Pacific case, the Commission asserts that it has the authority to "obtain information from TPG regarding its control of PGE." Order No. 05-114, page 29, March 10, 2005. While this is reassuring, it should be noted that none of the parties to that case assumed the Commission had that power and it is not clear how high up the corporate structure that authority applies. Furthermore, as Ms. Hargis points out in her comments, access to information is worthless if there is no information to access. To make the Commission's access to information meaningful, it must be allowed to determine the types of information that must be preserved at corporate layers above PacifiCorp. Since Berkshire Hathaway and Warren Buffett are not applicants, we cannot negotiate such a condition with them. Equally important, however, their absence from this application may indicate a fight if the Commission asserts it has this or some other authority, as it did in UM 1121.

We do not think this is a theoretical situation. "Upon conversion [of the zero coupon convertible preferred stock of MidAmerican] Berkshire Hathaway would have the rights of a common stockholder and the ability to elect nine of the ten members of MidAmerican's board of directors … On or shortly after the effective date of repeal of PUHCA, Berkshire Hathaway will exercise its conversion rights. This will create a technical change in control of MEHC." PPL/400/Goodman/20, revised. With or without the conversion, but especially with, Berkshire Hathaway's control of MidAmerican and Warren Buffett's control of Berkshire Hathaway mean that the man and his company will or could have a huge influence over PacifiCorp. We think the statute anticipated that this influence should be examined by and, if necessary, regulated by the Commission. We can interpret the absence of Berkshire Hathaway and Warren Buffett from the application to mean they do not agree with the statute.

VII. Buffett, Berkshire & MidAmerican Environmental Vision

In press releases announcing its intent to buy PacifiCorp, company representatives stated "MidAmerican will be the last owner of PacifiCorp." Well, whoever owns PacifiCorp in the 21st Century should run PacifiCorp like a 21st Century utility, not like a 19th Century utility. Coal is the primary resource in PacifiCorp's generation portfolio. PacifiCorp's history of coal investment has served customers well with regard to rates – until now. However, the risks of global warming and of future carbon regulation require an attitude shift for the future. As we said in our LC 39 comments:

> We believe that global climate change may well become the dominant policy and cost driver in the energy industry in the decades to come. A coal-heavy utility like PacifiCorp may reasonably be targeted by governmental and societal responses to atmospheric carbon loading. Such a situation would prove exceedingly costly to both PacifiCorp shareholders and customers. Failing to look ahead and plan for such an eventuality is imprudent in the extreme. While we would like to see PacifiCorp avoid carbon-intensive coal generation for the sake of the planet, we also want to avoid exacerbating PacifiCorp's already significant carbon exposure for the sake of our pocketbooks.

CUB's Opening Comments, LC 39, p. 3, May 23, 2005.

MidAmerican's testimony on global warming and its policy position on the subject amounts to one paragraph in the filing. MidAmerican's position is that

PacifiCorp has recognized carbon risk in its planning process. The remainder of the environmental discussion has to do with the benefit to customers of MidAmerican's proposed $812 million investment in emissions control equipment on coal plants that may or may not be a benefit because it is likely that PacifiCorp would have to make those investments to continue running their coal plants anyway, and that cost would be recoverable with interest from customers.

MidAmerican's effective silence on the connection between global warming and PacifiCorp's future is disturbing. It is decidedly not a benefit to have an owner of a coal-heavy utility that doesn't have a position on how global warming affects operations and future investment. As the would-be owner of two utilities, each of whose portfolio make-up is mostly coal, MidAmerican may well have an incentive to fiddle as the world burns. Indeed, in correspondence from MidAmerican to individual U.S. Senators, MidAmerican takes a position that the McCain-Lieberman bill to address climate change is not appropriate, and instead supports a long-term policy that applies to all countries on a measurable, proportional basis, *i.e.*, we support something that ain't gonna happen any time soon, and, until then, we'll keep doing what we're doing. We will explore this issue further in testimony.

Furthermore, a natural consequence of the MidAmerican investment-heavy business plan that we explored earlier is a preference for coal generation. A coal plant is an expensive resource and, compared to a gas plant, most of that expense is in capital rate base, not in fuel. So both past investment in coal and future earnings potential from coal can interfere with an objective analysis of coal versus other cleaner resource alternatives that do not carry this massive emission-related risk. Customers have shown a willingness to support more expensive investments where these investments make the utility's resource portfolio more diverse, cleaner, and less risky.

MidAmerican's singular lack of leadership and direction on global warming moves us backward in comparison to PacifiCorp's current owner. The home country of ScottishPower is subject to the Kyoto Accord, and ScottishPower has prided itself on a mature consideration of global warming. On this very significant issue, one that we truly think will dominate electric industry policy from now on, MidAmerican's ownership of PacifiCorp is a net harm.

Respectfully Submitted,
October 14, 2005,

Jason Eisdorfer #92292
Attorney for the Citizens' Utility Board of Oregon

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1209

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In the Matter of	)
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MIDAMERICAN ENERGY HOLDINGS	)
COMPANY & PACIFICORP,	)
	)
Application for Authorization to Acquire	)
Pacific Power & Light, dba PacifiCorp	)
	)

COMMENTS OF LYNN HARGIS

ON BEHALF OF THE

CITIZENS' UTILITY BOARD OF OREGON

PART II

October 14, 2005

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1209

In the Matter of MIDAMERICAN ENERGY HOLDINGS COMPANY & PACIFICORP, Application for Authorization to Acquire Pacific Power & Light, dba PacifiCorp	COMMENTS OF LYNN HARGIS ON BEHALF OF THE CITIZENS' UTILITY BOARD OF OREGON

Pursuant to the August 31, 2005, Order of the Oregon Public Utility Commission (PUC), the Citizens' Utility Board (CUB) files these comments by Lynn N. Hargis,[1] regarding the application of MidAmerican Energy Holdings Company (MidAmerican) to acquire and merge with Pacific Power & Light, dba PacifiCorp (PacifiCorp). Recent changes in federal law, particularly the repeal of the seventy-year-old Public Utility Holding Company Act of 1935 (PUHCA)[2] have enhanced both the potential dangers of such a merger for Oregon ratepayers and the importance of the role to be played by the Oregon PUC in ensuring that such a merger not be approved unless it would benefit the public interest and the utility ratepayers of Oregon. These recent changes in federal law, including the loss of substantial consumer protections through the repeal of PUHCA, as well as certain decreases and increases in the authority of the Federal Energy Regulatory Commission (FERC) over utility mergers, are discussed below. This part of my

[1] Ms. Hargis' resume is attached as Attachment 1.
[2] 15 U.S.C. §§ 79a et seq. (2000)

comments is followed by a discussion of the essential concerns that I believe the Oregon PUC should explore and the potential conditions that must be required by the PUC if the merger is to be approved.

I. LOST CONSUMER PROTECTIONS: THE REPEAL OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

On August 8, 2005, President George W. Bush signed the Energy Policy Act of 2005 (EPAct 2005)[3] into law. One of its provisions repeals PUHCA as of February 8, 2006. This vital and successful consumer protection law prevented non-utilities from owning U.S. electric utilities and natural gas distribution utilities for seventy years, as well as limiting the size and geographic scope of the owners of utilities, limiting their corporate complexity, and restricting the types of financial transactions they could enter into with their utility affiliates. To understand what has been lost in terms of utility consumer protections, it is helpful to briefly review the history that led to the passage of PUHCA, precipitated "the most bitter legislative battle of [President Franklin D.] Roosevelt's first term,"[4] and resulted in what one historian has called **"**the most effective antitrust program in U.S. History."[5]

A. BACKGROUND: Why State Utility Rates Caused PUHCA To Be Passed In 1935

According to the same historian, the New Deal's "greatest showdown between Washington and Wall Street did not concern the Securities Act of 1933 or the Securities Exchange Act of 1934, but, rather, the Public Utility Holding Company Act of 1935."[6]

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[3] Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005),
[4] Parrish, *Securities Regulation and the New Deal*, Yale University Press 1970, at p. 145.
[5] Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance*, Northeastern University Press Boston, Revised Edition, 1995, p. 247.
[6] Seligman, at p. 127.

The history leading to this confrontation arose from the intense growth and concentration of ownership in the electric and gas industries between 1902 and 1927. As the SEC PUHCA staff described it in its report to the Congress in 1995 at pp. 1-2:[7]

> During this period, holding company expansion was also encouraged by investment bankers, who saw opportunities for profits and commissions from the sale of securities, and by promoters, who saw opportunities for increased fees. The holding company structure permitted these persons to concentrate control of vast utility empires in a few hands, which led to deception of investors, excessive rates for consumers, and obstruction of state utility regulation.
>
> The multistate character of the holding companies prevented effective control by state regulators. Between 1900 and 1935, the U.S. Supreme Court struck down many state efforts to undertake economic regulation on grounds of interference with contract and property interests. In addition, states were unable to regulate matters, such as the activities of multistate holding companies, that had a "direct" effect on interstate commerce. (citations omitted.)

The result was massive concentration in the ownership of public utilities. By 1932, 16 major holding company systems produced about 92 percent of the electric energy output generation by privately-owned companies, and three super-holding company systems produced 45 percent of the electric energy generated in the U.S.[8]

PUHCA was only passed, over massive industry opposition, because it enjoyed the strong personal support of President Franklin D. Roosevelt. As the Governor of New York State, FDR had had many skirmishes with utilities and their owners in trying to reduce New York's utility rates. Despite "superb appointments to the Public Service Commission" and the creation of a state Power Authority to plan state hydroelectric developments, Roosevelt was unable to substantially affect New York electric rates

[7] *The Regulation of Public-Utility Holding Companies*, Division of investment management, United States Securities and Exchange Commission, June 1995.
[8] Seligman, at p. 127.

because of the multi-state utility holding companies that owned them.[9] One historian finds that, of far greater importance than any utility regulatory reforms actually achieved in New York, was:

> Roosevelt's zest for personal education in the nuances of regulation and his success in recruiting men who were experts in public utility finance, valuation, rate-making, and the law.[10]

Once Roosevelt became President, he established a National Power Policy Committee whose first order of business was regulation of utility holding companies.

Roosevelt himself wanted to abolish holding companies for utilities. "The President's thesis," one adviser wrote, "was that you can't regulate holding companies so the only thing that can be done is to eliminate them entirely."[11]

In addition to Roosevelt's personal experience with the utility holding companies, the stock market crash of 1929 and the ensuing depression rebutted the utilities' claim that the far-flung geographic dispersion of utility holding companies and their immense size resulted in economic efficiencies. Despite only about a 15 percent drop in utility operating revenues between 1929 and 1936, 53 utility holding companies went bankrupt and 23 more defaulted on bank loans. By 1932, just three holding companies, including the infamous Insull empire, controlled 45% of the electric generation in the country. Before its collapse, the Insull empire had been the third largest utility group in the nation and produced 10 percent of the country's total electrical output.

A collapse of the stock markets in the 1930s brought down the heavily indebted Insull empire. Newspapers at the time called it "the biggest business failure in the history

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[9] Parrish, *supra*, at p. 152.
[10] *Id.*
[11] *Id., at 154.*

of the world." Insull, an early advocate of "customer ownership," took down with him 600,000 shareholders and 500,000 bondholders.

1. The FTC Report And Congressional Investigations

As a result of the massive concentration of control in the utility industry, the Federal Trade Commission (FTC) had started in 1928 what one historian says "may have been the most extensive study of an American industry ever conducted."[12] By 1935, there were 84 volumes of hearings and evidence regarding abuses by the utility holding companies, and ultimately, the FTC Report comprised 101 volumes. The reports showed how individuals like Insull and investment banks like J.P. Morgan & Co. were able to control holding company empires with minority common stock ownership through such means as stock "pyramiding," non-voting stock, voting trusts, classified boards of directors, interlocking directorates, and contractual relationships.

The Congress conducted its own utility corporation study. Far smaller in scope, it did establish that fifteen different individuals each sat on the board of directors of at least a hundred separate utility corporations. Two people each sat on over two hundred boards of directors.

The FTC report found that the utilities were financed with a large proportion of debt securities, resulting in a significant increase in the risk of business failure, since the fixed interest charges on debt securities had to be paid, regardless of earnings by the utilities, whereas the dividends to stockholders were discretionary. Excessive debt-to-equity ratios were the primary cause of the utility holding company bankruptcies during the 1929-1935 period.[13] In addition, the holding companies took utility revenues from

[12] Seligman, at p. 127-8.
[13] *Id.*, at 128.

captive ratepayers to subsidize their non-utility or foreign utility business ventures, which were typically riskier than the domestic utility business.

The FTC report also found unsound accounting techniques, and inflated asset valuations achieved by the repeated buying and selling of utility assets and writing up asset values to justify dividends.[14] The holding companies further swelled their profits by providing engineering, construction, accounting, and managerial services to operating utilities, sometimes at profits ranging from 50% to 300% of actual cost of services.[15]

The leading role played by investment bankers in encouraging and enabling the holding company abuses caused President Roosevelt to state in his letter accompanying the PUHCA legislation to Congress in early 1935 that:

"[PUHCA] is as much about regulating investment banks as public utilities."

2. The "Heart Of The Act" Or "The Death Sentence"

The "Heart of the Act" or "The Death Sentence," depending on whether you are a consumer/regulator or in the utility/investment banking industry, was section 11 of PUHCA. This section limited all "registered" utility holding companies to owning a single, integrated utility system in a single region of the country, unless certain specific requirements were met. Perhaps even more important, it requires utility holding companies to divest all businesses except those that were functionally related to the utility business. The latter provision effectively prevented oil companies, insurance companies, investment banks, construction companies, etc.—any company with non-utility businesses—from becoming a registered utility holding company under PUHCA. This provision arose from the massive conflicts of interest, between utility owners with

[14] SEC Staff Report, at p. 5.
[15] Seligman, at p. 128-9.

other businesses and the interests of utility consumers, that were uncovered in the FTC's massive report.

To avoid having to register under PUHCA, a holding company had very few options. The chief one was to be a "single-state" holding company, where both the parent and the operating utility are organized—incorporated—in a single state in which the utility business is primarily conducted. The enactors of PUHCA assumed that state regulators under state law could effectively regulate a holding company incorporated in the same state as the operating utility, whereas states could not effectively regulate multi-state holding companies. For many decades, most U.S. utilities operated in this "single-state" fashion in order to escape the comprehensive regulation and statutory limitations under PUHCA. When the Securities and Exchange Commission (SEC), that enforces PUHCA, announced in 1995 that it would offer "flexible" regulation of the statute, the number of multi-state, registered holding companies grew dramatically—from 12 to 56—since utility owners no longer feared registration under PUHCA.

The utility industry, and other industries, have tried to rescind "The Death Sentence," contained in PUHCA Section 11(b)(12), during the entire time it was in effect. When William O. Douglas, the third Chairman of the SEC, left the Commission to join the United States Supreme Court, he wrote the following report to President Roosevelt:

> First, as to the Public Utility Holding Company Act of 1935. Over the years minor amendments may be desirable in light of administrative experience. But in my opinion none is now necessary. The statute has proven to be workable and sound. Substantial progress has already been made under it. There is still some desire in the industry to alter the provisions of the "death sentence", particularly Section 11(b)(1). Any such attempt should be vigorously opposed. That section is soundly conceived. It is practical and workable. When fully executed it will provide a large degree of decentralization in the utility industry and cause a return of that industry from Wall Street to Main Street.

During the Truman administration, the completion of the restructuring of the public utility industry was the predominant concern of the SEC, according to that agency's unofficial historian.[16] After the Supreme Court upheld the constitutionality of Section 11, holding companies divested themselves of substantial assets. The SEC historian concludes that "the SEC's geographic integration and simplification of the utility holding companies historically has been the agency's single most significant achievement." [17]

He also concludes:

> The enforcement of Section 11 of the Holding Company Act was the most effective antitrust enforcement program in United States history….

3. Partial PUHCA Repeals

Although the utility industry had sought to repeal PUHCA from its inception, the first partial PUHCA repeal only occurred in 1978 as part of a national energy program to reduce foreign oil consumption by encouraging Qualifying Facilities (QFs) under the Public Utility Regulatory Policies Act of 1978 (PURPA).[18] QFs are generating plants that either use renewable resources (wind, sun, etc.) or use the same fuel sequentially, and therefore more efficiently, to both generate electricity and provide some other useful thermal output (called cogeneration).

In order to encourage the building of such power plants, FERC was authorized to exempt them from regulation under PUHCA, the Federal Power Act, and state utility, financial, and organization laws. In addition, traditional public utilities were required to buy power delivered to them by QFs at the purchasing utility's avoided cost—the cost it

[16] Seligman, at p. 247.
[17] *Id.*
[18] Pub. L. 95-617, 92 Stat. 3117, 16 U.S.C. § 2601.

would otherwise spend in generating or purchasing such power, calculated at the time that the sales agreement was entered into, at the QF's option.

The mandatory purchases by utilities, and the resulting long-term contracts necessary to finance QFs, resulted in a new view of electric generating plants as being susceptible to "project financing," *e.g.,* financing based on the revenue stream from the contract alone. Electric utilities and electric utility holding companies were limited to owning only 50% of QFs, and sought to fully own their own PUHCA-exempt power plants. In 1992, Congress passed the first Energy Policy Act which included two new exemptions from PUHCA for certain utility owners. The first, Section 33, exempted wholesale generators (EWGs) that were exclusively in the business of selling electric energy for resale. This allowed utilities and utility holding companies to own 100% of generating facilities that were exempt from PUHCA. The second new PUHCA provision, Section 32, provided an additional exemption for the owners of foreign utility companies (FUCOs), since PUHCA's reach originally covered the entire world.

Exempt wholesale generators became increasingly popular, particularly when FERC decided to allow wholesale rates to be set by the "market," *e.g.,* utilities negotiating among themselves or by auction. In a world-wide enthusiasm for deregulating electric rates, some states actually required their utilities to sell off some or all of their generating plants, and buy back power from wholesale sellers.

Enron Corp, always at the forefront of utility deregulation, obtained a "no action" letter from the SEC's PUHCA staff stating that the staff would not recommend enforcement against Enron under PUHCA if the company sold electricity through a "power marketer," a company that owned only contracts for wholesale sales of electricity. The rest of the industry promptly followed Enron, and power marketers began trading increasingly large amounts of energy and power without any regulation under PUHCA, although the FERC continued to "regulate" such contracts under its "market rate" regime.

Finally, in 2000, the infamous California deregulation experiment required all utilities to purchase power in the market, or under long-term contracts, with the price set either by reverse auction (highest bid is paid to all) or by the negotiating parties. The courts, FERC, and affected states are still trying to unravel claims and settle charges that ratepayers are owed billions of dollars in refunds for unjust rates resulting from market manipulations.

Meanwhile, an oversupply of new EWG merchant plants and other generating capacity resulted in lower electric prices, which meant in many cases that merchant power plant owners could not pay their debt costs. There were numerous fire sales and several bankruptcies, including Mirant, which had acquired the spun-off, non-PUHCA-regulated assets from the Southern Company, a major registered holding company, and NRG, which had acquired non-PUHCA-regulated assets from Excel, also a registered holding company. The credit ratings agencies lowered the credit ratings for the entire sector.

In 1996, Congress in its wisdom decided that telecommunications were a safe investment for gas and electric utilities and enacted Section 34 of PUHCA to allow registered utility holding companies to acquire Exempt Telecommunications Companies. This made it possible for utility holding companies to get in on the Telecom Boom, right before it went bust.

The most infamous utility holding company bankruptcy, of course, was Enron's. Enron had made certain that it obtained numerous exemptions from PUHCA from a compliant SEC. As noted elsewhere, the SEC ultimately decided that Enron was not entitled to its major, single-state exemption. In the Enron bankruptcy's aftermath, many utility consumer representatives called for increased regulation of utility holding companies. The Congress responded instead by repealing PUHCA in August 2005.

B. Federal Protections LOST With PUHCA Repeal

The sections below describe the provisions of PUHCA that were so effective in protecting utility consumers for seventy years, and what has been lost with PUHCA repeal. It is well to keep in mind when reviewing these provisions that PUHCA was prophylactic, designed to *prevent* holding company abuses, not allow them to occur and then try to clean up the mess after the fact. It could be compared to shoring up the levies in New Orleans at substantial cost, rather than allowing the city to be flooded, at incredible cost, to people, property, and the economy of the United States.

1. LOST: Prohibition Against Non-Utilities Owning Utilities To Prevent Conflicts Of Interest

As noted above, Section 11 of PUHCA effectively prevented non-utilities from owning or controlling public utilities by requiring multi-state utility holding companies to divest their non-utility businesses. The purpose behind this requirement was to prevent the conflicts of interest that arise when a holding company acquires utilities as a buyer for the services or products of its other businesses. It is also designed to eliminate the ability of a parent company to use regulated but steady utility revenues to invest in more "exciting"—*e.g.,* risky and therefore potentially more lucrative—ventures.

The holding company device was originally applied to public utilities in order to promote the interests of owners of other businesses who found that owning utilities promoted the interests of their other products or services. General Electric was the first, in 1905, creating Electric Bond and Share to hold the securities of other corporations. It financed the purchase of generators (that it manufactured) in return for an equity interest in operating public utilities. Ultimately, Electric Bond and Share, through intermediate holding companies, controlled operating utilities in twelve states, Mexico, Cuba, and Latin America. In addition to holding stock, the company provided the operating utilities with financial, sales, engineering, and construction services, all at substantial profits.[19]

Others hurried to follow. Stone and Webster, an engineering firm, adopted the holding company device to control its own chain of operating utilities to buy its services. Samuel Insull and others recognized the "fabulous bonanzas" to be made through the issuance of securities. Commonly, operating utilities within one system serviced both their own securities and those of the holding companies above.

> The financial chain that bound operating utilities to holding companies, including fixed management fees and extortionate interest rates, prevented the maintenance of adequate reserves, reduced depreciation charges, and curtailed improved service.[20]

A historian notes that, above the operating utility level, a holding company's financial structure was limited only "by the fecund imagination of its promoters, the resourcefulness of lawyers, and the permissiveness of state incorporation laws."[21]

PUHCA eliminated these concerns about captive ratepayers being forced to subsidize affiliate, non-utility businesses or being used as a captive market for affiliate

[19] Parrish, at p. 146-7.
[20] Parrish, at p. 147.
[21] Parrish, at p. 148.

products or services, by statutorily abolishing affiliate, non-utility businesses, at least for multi-state, registered utility holding companies. Again, the states were considered to be able to control diversification by a utility if the utility and its holding company were incorporated in a single state. Moreover, even if a major business that could afford to buy a public utility could incorporate in the same state to avoid registration under PUHCA (as Enron did when it acquired Portland General Electric), it could only use this "single-state" exemption to avoid PUHCA regulation once. (In Enron's case, the SEC ultimately decided that Enron was not entitled to the single-state exemption in any event because Portland General's utility activities were not carried on substantially in the same state, Oregon, in which Enron was now incorporated.)

With the repeal of PUHCA, the statutory prohibition against non-utility companies owning utilities has been removed. For the first time in 70 years, non-utilities such as oil companies, investment banks, electric equipment suppliers, private equity funds, insurance companies, construction companies, and any other entities that can afford to, can acquire public electric and gas distribution utilities without any statutory prohibition on their ability to do so because they are not in the utility business.

Both PUHCA and the Federal Power Act (FPA) prohibit interlocking directorates without agency approval, because of the history of conflicts of interest between electric equipment suppliers and banks authorized to underwrite utility securities, or, in the case of PUHCA, investment banks. Ironically, the FERC has just issued new rules to require timely compliance with the FPA's requirement that interlocking directors obtain prior FERC approval. Now, with PUHCA repeal, electric equipment suppliers and investment banks can both *own* and *control* public utility holding companies outright, not just sit on their boards of directors!

PUHCA provided a barrier reef of federal law preventing public utilities from being acquired by non-utility companies in order to advance the interests of their non-utility businesses. With PUHCA gone, a flood of utility acquisitions by non-utility companies such as oil companies, investment banks, etc., and by foreign companies and even by foreign countries, can be expected. Indeed, the financial industry is preparing for it.

2. LOST: Prohibition Against Utilities Diversifying Into Non-Utility Businesses

PUHCA's requirement that multi-state utility holding companies divest their non-utility businesses also, of course, prevented the utilities themselves from owning businesses not functionally related to their utility business, since these would be indirectly owned by the holding company parent as well.

PUHCA regulated registered holding company diversification, while single-state PUHCA-exempt holding companies such as PGE were subject to a determination by the state commission regarding diversification by their utility subsidiaries. With the repeal of PUHCA, not only can the holding companies diversify, it is unclear whether individual states will be able to control diversification by a utility itself if the utility operates in more than one state.

3. LOST: Prohibition Against Most Foreign Companies Or Countries Owning Major U.S. Utilities

PUHCA long effectively barred any foreign company or country from owning any substantial utility within the United States. Early on, PUHCA was interpreted as covering the entire world, since many of the pre-PUHCA problems had arisen from foreign utility investments made by U.S. utility holding companies. Utility holding companies organized and owning utilities outside the United States received an automatic exemption from PUHCA under Rule 5, until they tried to acquire a utility within the U.S. At that point, they had to meet the requirements of Sections 9 and 10, which required, among other things, geographic integration of their utilities with those in the U.S. With the exception of certain Canadian or Mexican utilities, this effectively ruled out foreign ownership. With the exception of certain Canadian or Mexican utilities, this effectively ruled out foreign ownership because the two sets of utilities could not be "physically interconnected or capable of physical interconnection" (across the ocean) as required by the PUHCA definition of an "integrated public-utility system" in Section 2(a)(29). 15 U.S.C. 79b(a)(29)."

If a company had no utilities outside the U.S., it would not have to meet the integration requirements, but it would have to divest its non-utility businesses. Since such a divestiture would result in a company with no assets, there were no foreign companies that could realistically acquire a major U.S. utility under PUHCA.[22]

PUHCA provides an exemption, 3(a)(5), for foreign companies that acquire minor U.S. utilities from which they derive no material part of their income. This exemption was stretched—some would say distorted—by the SEC in 1999 to allow AES Corp to acquire first Cilcorp, then Ipalco, and still obtain a Section 3(a)(5) exemption from registration under PUHCA.[23]

Other limited exemptions for foreign utility subsidiaries owned by American companies were available under Section 3(b).

[22] One exception was, indeed, a Canadian gas company, which acquired the natural gas distribution companies of Vermont in 1994 under PUHCA. *Gaz Metropolitain , Inc.,* HCAR No. 26170 (Nov. 1994).
[23] AES Corp., HCAR No. 27063 (Aug. 20, 1999).

The EPAct of 1992 created a new foreign exemption for foreign utility companies, or FUCOs. This exemption appeared to be aimed at permitting American companies under PUHCA to acquire foreign utilities that were not just generating companies. (New Section 33 of PUHCA allowed such companies to acquire foreign exempt wholesale generators.) Nonetheless, after a number of years, foreign utilities argued that they should be allowed to notice their own utilities as "Foreign Utility Companies," and thereby lose their designation as a "holding company" under PUHCA. This meant that, after the EPAct of 1992, foreign utility holding companies, such as Scottish Power and National Grid, could purchase utilities in the United States without having to meet the "physical integration" requirement, which would have been impossible. [Even so, other foreign companies could not acquire utilities without divesting their non-utility businesses.]. Although the SEC publicly stated that it didn't believe the Congress had necessarily intended this result, it allowed the acquisitions in the face of massive Congressional silence.

4. LOST: Limit On Number Of Utility Systems Controlled By A Single Holding Company

Because of the holding company abuses uncovered in the FTC Report and the fact that three such companies controlled 45% of the electric generation in the country, registered holding companies were limited under PUHCA to owning a "single, integrated" utility system unless they could meet the limited and specific requirements of Section 11(b)(1)(A)(B) and (C) of the statute. These requirements included a finding that such additional systems could not be operated as independent systems without substantial losses of economies, were located in one state or adjoining states, and were not so large as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

Since PUHCA regulated all electric utilities and natural gas distribution utilities, the SEC determined early on that PUHCA's limit to a "single, integrated" system meant *either* an electric utility system or a natural gas distribution system, but not both. Early on, this provision was "flexibly" enforced, so that many exempt holding companies of combination electric/gas utilities were permitted to survive, with the permission of the relevant states. However, registered holding companies were limited to either electric or gas companies. The purpose of separating electric and gas utilities was to eliminate the obvious potential for antitrust concerns and conflicts of interest between the two groups of utilities, such as were recently alleged prior to the El Paso Natural Gas Company's multi-million dollar settlement in the California market disaster of 2000-20001. Also, Section 8 of PUHCA required explicit state approval before a multi-state (registered) holding company could acquire a direct or indirect interest in electric and gas utility companies serving the same territory, if state law required state approval.

With PUHCA repeal, there are no longer any federal statutory limits on the number or type of utility systems that a single holding company may own.

5. LOST: Geographic Limits Designed To Ensure Local Control

PUHCA required that a multi-state, or registered, holding company be confined to owning a single, integrated utility system located within a single region of the country. As explained by a historian:

> The recommended concept of geographic integration was similar to Senator Burton Wheeler's oft-quoted sentiment, "A utility is essentially a local institution. It should be locally controlled and locally owned."[24]

A central purpose of PUHCA was therefore to avoid having absentee management, without an interest in local concerns, control local utilities. This was in direct response to the history of utility owners in the 1920s and before, when utility properties were bought and sold all over the country without regard to economies in the provision of electric or natural gas distribution service, but simply to increase the profits of the owners. This is why SEC Chairman Douglas wrote President Roosevelt that PUHCA had returned utility ownership from Wall Street to Main Street.

6. LOST: "Watchdog Provisions" Of PUHCA That Prevented Huge "Power Trusts" From Re-Forming

Not only did PUHCA, in Section 11, give the SEC the power to break up the huge "power trusts," or mammoth utility holding companies of the 1920s and '30s, but it also gave the SEC authority to prevent such utility behemoths from being recreated. Sections 9 and 10 of the Holding Company Act have been called the "watchdog provisions," because they prevented huge holding companies from being recreated by requiring all second utility stock acquisitions by "any person," and any business acquisition at all by a registered holding company, to have prior approval by the SEC, consistent with the standards of Section 11.

With the repeal of PUHCA, this watchdog has been removed.

[24] Seligman, at p. 129.

7. LOST: Size Limits Designed To Permit Effective State Regulation

In addition to requiring that multi-state (registered) holding companies be limited to owning a single integrated system in a single region of the country, Section 2(a)(29) of PUHCA also stipulated that such a utility system be:

> Not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation;….

This limit on the size, as well as the geographic spread, of a utility system was designed to satisfy the need for PUHCA, set forth in Section 1(a)(5), to correct the "lack of effective public regulation" arising from the unregulated growth and expansion of utility holding companies.

As noted above, after PUHCA was enacted and successfully enforced, most utilities opted to avoid comprehensive SEC regulation of registered holding companies by confining their operations to a single state, in which their utility primarily operated, thus entitling them to an exemption from PUHCA regulation [see below]. This was assumed to give states essential control over the in-state utility holding companies under state corporate laws. With the repeal of PUHCA, there will no longer be an incentive for holding companies to confine their operations to a single state in order to escape PUHCA regulation. Indeed, since the SEC announced in 1995 that it would be "flexible" in its PUHCA enforcement, utilities have increasingly merged in contiguous states, as permitted under PUHCA, because becoming a "registered" holding company no longer appeared to be a long-term regulatory concern.

8. LOST: Limits On Corporate Complexity To Prevent Accounting And Other Frauds By Making Books Transparent

Among the many abuses uncovered in the FTC Report was the use by utility parents of layers and layers of holding companies that effectively obscured accounting and other information regarding the companies' corporate transactions between utility subsidiaries and their affiliates and parents. PUHCA authorizes the SEC to limit the number of holding companies above a utility to two.[25]

As William O. Douglas once explained it: "[Holding companies] can have children and grandchildren, but not great-grandchildren."

The SEC, in recent years, under its "flexible" program of PUHCA regulation (some call it administrative *deregulation*), has allowed double sets of registered holding companies to exist over utilities. Even so, both registered holding companies (as well as all of their subsidiaries) has each been subject to comprehensive financial and other regulation under PUHCA.

PUHCA's elimination of corporate complexity prevented the kind of accounting and affiliate-dealing obfuscation that has occurred with, for example, Enron Corporation. One of the first things that Enron did was to get a number of exemptions from PUHCA, including a "single-state" exemption, to enable Enron to control Portland General Electric, an Oregon public utility, without PUHCA regulation, by reincorporating Enron in Oregon. (The SEC, long after the Enron bankruptcy, determined that Enron was not entitled to its self-filed single-state exemption because of Portland General's substantial out-of-state electricity sales.)[26]

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[25] Section 11(a)(2).
[26] In Re Enron Corp, Release No. 27782, 81 SEC Docket 3083 (Dec. 29, 2003).

With non-utilities like Exxon-Mobil and GE and Morgan Stanley now able to own and control public utilities, the lack of limits on holding company layers will likely result in innumerable layers and layers of intermediate and top holding companies above a public utility that a state commission, or even FERC, will be helpless to penetrate.

9. LOST: Limits On Financial Transactions With Utility To Protect Utility Finances And Utility Cost Of Capital

Under PUHCA, multi-state “registered” utility holding companies that could not be effectively regulated by single states, were subject to comprehensive regulation of their financial transactions with their utility subsidiaries by the SEC. There were restrictions on securities issuances (see Sections 6 and 7) and on intercompany loans and dividends from the utilities to the parent (see Section 12). Registered holding companies could not even issue commercial paper or short-term securities without SEC approval.

These provisions were designed to prevent the parent companies from looting the utility subsidiaries in order to finance other, potentially more lucrative (and probably riskier) businesses. These provisions were also designed to protect the health of a utility’s access to capital, since pre-PUHCA there were 53 utility holding company bankruptcies and 23 bank loan defaults resulting from over-leveraging based on utility operations. Indeed, the partial repeals of PUHCA enacted in 1992 have resulted in a large number of bankruptcies of PUHCA-exempt merchant plant and power marketing companies. In stark contrast, not a single PUHCA-regulated electric utility holding company ever went bankrupt prior to repeal.[27]

Both Standard & Poor’s and Fitch’s credit rating agencies issued reports in 2004 finding that PUHCA-regulated utilities had better credit ratings, and therefore lower costs

[27] Ironically, Entergy New Orleans filed for bankruptcy after EPAct 2005 was enacted, but prior to PUHCA termination on February 8, 2006, because of the Hurricane Katrina disaster in New Orleans.

of capital, than the unregulated, PUHCA-exempt merchant plants, etc. The credit rating agencies recommended that PUHCA's credit-protecting regulations be maintained.

With PUHCA repeal, the comprehensive financial regulation of multi-state registered holding companies and their subsidiaries disappeared.

10. LOST: Bankruptcy Protection For Utility Consumers Of Multi-State Holding Companies

After the massive bankruptcies preceding PUHCA enactment, the statute made provision for the SEC to have priority over a bankruptcy court in determining the reorganization plan of a bankrupt multi-state (registered) utility holding company or its utility subsidiary. See Section 11(f). Indeed, if the SEC so chose, it could itself become the receiver or trustee for a bankrupt registered holding company, and could propose the reorganization plan itself.

This protection disappeared with PUHCA repeal.

11. LOST: Authority To Require Utility Holding Companies And Their Affiliates To Keep Books And Records Related To Retail Rates

Section 15 of PUHCA provided extremely broad authority for the SEC to require registered (multi-state) holding companies and all of their subsidiaries to "make, keep, and preserve" any accounts, cost-accounting procedures, correspondence, memoranda, papers, books, and other records that the Commission deemed "necessary or appropriate" in the public interest or "for the protection of investors or consumers…" Since PUHCA covered retail, as well as wholesale, electric consumers, and natural gas distribution consumers, the SEC had virtually unlimited power to require the keeping of records by utility holding companies and their subsidiaries.

In contrast, as will be shown below, the FERC has been given extremely limited powers under EPAct 2005 to require the keeping of records, and the states have been given no authority at all to require any holding company or its affiliate to maintain and preserve *any* books or records.

12. LOST: Limits on Affiliate Transactions to Protect Utility Ratepayers

As noted above, one of the ways in which utility holding companies abused their utility subsidiaries prior to PUHCA was by selling them products and services at exorbitant prices or fees. These high costs were then reflected in utility rates. As a result, registered holding companies were not allowed to provide any services, sales or construction contracts to their utility subsidiaries without following the restrictive rules set forth for "mutual service companies" under PUHCA Section 13.

Although these rules became controversial at one point at the FERC, because the SEC had required such sales to be made at "cost," rather than at the lower of market or cost, the SEC nonetheless had broad authority to regulate the sales of such services by affiliates.

II. **"NEW" ACCESS TO BOOKS & RECORDS VIRTUALLY MEANINGLESS FOR STATES**

The many provisions of PUHCA discussed above that protected ratepayers and investors from obfuscation of books and records and other abusive holding company financial transactions with their utility affiliates were "replaced" by a provision in the 2005 EPAct, Section 1265, that allegedly provides states with access to the books and records of holding companies and associate companies of public utilities. However, access to books and records is meaningless if no such books and records exist. Unlike the provisions of the 1935 PUHCA Section 15, which gave the SEC virtually unlimited authority to require every registered holding company and every one of its subsidiaries to make, keep, and preserve any records that the SEC deemed to be necessary and appropriate for the protection of investors or consumers or for the enforcement of the statute, the 2005 EPAct provision grants states *no* authority to require holding companies or their associates to make, keep, or preserve any records at all.

Moreover, the new provision for federal access to records, Section 1264, only grants FERC the authority to require holding companies to maintain records that meet two criteria: they apply to costs; *and* they are necessary and appropriate for the protection of utility customers with respect to FERC's rates. This means, first, that even FERC cannot require holding companies and their subsidiaries to keep records that are relevant only to state retail rates. In addition, since FERC generally allows utilities to charge market rates for wholesale sales of electricity, that are not based on the utility's costs, most of FERC's wholesale rates would not appear to meet the double test of the new statute, that the books and records be both relevant to costs <u>and</u> to FERC jurisdictional rates. Thus FERC's authority to require holding company system members to keep books and records at all would appear to be greatly limited. Since the states also have no authority to require the maintenance and preservation of records under Section 1264, the new law provides no legal authority for any utility regulator to require such companies to maintain, keep, or preserve records that are relevant to state retail rates.

Clearly, access to books and records that do not exist or need not be preserved does not provide state commissions with a useful tool to protect consumers. Companies could simply and legally destroy relevant records if they were requested. Moreover, states' commissions are not even entitled to access any books and records that happen to exist and happen to be preserved without identifying such records in advance in a proceeding before the state commission. The state commission must determine, apparently without seeing such books and records, that they are relevant to costs and are necessary for the effective discharge of the state's responsibilities. How states would know in advance what records to investigate, since they cannot require that any be kept, is an unanswered question.

III. NEW FERC MERGER AUTHORITY: FAR SHORT OF PUHCA PROTECTIONS

In addition to the very limited access to the books and records of holding companies and their associate companies, the EPAct 2005 both increases and decreases the jurisdiction of the FERC under section 203 of the Federal Power Act (FPA) over utility mergers, and gives FERC new, but limited, jurisdiction over utility holding companies.

A. Decreases In FERC's Merger Jurisdiction

Section 1289 of EPAct 2005, "Merger Review Reform," actually *decreases* the merger jurisdiction of FERC by raising the dollar values of facility acquisitions subject to FERC review from $50,000 to $10,000,000. FERC currently has merger jurisdiction over only two categories of "facilities": transmission assets; and wholesale contracts on file with FERC. By raising the triggering dollar amount to ten million dollars, the new law would allow transfers of wholesale rate contracts below that amount to escape FERC review. Clever sellers could arguably reduce the dollar values of their contracts by splitting them up into smaller segments to avoid FERC review of their transfers and consolidation.

In addition, while large transmission lines would clearly exceed the ten million dollar figure, the generator leads and step-up transformers that are attached to generating plants, and on which FERC has asserted merger jurisdiction in the past,[28] may not exceed the ten million dollar amount. While FERC is given new merger authority over at least some generators that sell at wholesale, it has no authority, new or old, over generators that sell at retail. And, FERC was also given no merger authority over electric distribution facilities.

In addition, it is unclear whether FERC will assert jurisdiction over existing Exempt Wholesale Generators (EWGs) under the new statute. The "merger reform" provisions, at Section 1289(a)(2), require most holding companies to obtain FERC approval of acquisitions of "an electric utility company" or a holding company that includes "an electric utility company" by another holding company that includes an "electric utility" or a "transmitting utility." The definition of "electric utility company" in EPAct 2005, Section 1262(5), is "any company that owns or operates facilities used for the generation, transmission, or distribution of electric energy for sale." However, the definition of an "Exempt Wholesale Generator" in the new statute has the same meaning as it had in Section 32 of the PUHCA of 1935, as those sections existed on the day before the effective date of 2005 EPAct's Section F, "Repeal of PUHCA.". Section 32(a)(2)(e) states that an EWG "shall not be considered an electric utility company under section 2(a)(3) of this Act…" If existing EWGs were eliminated from FERC merger review, this would leave a huge hole in the new merger authority that Congress purports to give to FERC. FERC's Notice of Proposed Rulemaking regarding its new merger authority makes no mention of this ambiguity. This Commission should urge FERC to clarify that it does have authority over existing EWGs.

[28] *See, e.g., Key Span-Ravenswood, LLC,* 107 FERC ¶ 62,086, April 28, 2004 (2004 WL 902349 F.E.R.C.).

B. Increases In FERC Merger Jurisdiction

The new law does give FERC clear jurisdiction over utility acquisitions of certain generation facilities for the first time, but only over those that are used for interstate wholesale sales and over which the Commission has jurisdiction for ratemaking purposes. FERC still has no jurisdiction over acquisitions or sales of generating plants used for retail sales, as the SEC did under PUHCA. In addition, FERC still has no jurisdiction over acquisitions and consolidations of electric or natural gas distribution facilities, as the SEC did under PUHCA.

Further, FERC has no jurisdiction, as sections 9(a) and 10 of PUHCA provided, over acquisitions or mergers of electric and gas utilities, over acquisitions by multi-state holding companies of non-utilities businesses, over acquisitions of foreign utilities, etc.

C. FERC's Merger Standard Of Review

The changes to FERC's merger review do not include a change in its primary standard for approving mergers, consolidations, or acquisitions, *viz.*, that the transaction be "consistent with the public interest." This standard, unlike the "Death Sentence" of PUHCA, is not at all structural, and is highly subjective. In addition, it does not require any benefits to the public interest or ratepayers, but merely that the transaction be "consistent" with the public interest as FERC defines it.

The new law, Section 1289(a)(4), does require a new finding from FERC, that the merger or acquisition "will not 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," unless FERC decides that these are good things.

IV. WHAT ARE THE LIKELY RISKS OF UTILITY HOLDING COMPANY MERGERS AND OF THIS MERGER?

In evaluating MidAmerican's merger application, this Commission must consider the changes discussed above in federal statutes protecting consumers from utility holding company mergers, since, as the SEC staff has testified in recommending conditional PUHCA repeal, the SEC's recommendation was based on increased authority by state commissions to guard against the abuses of multi-state utility holding companies, abuses that PUHCA has prevented or mitigated for the past seventy years.[29]

A. Use Of Utility Revenues For Non-Utility Businesses

The classic abuse of utility subsidiaries by their parent holding companies was to dividend up the steady utility revenues to the parent for its use in other businesses, so that captive ratepayers were forced to subsidize their affiliates. Since these businesses were often riskier than the utility business, they often failed, and the utility ratepayers bore the burden of the loss in a higher cost of capital and other ways.

B. Use Of Utility Credit To Service Holding Companies Above

In the 1920s and '30s, holding companies borrowed enormous amounts of money, all based on the credit of the public utility at the bottom of the pyramid. When the banks called in their loans, the holding companies collapsed.

C. Loss Of Local, Even Regional, Control And Focus

Without the limits on geographic spread and size of utility holding companies, they are likely to grow in uneconomic and unconstrained fashion as they did in the 1920s and '30s. As a result, there will be a loss of local control and concern for local communities. MidAmerican has already announced that it reserves the right to fill vacant

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[29] *"The Regulation of Public-Utility Holding Companies,"* Division of Investment Management, United States Securities and Exchange Commission, June 1995.

executive positions in either Portland or Salt Lake City, which, practically speaking, means a shift of at least some executives to Utah, which is closer to MidAmerican's Iowa headquarters.[30] In addition, Iowa is part of the Midwest coal culture, and unless Oregon and the Pacific Northwest object, MidAmerican, and its parent, Berkshire Hathaway, may decide to promote coal-fired plants in their newly acquired territories.

MidAmerican appeared to be the primary lobbyist for PUHCA repeal before Congress, constantly touting the interest of Berkshire Hathaway's Warren Buffett in investing at least fifteen billion dollars in the transmission infrastructure if PUHCA went away. This certainly indicates a major interest on Berkshire's part in acquiring substantial utility assets, of which PacifiCorp appears to be only the beginning. If Berkshire/MidAmerican acquires utilities in other parts of the country, as expected, the concerns of the parent company may focus less and less on the interests of Oregon ratepayers and on Oregon environmental concerns.

D. Loss Of American Control Over Utility

As noted above, a stretched definition of EPAct 1992's Section 33, Foreign Utility Companies, allowed foreign utility holding companies such as Scottish Power and National Grid to declare their own utilities to be FUCOs under Section 33, and thereby define themselves out of the definition of a "holding company" under PUHCA. While the experience with Scottish Power may seem benign to most Oregon ratepayers, it should be recalled that Scottish Power did have to be a utility owner in Scotland, could not have non-utility businesses, and had to register with and be regulated by the SEC under PUHCA. With PUHCA repeal, none of those requirements will continue to exist.

[30] See, *PacifiCorp Headquarters Will Stay in Portland*, September 23, 2005. Attachment 2.

Even with Scottish Power, it should be noted that American Indian tribes had to go to Glasgow to protect their fishing rights in American rivers.[31]

Indeed, with PUHCA repeal, there is nothing to prevent a foreign state from acquiring U.S. utilities, short of intervention by security agencies of the U.S. A Chinese company such as CNOOC, that is owned by the government of China, could acquire a major U.S. regulated utility. The same is true of companies owned by Russia, India, Japan, Venezuela, etc. The question that might arise is not so much whether the military security of our country would be breached (although power plants and transmission lines could be considered major military targets), so much as whether the economic security of the country could be affected by a foreign country's ability to bring about a California-like disaster or even a major blackout.

E. Loss Of Ability Of Oregon PUC To Protect Ratepayers

Another primary purpose of PUHCA was to protect effective state regulation, which multi-state holding company ownership made virtually impossible. Both the SEC under PUHCA, and the substantial incentive to avoid PUHCA regulation by incorporating and operating in a single state, have made effective state regulation not only possible, but typical. However, without PUHCA and without the incentive to incorporate and operate in a single state, utilities may soon operate only as interstate conglomerates. Like FDR in New York, the Oregon PUC may soon find that it has little control over or impact on major, interstate conglomerates headquartered far away.

A large portion of generation costs are now being determined by FERC, which allows "the market," *viz.*, the utilities, to determine wholesale electricity rates. These used to account for only 10% to 17% of generation nationally. The last official figure

[31] See, *Four Native Tribes Head to Scotland To Save Klamath River Salmon,* July 6, 2004. Attachment 3.

that I heard is that wholesale rates now account for 44% of national generation prices, a number that is growing. Generation costs are the largest single portion of retail rates, and the wholesale prices that FERC allows must be passed through to retail ratepayers under the Supremacy Clause of the U.S. Constitution, as well as under doctrines of federal preemption.[32]

When multi-state holding companies can control vast amounts of generating plants, as well as distribution facilities, and set their own prices for electric generation through "the market," state commissions will be reduced to ministerial functions, even if one assumes that "open access" transmission is successful in allowing "competitors" to use transmission lines on an equal basis with transmission owners.

F. No Ability Of Oregon PUC To Control Subsequent Mergers Of MidAmerican Or Berkshire Hathaway

The Oregon PUC currently has substantial control over Pacific Power & Light Company, because it is only one of six divisions of PacifiCorp. However, once MidAmerican owns PacifiCorp, and additional utilities as Berkshire Hathaway has indicated, the Oregon PUC's ability to affect the giant holding company will become smaller and smaller. If, say, Berkshire Hathaway itself were to be sold to a giant oil company or to another company, it seems unlikely that protests from the Oregon PUC would count for much in opposing such a sale.

G. Affiliate Abuses From Associate Companies

Another of the classic holding company abuses was the sale of products and services to utilities by affiliated companies at exorbitant prices. While FERC may look at such practices when a holding company merger is first approved, there is no ongoing

[32] *Nantahala Power & Light Co. v Thornburg,* 476 U.S. 953, 970 (1986).

regulation of such affiliate transactions under the new statute as there was under PUHCA sections 6, 7, 12 and 13.

Just as one example, Warren Buffett bragged in his last two annual reports to Berkshire Hathaway shareholders that, despite the fact that Berkshire could not "control" MidAmerican under PUHCA, Berkshire was able to loan money to MidAmerican at 11% interest. Whether this was a "market" rate or not, Buffett obviously thought it was something worth telling his shareholders about. This is simply one example of the kinds of self-serving affiliate deals that can occur between a non-utility holding company and its controlled utility subsidiaries.

H. Inability Of Oregon PUC To Reach Holding Company Finances

One of the chief concerns of a MidAmerican/PacifiCorp merger is that the Oregon PUC will not be able to control or impact either the finances or business activities of an interstate holding company, which MidAmerican, and Berkshire Hathaway, will become. If Berkshire Hathaway wants to diversify into risky businesses, or into businesses that present a strong conflict of interest, the Oregon PUC will be as helpless as FDR was in New York to regulate the interstate, and international, activities of these holding companies, and any holding companies they decide to erect above their current companies.

Indeed, as discussed above, PUHCA allowed the SEC to go all the way to, not only the top holding company, but to individuals who had "controlling influence" over a holding company, and indirectly, over a utility. The history of the collapse of the holding companies in the 1920s and '30s made it clear that a few individuals were controlling the vast utility empires, and PUHCA was structured accordingly to give the SEC regulatory authority over them.

Since two of the individuals with substantial shares in Berkshire Hathaway, Bill Gates and Warren Buffett, are currently the number one and number two richest people in America according to Forbes Magazine, an ability to reach controlling individuals may be both necessary and appropriate to protect the ratepayers of the utility subsidiaries of Berkshire Hathaway. Although such individuals can no longer be required to "register" and be fully regulated by the SEC, they can still be declared to be "holding companies" by FERC under the new law, and the Oregon PUC may wish to remind FERC in its rulemaking that it has that authority.

I. Lack Of Authority To Monitor Ongoing Holding Company & Utility Financial Transactions

As noted above, the 2005 EPAct requires FERC to find that a holding company acquisition or merger under Section 203 will not result in cross-subsidization of non-utility businesses by utility ratepayers, or of the pledge or encumbrance of utility assets for the benefit of an associate company, unless FERC determines such transactions are consistent with the public interest. However, this is a one-time finding, at the time that a merger or acquisition is approved, under FPA section 203. There does not appear to be any ongoing review or authority to prevent such cross-subsidization as soon as the merger has been approved and completed.

J. Inability Of Oregon PUC To Require Berkshire Hathaway Or MidAmerican To Keep Books And Records

As discussed above, the Commission is given no authority under the 2005 EPAct to require either holding companies or their non-utility subsidiaries to maintain any records relevant to retail rates, and FERC is only given authority to require records relating to both wholesale rates and to costs. In addition, this Commission would have to hold a proceeding and identify any holding company or associate company records that it might guess could exist regarding inter-affiliate transactions that might affect retail rates.

Even in terms of the books and records that Berkshire and MidAmerican do retain, the burden of proving that they contain information relevant to retail rates appears to be on this Commission. Berkshire has already shown itself reluctant to reveal its books to the SEC under the Securities laws, since it has asked for (but been denied) several exemptions from filing information with the SEC.[33]

This does not bode well for the Commission's access to Berkshire's books where the law does not even clearly require either that relevant records be kept or be produced.

K. Uncontrolled Complexity Of Holding Companies

Without PUHCA's Section 11(b)(2), FERC has no direct authority to require a limit to the number of holding companies allowed to exist over a public utility. This could lead to so much corporate complexity that this Commission, as well as FERC, will be realistically unable to navigate through the books and records of a mammoth conglomerate such as Berkshire Hathaway in any meaningful way.

L. Inability To Prevent Risky Non-Utility Investments By Holding Company

The Oregon PUC would presumably still have authority to prevent Pacific Power & Light itself from investing in risky or otherwise inappropriate non-utility businesses, but it seems unlikely that the Commission could prevent an interstate holding company from engaging in such activities. PUHCA not only forbade holding companies from investing in non-utility businesses, but also regulated their investments in utility-related businesses, so its repeal leaves a substantial gap. Berkshire's enormous losses in its

[33] In Re Berkshire Hathaway Inc., Release No. 34-48368, 80 SEC Docket 2635 (Aug. 20, 2003). Attachment 4.

insurance business due to Hurricanes Katrina and Rita's devastation are a recent example of what can transpire at companies that now huddle under the same corporate umbrella with a public utility.[34]

M. Increase In Cost Of Capital Of Holding Company Or Utility

Where holding companies are free to invest in other business ventures, no matter how risky, the likely result is that their credit rating will be impaired, just as that of the entire merchant power plant sector was recently reduced. This raises the cost of capital of the utility subsidiary to obtain the large amounts of capital that it needs.

For example, Excel, a registered holding company, spun off most of its "unregulated" merchant plant businesses to NRG. NRG declared bankruptcy, and this lowered the credit rating (thereby raising the cost of capital) of its remaining three PUHCA-regulated subsidiaries.

N. Inability To Control Reorganization After Bankruptcy

In the case of Enron, the Oregon Commission is learning that, even if it can protect an Oregon utility subsidiary from direct exploitation by a "single-state" holding company such as Enron, it has limited control over what happens to the utility once its parent company declares bankruptcy and its creditors take priority in a bankruptcy proceeding. PUHCA provided such priority to ratepayers and investors in bankruptcy for multi-state (registered) holding companies, but that has been lost.

O. Uncontrolled Growth Of Holding Companies

Without PUHCA, there is no structural law that can prevent the kind of uncontrolled growth of utility holding companies that occurred in the 1920s and '30s. FERC has only its "consistent with the public interest" standard, and has not interpreted

[34] See, *Hurricane Buffets Berkshire Hathaway*, October 2, 2005. Attachment 5.

that as including a concern over the size of the merged entities. Indeed, ownership of sprawling, non-contiguous groups of utilities of the type that caused PUHCA to be passed in the first place would apparently not offend FERC's current merger analysis. The American Public Power Association and the National Rural Electric Cooperative Association have filed comments in the FERC rulemaking for the new PUHCA provisions in the 2005 EPAct pointing out this irony to FERC, and asking FERC to reconsider its current merger analysis. In addition, the antitrust laws appear unable to prevent the giant power trusts, just as they failed to do in the 1920s and '30s, since they have no structural provisions such as PUHCA provided.

P. Inability To Stop Growth Of Holding Companies In Incipiency

Because the drafters of PUHCA were well aware that the vast holding companies had been controlled at the top by a small handful of shareholders, they designed PUHCA to stop the acquisition of power over utilities by individuals or companies at their incipiency. The so-called "first bite" allowed anyone or any entity to buy a first public utility without SEC approval under sections 9 and 10. However, a "second bite" of even 5% of the voting shares of a second public utility, or holding company, triggered the provisions of sections 9 and 10.

As a consequence, William H. ("Bill") Gates III recently had to get approval under these sections when he acquired 5% of the voting shares of TNM after already owning 5% or more of the voting shares of PSNM (when the latter acquired the former).[35]

Without the "watchdog provisions" of PUHCA, there is no way to prevent the rebirth of huge power trusts at an early date.

[35] Public Service of New Mexico. HCAR Release No. 35-27979, 2005 WL 1323109, June 1, 2005.

Q. Conflicts Of Interest Between Gas And Electric Utilities

A large PUHCA concern was with the non-competitive effects, and potential conflicts of interest, between electric and gas utilities if they are owned by the same holding company. The SEC thus interpreted PUHCA as allowing only a single electric or a single natural gas distribution utility system, not both.

Berkshire Hathaway (through MidAmerican Energy Holdings) owns both natural gas pipelines, not regulated by PUHCA, and electric utilities. Conflicts of interest in such dual ownership were the basis for allegations of withholding natural gas supplies to drive up the prices of power marketer affiliates that led to multi-million dollars settlements between the FERC and El Paso Natural Gas Company.

R. Conflicts Of Interest Between Non-Utility And Utility Businesses

One of the chief affiliate abuses that led to PUHCA's enactment was the use of utility ownership to increase the profits of the holding companies' non-utility businesses. As has been noted, General Electric wanted to sell electric turbines to its utility subsidiaries (and probably would still like this connection), and Stone and Webster wanted to sell engineering and construction services to the utilities it acquired for that purpose. It is impossible to guess what uses the various subsidiaries of Berkshire Hathaway could make of affiliate utilities, but it is reasonable to assume that such possibilities exist. As noted above, Berkshire Hathaway loaned money to MidAmerican at a healthy interest rate.

V. WHAT ELSE THE PUC SHOULD CONSIDER IN REVIEWING THIS MERGER

As noted above, MidAmerican (backed by Warren Buffett and Berkshire Hathaway) was a major lobbyist trying—successfully, as it turned out—to repeal PUHCA. This is a strong indication that the PacifiCorp acquisition is only the first in a substantial line of utilities and utility assets that Berkshire hopes to acquire, either through MidAmerican or through another intermediary holding company. Berkshire has long owned the major financial share of MidAmerican (over 80%), and now with PUHCA gone, has said that it will exercise its right to convert its non-voting shares to voting shares and exercise control over MidAmerican (and its subsidiaries) outright.

A single share of Berkshire Hathaway trades at $81,000 on a bad day. Bill Gates has recently increased his holdings of Berkshire, of which he is a director, to 3,640 shares, worth about $300 million. Mr. Gates already owns 5% or more of the voting shares of several other utilities.

The investing philosophy of Warren Buffett, "the Sage of Omaha," and of his company, Berkshire Hathaway, is to buy "value stocks"; this is described by Standard & Poor's credit rating agency as "bargain hunting,"[36] buying stock that is currently undervalued based on its business fundamentals. The theory is to buy cheap and hope there is an increase in profits. The utility business is a likely target for this kind of investment, as Texas Pacific Group and other private equity funds have recently shown by turning around a two-year investment in Texas Genco for a handsome $2 billion profit. Goldman Sachs and its joint venturers earned a $1 billion profit in 2001 for similarly simply buying and holding generating plants for a few years. The reason that these huge profits are possible is that there has been an excess of generating capacity in the country, but now demand is catching up with it.

In 2000, an economist explained how this works; if there is even a 2% excess capacity in the electric generating market, merchant sellers into the market can't pay their debt costs. However, if there is even a 2% deficit capacity, electricity sellers can charge

[36] See, *S&P updates growth, value stock formulas,* Sunday, October 9, 2005. Attachment 6.

whatever they like,[37] as we saw in California in 2000-2001. We have been in an excess capacity situation for a number of years, but demand is catching up, new plants are not being built, and old plants are shutting down.

The reason that utilities such as PacifiCorp meet Berkshire's "bargain" criterion is that utility profits are expected to go up, and that is because electric utility and natural gas rates are expected and widely predicted to go up. In hindsight, there is concern in Texas that the Texas Genco plants were sold off too cheaply, allowing the purchasers to make huge profits, without adequately repaying the utility ratepayers who had helped to build many of the plants. Given this recent history, of investment companies making huge profits off the purchase and resale of utility assets, the Commission should thoroughly study why Mr. Buffett and Berkshire believe PacifiCorp is a "bargain," and why the ratepayers of Pacific Power & Light, who have paid to build their utility over the years, will benefit if the utility is sold off to become part of a huge, distant utility and investment empire at a "bargain" price.

Investors who pay $81,000 for a single share of stock in Berkshire are not likely to be satisfied with low returns on their investments. Even though Mr. Buffett has announced that he will be satisfied with regulated rates of return and intends to remain in the utility-owning business for many years, there is no requirement for him to adhere to either of these intentions. In addition, Mr. Buffett is seventy-five years old and might retire from the helm of Berkshire at any time; questions are already being asked if Bill Gates will succeed him at the helm of Berkshire.[38] This Commission should realistically assume that either new Berkshire leadership, or the sale of MidAmerican or Berkshire to

[37] See, *Chadbourne & Parke LLP Project Finance NewsWire*, September 2000. Attachment 7.
[38] See, *Billionaires Warren Buffett and Bill Gates Answer Questions*, October 1, 2005. Attachment 8.

a totally different entity, could substantially change the future ownership picture for PacifiCorp. Even if Berkshire and MidAmerican remain in control of PacifiCorp, there appears to be no question that they do not intend to stop their utility investments with this purchase.

In addition, the insurance industry, which constitutes major Berkshire holdings, may be entering on troubled times after Hurricanes Katrina and Rita. Berkshire subsidiary, General Reinsurance Corp., has already been part of a regulatory probe by the Securities and Exchange Commission for its dealings with troubled insurance heavyweight American International Group Inc. (AIG).[39] A concern of this Commission should be whether troubles in the insurance industry, or in other business ventures owned by Berkshire Hathaway, could result in reductions to the credit ratings of MidAmerican and PacifiCorp, and a higher cost of capital for these utilities, as well as others that Berkshire may acquire. In addition, there must be an ongoing concern for conflicts of interest among associate companies in the holding company system, particularly any financial companies that stand to earn major fees for buying and selling utility assets, or insurance policies, make inter-affiliate loans, and other associate company transactions, regardless of the benefit or harm to utility ratepayers or service.

VI. ARE CONDITIONS THAT THE OREGON PUC COULD IMPOSE ADEQUATE TO PROTECT CONSUMERS?

In deciding whether the merger will benefit Oregon consumers, there are conditions that the Commission could impose on its approval to attempt to protect Oregon's interests in the cost and quality of its utility service, as well as regarding environmental and other concerns. "Ring-fencing" of utility revenues to keep them from

[39] See, *Ex-Buffett employee may face SEC action*, October 7, 2005. Attachment 9.

being used for non-utility businesses of the holding company should be a minimum condition. Other agreements may be reached on the willingness of the holding company to maintain and keep certain kinds of records that reasonably may affect ratepayers, including those that would allow the Commission to determine whether power and other purchase expenses were prudently incurred. There may be other conditions that the Commission cannot order, but may get the holding company to agree to in return for merger approval.

In addition, the Commission may wish to be active in the FERC rulemaking for the new PUHCA provisions in the 2005 EPAct currently before FERC to implement its new books and records authority, as well as its new merger authority, in light of lost PUHCA protections.

Whether such conditions or others can ultimately protect Oregon ratepayers from the loss of local control and regulation that will occur when Pacific Power & Light becomes a minor part of a potentially huge utility and non-utility conglomerate, operated far from Oregon, are questions that the Commission will need to address in evaluating whether to permit MidAmerican's (and Berkshire Hathaway's) proposed acquisition of Pacific Power & Light, dba PacifiCorp.

Respectfully Submitted,
October 14, 2005,

/s/ Lynn N. Hargis

Lynn N. Hargis
For the Citizens' Utility Board of Oregon

Lynn N. Hargis — Summary of Qualifications

Ms. Hargis is a volunteer attorney/lobbyist at Public Citizen, Inc., a Washington, D.C. based national consumer advocacy organization, from June, 2003 to present. She is currently working on a lawsuit for Public Citizen and a number of state and other consumer advocates challenging the legality of the market rate regime of the Federal Energy Regulatory Commission under the Federal Power Act. She also lobbied Congress to save the Public Utility Holding Company Act of 1935 and intervened in PUHCA cases before the SEC.

Ms. Hargis was Counsel in the Washington, D.C. office of Chadbourne & Parke, LLP, a New York-based, international law, from 1986 through May, 2003, for developers of or lenders to independent power plants around the world.

Ms. Hargis served as Assistant General Counsel for Electric Rates and Corporate Regulation at the Federal Energy Regulatory Commission from 1979 to 1985. She also served in the appellate and trial divisions of FERC. She received her J.D. from the University of California at Berkeley School of Law (Boalt Hall) in 1975.

September 23, 2005

PacifiCorp Headquarters Will Stay in Portland, Officials Say

PORTLAND, Ore. - Hoping to ease concerns about potential job losses to the state, MidAmerican Energy Holdings Co. officials promised Friday to keep the PacifiCorp headquarters in Oregon if a buyout is successful.

The pledge came after representatives of MidAmerican met with Gov. Ted Kulongoski and Mayor Tom Potter, who both have been pressing the company to avoid significant job cuts, should it receive state and federal approval to buy the utility.

"The governor received assurances that the headquarters would remain in Oregon," said Kulongoski spokeswoman Anna Richter Taylor.

She said it was "a successful meeting that showed a joint commitment to maintaining a strong base in Oregon and strong opportunities in the future."

MidAmerican, based in Des Moines, Iowa, and owned primarily by billionaire investor Warren Buffett's Berkshire Hathaway, has offered a $9.4 billion to purchase PacifiCorp, which distributes electricity in six states, primarily Oregon and Utah.

About 1,164 people work at PacifiCorp headquarters in Portland while another 246 work at the corporate offices in Salt Lake City.

Keith Hartje, a senior vice president with MidAmerican, said the company would reserve the right to fill executive-level vacancies by assigning people to either city.

But Hartje said he told Kulongoski and Potter that the bulk of PacifiCorp's Oregon employees "will stay put" after the acquisition and not have their jobs moved out of state.

MidAmerican and PacifiCorp officials have expressed concerns about a bill passed by the 2005 Legislature and signed by Kulongoski that makes changes in the way utilities are taxed.

Under the new law, money that utilities collect from their customers to pay taxes will have to be given back if the taxes wind up not being owed.

At Friday's meeting with Kulongoski and Potter, MidAmerican raised concerns about draft rules being proposed by the Oregon Utility Commission to put the new tax law into effect.

However, Richter Taylor said the company understood that changes were on the way, and accepted them.

"There was common agreement that there would be change, and when utilities collect money from rate payers for states taxes, those dollars will go to the state," Kulongoski's spokeswoman said.

PacifiCorp has been owned since 1999 by ScottishPower, based in Glasgow, Scotland.

Ian Russell, ScottishPower CEO, announced in June the PacifiCorp sale was part of a corporate restructuring intended to save more than $100 million.

Press Room

NEWS ADVISORY

Klamath River Inter-Tribal Fish and Water Commission
Friends of the River
Pacific Coast Federation of Fishermen's Associations

For Immediate Release
July 06, 2004

For More Information Contact:
Leaf Hillman, Vice-Chair of Karuk Tribe, 1-800-505-2785 x2040
Glen Spain, Pacific Coast Federation of Fisherman's Associations, 541-689-2000
Merv George, Jr., Klamath River Inter-Tribal Fish and Water Commission, 530-625-1646
Craig Tucker, Friends of the River, 916-995-1794

FOUR NATIVE TRIBES HEAD TO SCOTLAND TO SAVE KLAMATH RIVER SALMON

Happy Camp, CA- On July 17, representatives from 4 California Tribal Nations will travel to Scotland and demand the restoration of their home river- the Klamath. In addition, representatives from the conservation group Friends of the River (FOR) and the commercial fishermen's group Pacific Coast Federation of Fishermen's Associations (PCFFA) will join the delegation in support of the Tribes' struggle.

At issue is a complex of dams on the Klamath River which block over 350 miles of historic spawning grounds, degrade water quality, and play a major part in the steady decline of salmon in what was once America's third greatest Salmon river.

The dams are owned and operated by PacifiCorp, a subsidiary of the multinational energy giant, Scottish Power (NYSE- SPI). The dams are currently undergoing relicensing by the US Government, a license that the Tribes and the salmon will have to live with for the next 30 years.

PacifiCorp officials solicited input from the Tribes and stakeholders over the past four years as their license application was drafted. However, the final 80 lb. document did not include salmon restoration strategies or an evaluation of dam removal - the fundamental issues raised by the Tribes, environmentalists, and fishermen.

"We are left feeling betrayed," says Leaf Hillman, Vice-Chair of the Karuk Tribe. "The company assured us that we would be partners in deciding the future of the Klamath, but our concerns obviously fell on deaf ears. We are going to Scotland to let Scottish Power and its shareholders know that its subsidiary is foreclosing on restoration options, and thereby jeopardizing the survival of our cultural."

The Karuk, Yurok, Hoopa, and Klamath Tribes have lived along the banks of the Klamath River for thousands of years. Their cultures revolve around the annual return of the salmon. Since the construction of the Klamath River dams, the number of salmon returning to spawn has plummeted. Once, over a million fish would return annually. Today, 100,000 returning fish is considered good. The once plentiful spring salmon runs are now extinct in PacifiCorp's project area. Because of this the Karuk no longer perform the first salmon ceremony each spring as they did for thousands of years.

“Obviously PacifiCorp is ignoring the needs and input of Klamath Basin residents. We hope that Scottish Power, as the parent company, will show more concern,” says Craig Tucker, spokesman for Friends of the River. Tucker goes on to add, “Scottish Power is known around the world as a ‘green’ energy company. We hope that if officials there are told what is happening on the Klamath they will want to work with the Tribes to save the Klamath River salmon.”

According to Merv George, Jr., Director of the Klamath River Inter-Tribal Fish and Water Commission, “We want to bring the salmon home to the Upper Klamath Basin. For too long these dams have robbed us of our most precious cultural and spiritual resource. Its time we get it back.”

When asked if PacifiCorp’s verbal proposal to “trap and haul” fish around the dams in trucks would work George scoffs, “that is not what we consider river restoration. The company does not understand how important salmon are to us- they are the heart of our people, and you can’t put a price on that.”

However, for others the salmon represent more than a cultural icon and an important food source, they represent a much-needed economic opportunity and thousands of jobs for economically depressed coastal rural communities. Glen Spain of the Pacific Coast Federation of Fishermen’s Associations says, “This river's original salmon fisheries had a net value to society of at least $4.5 billion, and even in their damaged state today could support many thousands of fishing-based jobs for coastal communities all along the Northern California and Oregon coastlines. A lot of fishing industry jobs have been destroyed by these dams, all to generate electricity that is little more than background noise on the grid.”

Spain refers to statements by the California Energy Commission (CEC) that suggest that the electricity produced by the antiquated dam complex could be easily replaced by other sources. According to a recent CEC report, “Because of the small capacity of the Klamath hydro units…removal of these units will not have a significant reliability impact on a larger regional scale…” The report went on to state, “decommissioning is a feasible alternative from the perspective of impacts to statewide electricity resource adequacy and that replacement energy is available in the near term” (1)

What power the dams do generate do not benefit the tribes. That is part of the message that Yurok Tribal Director Troy Fletcher wants to share with Scottish Power, “While Scottish Power and its shareholders reap the economic rewards of this project, downstream Native Americans go without fish to eat or electricity in their homes.” Fletcher points out that on the Upper Yurok reservation, 61% of the homes, a school, and two churches are without electricity.

The delegation of Tribal members, environmentalists, and fishermen will be in Scotland speaking to citizen groups and performing outreach to Scottish Power shareholders in mid July.

United States of America
Before the
Securities and Exchange Commission

Securities Exchange Act of 1934
Release No. 48368 / August 20, 2003

In the Matter of Berkshire Hathaway Inc.	ORDER AFFIRMING THE DETERMINATION OF THE DIVISION OF INVESTMENT MANAGEMENT TO DENY CONFIDENTIAL TREATMENT

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and consistent with the public interest and protection of investors, pursuant to Rule 431(a) of the Commission's Rules of Practice ("Rules of Practice"), to affirm the determination of the Division of Investment Management ("Division") to deny the request for confidential treatment of information for the calendar quarter ended September 30, 2002 filed by Berkshire Hathaway Inc. ("Berkshire") pursuant to Section 13(f) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

1. Berkshire's Petition for Review, filed on February 28, 2003, describes Berkshire as a diversified holding company whose subsidiaries are engaged in numerous businesses, including property and casualty insurance and reinsurance.

2. Under Section 13(f)(5)(A) of the Exchange Act, Berkshire is an institutional investment manager that exercises investment discretion over $100 million or more in reportable securities, as defined in Rule 13f-1(c) under the Exchange Act.

3. Berkshire is subject to the reporting requirements of Rule 13f-1(a) under the Exchange Act, which requires Berkshire to file Form 13F reports with the Commission on a quarterly basis.

4. On November 14, 2002, Berkshire filed a request, pursuant to Rule 24b-2 under the Exchange Act, for confidential treatment of information required to be filed with the Commission pursuant to Section 13(f) of the Exchange Act ("Form 13F information") for the calendar quarter ended September 2002. Berkshire also filed a public Form 13F report for the calendar quarter ended September 2002.

5. On February 13, 2003, the Division, acting under delegated authority, sent Berkshire a letter that denied Berkshire's request for confidential treatment of Form 13F information for the calendar quarter ended September 2002 ("Denial Letter').

6. On February 21, 2003, Berkshire filed a Notice of Intention to Petition for Review indicating that it would appeal to the Commission the Division's decision to deny confidential treatment of Form 13F information.

7. On February 24, 2003, Berkshire filed an amendment to its public Form 13F report for the calendar quarter ended September 2002 that disclosed one of the securities positions included in Berkshire's request for confidential treatment of Form 13F information for the calendar quarter ended September 2002.

8. On February 28, 2003, Berkshire filed a Petition for Review, appealing the Division's February 13, 2003 denial of Berkshire's request for confidential treatment of Form 13F information for the calendar quarter ended September 2002.

9. On May 6, 2003, Berkshire filed an amendment to its public Form 13F report for the calendar quarter ended September 2002 that disclosed one of the securities positions included in Berkshire's request for confidential treatment of Form 13F information for the calendar quarter ended September 2002. Berkshire's public disclosure of that securities position, which was also included in its Petition for Review, makes the Commission's review of the denial of confidential treatment for that position moot.

III.

We have carefully considered Berkshire's Petition for Review in this matter and the Division's Denial Letter. The Division states that Berkshire failed to demonstrate a likelihood of substantial competitive harm from the disclosure of its acquisition program for two securities. Berkshire essentially relies on general statements and exhibits involving other selected securities, indicating that revelation of Berkshire's position in the securities which are the subject of their Petition would, because of its CEO's (Mr. Buffett's) reputation for successful stock selection, adversely affect Berkshire's acquisition program. Berkshire argues that other market participants would on learning of Berkshire's interest join in acquiring the stock, causing a material increase in the price of the stock, thus making pursuit of the acquisition program more costly. Berkshire provided a list of instances where disclosure of Berkshire's positions in other securities was followed by increases in the prices of the securities in question. (Exhibit 1 to Berkshire's Petition for Review.)

The Division's denial of Berkshire's request rests largely on its view that Berkshire has not adequately demonstrated the likelihood of *substantial competitive harm* in that the information provided regarding these particular securities is essentially general and does not provide sufficient information regarding "whether [Berkshire's] ability to acquire or liquidate a securities position, *in the context of the market for those securities*, is likely to be impaired if its investment strategy were made known to the public." (Denial Letter, pages 3-4, citing the Division's June 17, 1998 letter to confidential treatment filers.) (Emphasis added.)

The Division, in requiring more specific information to substantiate the likelihood of competitive harm, in the context of this record, appears to be within the guidelines set out for filers and in accordance with the purposes of Section 13(f) and the rules and current Division guidance thereunder.

We recognize that there have been a number of occasions where disclosure of Berkshire's stock purchase or selling programs has resulted in temporary spikes in the market, and may to varying extents "foreclose [Berkshire's] ability to increase its holdings in that security at prices Mr. Buffett concludes are attractive." (Berkshire's Petition for Review, page 4.) However, we hesitate to declare that such disclosures will inevitably lead to market disruption so severe as to cause substantial competitive harm to Berkshire's competitive position in all cases. That would lead to a virtual *per se* justification for confidentiality for Berkshire, without specification of limits or specific time frames for any acquisition (or sales) program Berkshire sees fit to undertake. In our view, Berkshire's request appears over-broad. The Division's request for additional substantiation of this aspect of Berkshire's request, including discussion and analysis of the market conditions and the likely effect of disclosure, *at the times in question for these securities*, and more specific reasons for Berkshire's assertion that its ability to acquire or sell these securities would be so adversely affected as to cause it substantial competitive harm, therefore appears appropriate. Moreover, we believe that the Division's request that Berkshire address both the status and expected duration of Berkshire's programs in these securities was also appropriate. Information concerning matters such as "historical price of and an average daily trading volume for these securities" (Denial Letter, page 4) and a more specific description of the planned program of acquisition or disposition could assist in informing the Commission's assessment of the impact of granting or denying Berkshire's request.

The Commission affirms the Division's February 13, 2003 decision to deny Berkshire's request because it failed to justify the requested one-year time period for confidential treatment, and failed to demonstrate that disclosure would be likely to cause substantial harm to Berkshire's competitive position.

IV.

IT IS ORDERED that, after considering Berkshire's Petition for Review under Rule 431(b)(1) of the Commission's Rules of Practice and under the standards for review set forth in Rule 411(b)(1)(iii) of the Rules of Practice, the Commission, pursuant to Rule 431(a) of the Rules of Practice, affirms the Division of Investment Management's decision to deny Berkshire's Form 13F confidential treatment request for the calendar quarter ended September 2002.

IT IS FURTHER ORDERED that the automatic stay of delegated action pursuant to Rule 431(e) of the Rules of Practice is hereby lifted.

By the Commission.

____
Jonathan G. Katz
Secretary

http://www.sec.gov/rules/final/34-48368.htm

Hurricane Buffets Berkshire Hathaway

By JACK SIRARD
THE SACRAMENTO BEE

Last Updated: October 2, 2005, 06:09:08 AM PDT

Q: Is Berkshire Hathaway a good value? Will Katrina hurt it?

— Steve P., Carmichael

A: After Katrina hit, Berkshire Hathaway Inc. said it expected to incur 3 percent to 5 percent of the insurance industry losses associated with the hurricane.

In its recent filing with the Securities and Exchange Commission, Warren Buffett's company noted that the extraordinary devastation caused by Katrina made it particularly difficult to estimate the actual cost of the catastrophe.

But if you use the most recent industry loss estimate of $60 billion, then it appears Berkshire's share could amount to between $1.8 billion and $3 billion.

In its analysis, Morningstar said that if Berkshire's losses come in at $3 billion, it would be equivalent to $1,950 per each Class A share.

While Berkshire's largest business is insurance, it operates other companies ranging from See's Candies and Dairy Queen to Fruit of the Loom and H.H. Brown Shoe Group.

The conglomerate also holds huge equity positions in such companies as American Express, Anheuser-Busch, Coca-Cola, Wells Fargo and The Washington Post. Chairman Buffett owns about 40 percent of the company's stock.

Is it a good value? That certainly depends on individual judgment, given that the stock is quite pricey.

The company's A shares have consistently been the highest-priced stock on Wall Street. The stock, which trades on the New York Stock Exchange (ticker symbol BRKA), closed Thursday at $81,400 a share, about midway between its 52-week low of $78,800 and its high of $92,000.

Value Line's recent three-to-five-year price projection anticipates Berkshire trading in a range of $112,000 to $136,500 per share.

Despite the potential heavy insurance losses the company faces, history has shown that it's never smart to bet against Buffett. I think that's still the case today.

Sacramento Bee columnist Jack Sirard can be reached at 916-321-1041 or jsirard@sacbee.com.

HeraldNet

Business

Published: Sunday, October 9, 2005

S&P updates growth, value stock formulas

Associated Press

The differences between growth and value might be lost on average investors, but among financial professionals, few investing concepts inspire more fervor.

Value stocks are companies that sell for less than they're worth, based on their fundamentals; this investment style is favored by bargain hunters like Warren Buffett and Bill Miller, portfolio manager of the Legg Mason Value Trust. Growth companies are expected to make substantial gains in revenue and profit relative to their peers. The share prices of growth stocks are apt to reflect the market's hopes for the future rather than their current fundamentals.

Wall Street has produced many options for professionals and individuals looking for ways to adhere to these investment styles, including a slew of actively managed funds focused exclusively on growth or value stocks of all sizes. The major indexes have also been sliced up into style pies.

Now, Standard & Poor's is in the process of updating its style indexes, with plans to offer two different ways to track value and growth stocks, including one that seeks to more closely match the strategies used by fund portfolio managers.

S&P is phasing out its Barra-style benchmarks, which relied solely on a stock's price-to-book value to determine whether it would be listed in a value or growth index, in favor of an approach devised by Citigroup that evaluates seven different factors. In addition, instead of classifying stocks as either growth or value, the new methodology will give companies a style "score." The stocks that are not 100 percent growth or 100 percent value will have their market caps distributed accordingly between the indexes.

PROJECT FINANCE NEWSWIRE

September 2000

US Heading For Merchant Plant Overdevelopment

by Christopher Seiple and Dr. Arnold Leitner, with RDI Consulting in Boulder, Colorado

Power shortages and price spikes in many areas of the United States this summer have put the electric power industry in the public spotlight and sparked demands for reregulation of the industry. However, our research indicates that that these price spikes and shortages will be temporary and that as early as next year some regions could be facing a glut of oversupply in the wholesale electricity market.

This glut is likely to begin just after developers and financiers ante up more than $30 billion in investment in new generating capacity.

Boom-and-Bust Cycles

Critical to success in a commodity market, such as electricity generation, is knowing when to buy, sell, or build generating assets. Academic research indicates that firms that are best able to drive their strategy by understanding cyclical trends are able to increase their return on investment by 3 to 4%.

No one can precisely predict boom and bust cycles in the future. However, a carefully structured analysis of the supply and demand balance that identifies the key sources of uncertainties and uses quantitative tools to assess the impact of these uncertainties provides a strong framework within which to develop a corporate strategy. To provide such an analysis, RDI employed a probabilistic model based on decision tree theory. This model incorporates uncertainty by applying probabilities to possible events and analyzing these events in hundreds of possible scenarios.

Our research indicates that four primary factors contribute to cyclical pricing trends in commodity industries.

continued on page 2

In Other News

MERCHANT PLANT INTERTIES remain under study at the IRS.

Independent power companies must pay the cost of connecting their power plants to the utility grid. The power company usually reimburses the utility for the cost of the intertie and any system upgrades required. The utility owns this equipment. At least since 1988, the IRS has not taxed the utility on the value of the equipment.

However, Judith Dunn, the deputy IRS chief coun-

continued on page 3

Attachment 7

Merchant Plants

continued from page 1

Lumpy Capacity Additions

One of these factors is the lumpiness of capacity additions in relation to a commodity's demand growth. This typically occurs in new or small industries where there are large economies of scale associated with capacity additions in relation to overall demand growth. For instance, demand for a new product may be increasing at 30% per year, but the construction of one new manufacturing facility may double manufacturing supply. Such conditions would likely create oversupply conditions for this product.

RDI believes that this factor could influence generation markets that are small in size due to a lack of transmission interconnections to neighboring regions. For instance, in eastern New York – an area where capacity is currently scarce – the peak demand is approximately 10,000 megawatts. Due to weak transmission interconnections, eastern New York is relatively isolated from the rest of the New York electricity grid. PG&E Generating is currently pursuing development of a 1,000 megawatt power plant in the region. Such a plant would increase overall supply by more than 10% in a market that is growing at a rate of less than 2% a year. Such a large capacity addition could meet future demand growth for as much as the next five years, causing a prolonged bust period in electricity prices.

Attachment X

Supply-Side Uncertainty

Another factor contributing to cyclical pricing trends is supply-side uncertainty. In some markets, the industry as a whole may be unaware of how much new supply is in the pipeline. Thus, companies acting independently pursue new capacity development that results in oversupply for the market as a whole.

Many conditions point to supply-side uncertainty in electricity markets:

- The long lead time of new power plant development – up to three years – and the uncertainty associated with the likelihood of individual projects going forward.
- Increases in capacity at existing units are occurring without public announcements.
- The development of unanticipated distributed generation could add to existing supply.
- Improvements in plant performance, combined with additional interruptible demand, could reduce the amount of reserve capacity required to provide the same level of reliability.

New Capacity Additions (MW)

		OPERATING/UNDER CONST.			ADVANCED DEV.		
Region	EOY 1999 SUPPLY	2000	2001	2002	2001	2002	TOTAL AS % OF EOY 1999 SUPPLY
AZNMA/CANVA	78,767	620	3,578	0	1,553	5,390	14%
ECAR/MAIN	161,702	6,811	6,331	0	3,395	4,108	13%
ERCOT	60,876	6,388	8,623	0	3,300	1,100	32%
FRCC	42,342	694	860	3,601	850	1,852	19%
MAAC	57,333	580	700	2,130	165	0	6%
MAPP	42,239	100	984	0	0	0	3%
NEPOOL	25,950	1,911	4,148	0	2,359	3,342	45%
NWPA	51,706	2	734	0	248	1,347	5%
NYPP	36,536	0	0		0	1,440	4%
RMPA	10,674	561	0	80	214	680	14%
SERC	155,766	9,233	8,352	1,940	2,157	5,998	18%
SPP	41,799	2,000	2,633	800	0	1,208	16%
Total	765,690	28,900	36,943	8,551	14,241	26,465	15%

Source: August 15th Release of RDI Consulting's NewGen database

Our research indicates that development of new power plants is currently the key driver of potential market downturns in electricity. The table on the previous page provides RDI's most recent projections of new capacity additions. This table includes only plants that have begun operating, are under construction, or in the advanced stages of development. Developers have proposed a total of more than 290,000 megawatts of new capacity.

Availability of Capital

A third factor contributing to cyclical pricing trends is the availability of capital. In general, companies tend to invest only when returns are high and funds are available either internally or from capital markets. As a result, too much capacity is typically added at the top of a cycle and too little capacity is added at the bottom of the cycle. In most commodity industries, this is the primary driver of boom-and-bust cycles.

In electricity markets it is clear that substantial amounts of capital are currently available for investment. Electricity marketers, such as PECO Energy, Williams and Coral, have played a large role in supporting the availability of capital due to their willingness to sign 20- to 30-year power purchase agreements that limit risk for the developer and for banks financing the project. The substantial cash flow of utilities – especially those securitizing stranded costs – has also contributed to capital availability. Finally, the general fondness the stock market has shown for companies like Calpine and AES is a sign that capital markets are willing to make substantial amounts of capital available for merchant developers.

Incorrect Demand Forecasts

The final factor driving cyclical pricing trends is that producers planning new capacity forecast demand incorrectly. Incorrect demand forecasts have played a substantial role in contributing to the current price spikes of the market. In some regions

continued on page 4

In Other News *cont.*

sel, said in a letter to two congressmen the agency made public at the end of July that the IRS is studying whether this policy should continue to apply in "a deregulated marketplace where the producer's power is not sold to the utility but is transported over the utility's transmission lines into a 'power pool' where third-party buyers bid on the producer's power." Dunn said the concern is whether the generator is a "customer" of the utility. Payments by a *customer* to a utility are considered a payment for services and are taxable to the utility.

There have been two meetings this summer with IRS and Treasury officials. The IRS said it plans to issue a revenue ruling when the issues are resolved, but probably not before next year. IRS officials said they would continue to rule that utilities do not have to report interties as income in cases where the generator sells his power to the interconnecting utility under a long-term contract.

THE TREASURY ISSUED A DEPRECIATION STUDY at the end of July.

The long-awaited study was ordered by Congress in 1998 after several industry groups complained that they were being forced to depreciate equipment over a longer period than the real economic life.

The study says the "class lives" on which tax depreciation is based are out of date, but it would take time and resources to update them. More than half of class lives were set in 1962 based on use studies conducted during the 1950's.

The study argues that economic studies — now 20 years old — suggest that tax depreciation is actually more generous in most cases than "economic" depreciation, or the rate at which assets actually depreciate in real life. One way to test this proposition is to look at whether the effective tax rate in an industry falls below the statutory rate of 35%. Treasury calculates the effective tax rate for electric light and

continued on page 5

Merchant Plants

continued from page 3

of the country, electricity demand recently increased by more than 4% annually – substantially higher than was anticipated by most forecasters.

There is ample room for error when trying to predict future demand because of the many variables that must be taken into account. For instance, incorrect forecasts of gross domestic product can contribute to incorrect demand forecasts. Other variables that we considered in our analysis include price elasticities, the feasibility of developing dispatchable demand, the impact of computers on electricity demand, and the weather.

Key Findings

The following table shows our predictions of which regions of the country will be in boom portions of the cycle and which regions will be in bust portions of the cycle in the years 2000, 2001, and 2002. This is based on the results from our probabilistic boom-bust model using decision tree theory and taking into account all of the factors discussed earlier. Bust regions are assumed to have at least 5% more capacity than needed, and boom regions are assumed to have at least 1% less capacity than needed.

Forecast Of Market Conditions By NERC Region

2000			2001			2002		
Boom	Equil.	Bust	Boom	Equil.	Bust	Boom	Equil.	Bust
FRCC	AZ/CA	ERCOT	FRCC	MAAC	ECAR/MAIN		FRCC	AZ/CA
MAAC	ECAR/MAIN			MAPP	ERCOT		MAPP	ECAR/MAIN
SERC	MAPP			SERC	NEPOOL		SERC	ERCOT
	NEPOOL			AZ/CA	SPP		NWPA	MAAC
	NWPA			NWPA	SPP			NEPOOL
	SPP							NYPP
								SPP

Our analysis has led us to a number of other conclusions.

This year, most of the country will either be in a boom portion of the cycle or at least close to market equilibrium levels in which prices are high enough to support new capacity development. With almost 30,000 megawatts of new capacity coming on line, we expect 2000 to be the year in which supply catches up with demand.

Due primarily to new capacity development, it is extremely likely that many regions of the country will enter bust portions of the cycle next summer. In the space of just two years – 2000 and 2001 – a minimum of 60,000 megawatts of new capacity will come on line. It is likely that total capacity additions by the end of next year will reach 75,000 megawatts. Total capacity additions during all of the 1990s were only slightly higher than 75,000 megawatts. In Texas and the northeast, we expect the market will have at least 20% more capacity than is required. Almost all of this capacity is already under construction. Only retirement of substantial amounts of capacity in these regions could provide price recovery.

By 2002, nearly all large markets in the US will be in the bust portion of the cycle. SERC is the only large market we predict may be at equilibrium levels. However, we believe this finding must be heeded with a bit of caution in that surplus capacity in ECAR/MAIN and SPP could potentially depress pricing in SERC as well. In smaller regions such as MAPP – where we predict equilibrium conditions – it would only take one or two large projects to move the market into oversupply conditions.

The most attractive regions for new development efforts include the southeast and mid-Atlantic. Florida is another attractive region, but the political climate is currently stymieing the efforts of developers to build new plants.

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Doom and Gloom Scenario

Based on the insights gained from the model, RDI identified a longer-term scenario that could potentially create a prolonged period of low prices and low returns for generators.

The first requirement for this scenario actually to occur is that electricity markets must be deregulated. That is, generators must be subjected to the disciplining force of market prices and consumers – or at a minimum marketers serving consumers – must be exposed to the volatility of these same prices. Price caps, standard offer rates, and partial deregulation in only a few states would impede the development of this scenario.

Because this scenario is driven by the imposition of supply and demand economics on the electric business, we refer to it as the economic rationalization scenario.

In this doom and gloom scenario, the imposition of supply and demand economics creates the following impacts. First, prior to 2003, generators build new capacity to meet expected demand as is occurring now. Next, persistent price spikes cause some level of dynamic demand to develop so that peak firm demand is reduced by 5% from expected levels between 2003 and 2008. Next, producers, trying to improve profitability, increase availability factors from an average of 82% to 88% between 2003 and 2008. Finally, generators are able to increase the capacity of their existing facilities by 1% per year between 2003 and 2008.

To consider the implications of this scenario, RDI used its electric simulation model to forecast future electricity prices in the midwestern US. In our base case, prices are at relatively high levels today due to shortages of capacity and high turbine prices. By 2002, prices reach long-run equilibrium levels and stay at that level over the forecast horizon. However, in the economic rationalization scenario, the combination of factors described above leads to substantial oversupply

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power companies, for example, is 31.5%. This compares to a corporate average of 30.9%.

Nevertheless, the study points to a number of factors in the power industry that will tend to make equipment in that industry obsolete more quickly. These include deregulation — generators are forced to maintain state-of-the-art equipment to remain competitive — advances in gas turbine technology, and the possible spread of distributed generation. The study also points to disparities in how the same generating equipment is depreciated depending on who owns it. For example, a power plant owned by a factory and used to generate power for internal consumption is depreciated over 15 years, while the same power plant owned by a power company and used to generate electricity for sale might be depreciated over 20 years.

What's next? Congress is unlikely to act on the report this year. Some action is possible next year, although neither presidential candidate has made this an issue and Rep. Bill Archer (R.-Texas) — the strongest advocate for updating depreciation allowances — is retiring from Congress.

A group organized by the Edison Electric Institute is lobbying Congress to allow all generating equipment to be depreciated over seven years. Most power plants are depreciated currently over 15 or 20 years.

CONNECTICUT said in a tax ruling that developers of merchant plants must pay sales taxes on machinery and equipment purchased for use in their projects, but at a 3% rate. This is half the normal rate.

The ruling — issued this summer — said four things. First, many states exempt equipment purchased for use in "manufacturing" facilities altogether from sales tax. Connecticut does, too, but the ruling said Connecticut does not consider generating electricity "manufacturing." Second, in Connecticut, a

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Merchant Plants

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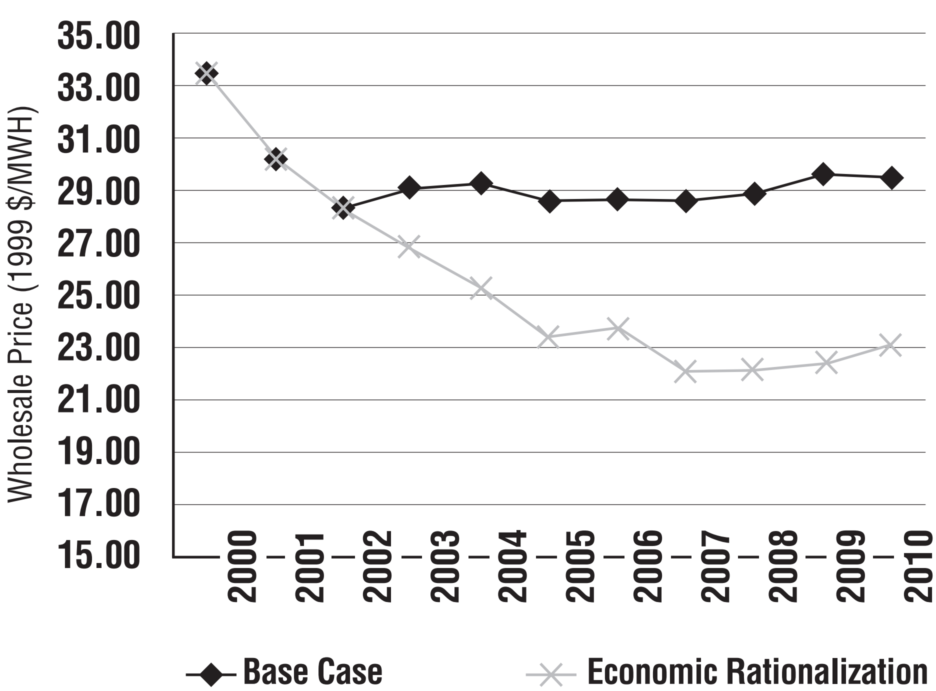
conditions for the duration of the forecast horizon. Prices are approximately 20% lower than in the base-case forecast.

This oversupply occurs for several reasons. First, the development of dynamic demand causes modest reductions in firm demand. Second, generators are able to produce more capacity from the existing system and improvements in availability factors also create more capacity. Third, the development of dynamic demand in combination with more reliable generators results in the market being able to provide the same level of reliability to customers with less capacity. Thus, overall target reserve margins are reduced.

It is difficult to assess the likelihood of this scenario actually occurring, but we believe it is an important scenario to watch for. Early signs of development would include the development of the infrastructure to facilitate dispatchable demand, continued price spikes, and improvements in plant performance.

Future Wholesale Electricity Prices Under Alternative Scenario



Policy Implications

Developers, power marketers and capital markets have responded to power shortage conditions and are rapidly building new plants that will provide customers with a reliable supply of electricity. New power plants are getting built in markets with regulated reserve requirements – like NEPOOL – and in markets with no reserve requirements – like Texas and western states. They are getting built in regions with independent system operators, or "ISOs," and in regions without ISOs. New power plants are even getting built in markets with significant regulatory risk – like California — or significant permitting and environmental hurdles – like the northeast. Our analysis indicates that developers should worry more about their investment returns than regulators should worry that plants will not get built in a deregulated market. Policymakers just need to ensure that the power plant development process is as easy, quick and fair as possible.

Finally, even though we expect most regions of the country will soon head into a period of low electricity prices, someday in the not too distant future, boom conditions will again return to the marketplace. Our analysis indicates that slight changes in the supply-demand balance can cause large changes in electricity prices. Markets with a 2% capacity shortfall have experienced significant price spikes, but regions with a 2% surplus have experienced very low electricity prices. There is one unknown that could reduce the threat of extreme

Attachment 7

price spikes – if customers begin to develop demand that can be curtailed during peak hours, price spikes could be diminished. Development of such demand should therefore be an important policy imperative. ■

Spotlight On Section 45 Credits

by Keith Martin, in Washington

The federal government offers a tax credit of 1.7 cents a kilowatt hour for generating electricity from wind, closed-loop biomass or poultry waste.

This article explains what qualifies for the credit and how to structure deals to transfer credits in cases where the developer lacks the tax appetite to claim them.

Credits run for 10 years after a power plant is first placed in service. However, the project must be in service by December 2001 to qualify. There is a fairly good chance that the US Congress will extend the deadline next year and also expand the list of eligible fuels.

Eligible Fuels

"Closed-loop biomass" means plants that are grown "exclusively" for use as a fuel in a power plant. Congress had in mind so-called electricity farms where plants are grown specifically to be burned as fuel. A Congressional committee report said in 1992 when the tax credit was enacted,

> "Accordingly, the credit is not available for use of waste materials (including, but not limited to, scrap wood, manure, and municipal waste) to generate electricity. Moreover, the credit is not available to a taxpayer who uses standing timber to produce electricity."

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In Other News *cont.*

reduced tax rate of 3% applies to equipment used in "processing" operations. Electricity generation is "processing." Third, spare parts and other supplies used "directly" in generating electricity are exempted from sales taxes under a special rule. Finally, there is no relief for material that ends up as part of the smokestack. Taxes must be paid on it at the full rate of 6%. That's because the smokestack is "real property" rather than equipment because it is affixed to land. The same logic probably applies to any portion of the project that is considered a "building" for tax purposes.

SECTION 29 TAX CREDITS come under fire.

The United States allows a tax credit of $1.035 an mmBtu for producing unusual fuels. The credit was enacted in 1980 after the Arab oil embargo. The idea was to reduce the need to import oil from the Middle East by inducing Americans to look in unusual places for fuel.

One of the things the credit encourages is production of "synthetic fuel from coal." Congress probably had in mind expensive and untested technologies like coal gasification or coal liquefaction. In the mid-1990's, several companies developed binders for gluing together waste coal fines recovered from gob piles and silt ponds and making pellets that could be burned as fuel in power plants. All remaining projects had to be placed in service by June 1998 to qualify for tax credits. Fifty-two plants for binding together coal fines were operating by the deadline, with many rushing to get into service in the last week of June.

The binders have not worked as well as hoped. Meanwhile, the IRS said in private rulings that the facilities could be moved to new locations and could qualify for tax credits by applying the binders to "run-of-mine" coal. As a consequence, a number of these facilities have been moved near utility power plants and are adding binder to coal that would have been

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Billionaires Warren Buffett and Bill Gates Answer Questions

Posted by: Paola Farer Web Producer
Created: **9/30/2005 9:55 PM MDT** - Updated: **10/1/2005 9:28 AM MDT**

LINCOLN, Neb. (AP) - Business students at the University of Nebraska-Lincoln had the chance to grill America's two richest men Friday afternoon.

Omaha investment wizard Warren Buffett and Microsoft Corp. founder Bill Gates took questions from about 100 students at the Lied Center for the Performing Arts while a crowd of about 2,200 people watched. The students asking questions were nominated by faculty.

Business ethics was the general topic, but Gates and Buffett fielded questions on a variety of issues including their definition of success, the future of video games, whether Gates plans to take over Berkshire and who plays bridge better.

Buffett and Gates mixed sound advice with humor throughout.

In response to a question about how to insure company managers behave ethically, Buffett explained the letter he sends to managers of his companies every couple years.

"It tells them we have all the money we need," he said. "We can afford to lose money, but we can't afford to lose reputation."

Gates agreed and said it's important to lead by example.

They have been friends since 1991, and Gates joined the board of Berkshire Hathaway last spring. Both men are worth at least $40 billion, but Gates again beat Buffett for the top spot on Forbes Magazine's list of the 400 wealthiest Americans this year with his $51 billion.

When one student asked whether Gates planned to take over Berkshire Hathaway, he initially tried to evade the question.

Gates said just being on the board is an honor and he is still learning about Berkshire's unique structure.

"It won't be me," Gates said. "Berkshire's got a lot of great people who understand their system."

Both Buffett and Gates told students the most important element of success was having families that love them.

"You have lived a successful life if the people you hope love you do," Buffett said.

When it comes to bridge, both agreed that Buffett was better -- mainly because he's played about 50 times as many hands as Gates.

Gates agreed to come to the University of Nebraska -- Buffett's alma mater -- as a favor to his friend and bridge partner. In 1998, the pair answered questions from University of Washington business students near Gates' home in Medina, Wash.

Students who attended said they were struck most by the two billionaires' sense of humor and how much they said they value family.

"I thought Warren Buffett was pretty funny," said Austin Weaver of Malcolm, Neb.

Megan Patefield of Norfolk, Neb., said it was awesome to be on stage with the two men even though she didn't get to ask her question.

"They're really personable," Patefield said.

Buffett, 75, leads his investment company, Berkshire Hathaway Inc., as chairman and chief executive. Gates is chairman and chief software architect of Microsoft. Berkshire Hathaway owns businesses and stock in a wide variety of industries, including insurance, furniture, restaurants, candy and newspapers.

Ex-Buffett employee may face SEC action

Berkshire Hathaway says General Re's Ronald Ferguson among several execs to receive notice from SEC.

October 7, 2005: 12:07 PM EDT

NEW YORK (Reuters) - Warren Buffett's Berkshire Hathaway Inc. said Friday the former chief executive of its General Re Corp. unit could face action from securities regulators as part of an investigation into non-traditional insurance products.

Berkshire Hathaway (unchanged at $83,100.00, Research) said it had been informed by counsel representing Ronald Ferguson that the former General Re CEO had received a Wells notice, which indicates the Securities and Exchange Commission is considering filing a civil action but provides an opportunity to dispute any potential charges.

Ferguson stepped down as CEO of General Re four years ago but provided consulting services to General Re and some of its affiliates until May 20 this year.

In September Berkshire Hathaway said securities regulators may also sue the current chief executive of its General Re Corp. unit, and former and current subordinates, over their roles in a 2000 transaction that helped American International Group Inc. inflate its reserves.

Berkshire said General Re CEO Joseph Brandon received a Wells notice from the Securities and Exchange Commission, indicating the SEC may file a civil suit against him alleging violations of securities laws.

Christopher Garand, a former senior vice president at General Re, and Robert Graham, a current senior vice president and assistant general counsel, also received notices, Berkshire said.

In addition to signaling that the SEC intends to pursue a civil action, a Wells notice allows the recipient to mount a defense.

The Justice Department and the SEC have been examining a transaction between General Re and AIG that helped the world's largest insurer improperly increase its reserves by $500 million, according to regulators.

In June, two former General Re executives, John Houldsworth and Richard Napier, pleaded guilty to charges that they helped AIG misstate financial results. They were fired.

Regulators want to determine whether General Re helped AIG inflate its financial condition.

The sweeping probe ultimately uncovered a host of wrongdoing at AIG that prompted the ouster of long-time CEO Maurice "Hank" Greenberg and forced the insurer to restate $3.5 billion of earnings over the past five years.

CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of October, 2005, I served the foregoing Comments of the Citizens' Utility Board of Oregon, in docket UM 1209 upon each party listed below, by email, or, when not available, by mail, postage prepaid, and upon the Commission by email and by sending 6 copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

Respectfully submitted,

Jason Eisdorfer

Jason Eisdorfer #92292
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