

GAO

Report to the Ranking Minority Member,  
Committee on Energy and Commerce,  
and the Honorable Edward J. Markey,  
House of Representatives

---

July 2005

PUBLIC UTILITY  
HOLDING COMPANY  
ACT

Opportunities Exist to  
Strengthen SEC's  
Administration of the  
Act



G A O

Accountability \* Integrity \* Reliability

---



Highlights of [GAO-05-617](#), a report to the Ranking Minority Member, Committee on Energy and Commerce, and the Honorable Edward J. Markey, House of Representatives

# PUBLIC UTILITY HOLDING COMPANY ACT

## Opportunities Exist to Strengthen SEC's Administration of the Act

### Why GAO Did This Study

The Public Utility Holding Company Act of 1935 (PUHCA), which is administered by the Securities and Exchange Commission (SEC), subjects public utility holding companies to federal regulation. Some recent events have raised concerns about SEC's administration of the act. GAO was asked to review SEC's administration of PUHCA. GAO's objectives included determining the nature and the extent to which SEC regulates registered holding companies and the results of its regulation, the extent to which SEC reviews claims of exemption and the results of these reviews, and how SEC determines whether companies have a controlling influence over public utilities or holding companies.

### What GAO Recommends

GAO is making recommendations that could improve the effectiveness and efficiency of SEC's oversight of registered holding companies and further enhance SEC's monitoring of exempt holding companies. GAO is also making a recommendation designed to clarify when the staff may issue no-action letters to utility investors. In addition, GAO recommends that SEC conduct a study on the impact of its decisions and flexible interpretations on the statutory objectives of PUHCA. SEC agreed with some of the recommendations, but did not address others. Further, SEC did not address action plans for other recommendations as GAO believes are necessary.

[www.gao.gov/cgi-bin/getrpt?GAO-05-617](http://www.gao.gov/cgi-bin/getrpt?GAO-05-617).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Yvonne Jones at (202) 512-8678 or [jonesy@gao.gov](mailto:jonesy@gao.gov).

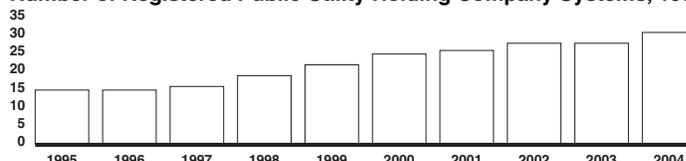
### What GAO Found

SEC regulates registered holding companies primarily by reviewing their applications for transactions and conducting periodic examinations that focus on improperly allocated costs and weak internal controls. As a result of these examinations, SEC has identified deficiencies at 20 companies since fiscal year 1999, which the agency estimates have resulted in consumer savings of over \$450 million. However, holding companies identified some PUHCA forms and regulations that are outdated, which SEC staff plans to address as time and resources become available. Some parties have also observed that SEC's interpretations of parts of the act have allowed holding companies to have complex corporate structures and exposed them to financial risks, but SEC has said that it interprets the act to respond to the demands of a changing industry. In addition, several holding companies indicated that SEC processes applications slowly, but none identified any financial consequences caused by such delays. SEC improved its timeliness in processing some applications in fiscal year 2004.

While PUHCA allows qualified holding companies to be exempt from registering under the act either by applying for an SEC order or filing an annual self-certification form, SEC has not reviewed the activities of all exempt holding companies to ensure that they continue to qualify for exemptions. However, in 2004 the staff reviewed the exemptions of all 81 holding companies that claim exemption by self-certification, which could lead to the revocation of some claimed exemptions. In addition, the staff did not evaluate the exemptions of holding companies that are exempt by SEC order as part of this review. SEC plans to take further steps to strengthen its oversight of exempt companies, including revising the self-certification form to collect more relevant information from exempt companies.

SEC has not yet deemed an investor that owns less than 10 percent of the voting securities of a public utility or holding company to be a holding company, as defined in the act. SEC has typically granted no-action relief to these investors. In considering these requests, staff must determine whether these investment structures contain consent rights that would allow an investor to exercise such a controlling influence over the management and policies of its invested entities as to necessitate regulation as a holding company under PUHCA. Over the past two decades, SEC staff has issued no-action letters to investors that have acquired an expanding list of consent rights over public utilities or other holding companies.

**Number of Registered Public Utility Holding Company Systems, 1995-2004**



Source: SEC.

---

# Contents

---

---

## Letter

Results in Brief	1
Background	3
Some Concerns Exist about the Effectiveness and Efficiency of SEC's Regulation of Registered Holding Companies	6
Exempt Company Oversight Has Been Limited, but Recent SEC Actions Are Designed to Strengthen It	12
SEC Conducts Analysis and Discussions When Considering PUHCA No-Action Requests, Similar to Processes in Other Government Entities	25
SEC Evaluates Controlling Influence on an Individual Basis, but No-Action Letters Reflect an Expanding List of Allowable Consent Rights	28
Conclusions	30
Recommendations for Executive Action	33
Agency Comments and Our Evaluation	35
	36

---

## Appendixes

<b>Appendix I: Objectives, Scope, and Methodology</b>	38
<b>Appendix II: Comments from the Securities and Exchange Commission</b>	42
<b>Appendix III: GAO Contact and Staff Acknowledgments</b>	44

---

## Table

Table 1: Complexity of Registered Holding Company Systems in 1995 and 2003	22
--	----

---

## Figures

Figure 1: An Example of a PUHCA "Pretzel" Structure	9
Figure 2: Number of Registered Holding Company Systems, 1995-2004	10
Figure 3: SEC's Office of Public Utility Regulation Organizational Chart	11
Figure 4: SEC's Process for Reviewing Applications Filed under PUHCA	14
Figure 5: Overview of SEC's Examination Program	17
Figure 6: SEC Estimates of Consumer Cost Savings as a Result of the PUHCA Examination Program	18
Figure 7: Time Elapsed between PUHCA Applications Submitted in Fiscal Years 2003 and 2004 and the Issuance of Related Orders	24

---

**Abbreviations**

CFTC	Commodity Futures Trading Commission
EWG	Exempt Wholesale Generator
FERC	Federal Energy Regulatory Commission
PUHCA	Public Utility Holding Company Act of 1935
SEC	Securities and Exchange Commission

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



United States Government Accountability Office  
Washington, D.C. 20548

July 8, 2005

The Honorable John D. Dingell  
Ranking Minority Member  
Committee on Energy and Commerce  
House of Representatives

The Honorable Edward J. Markey  
House of Representatives

Congress passed the Public Utility Holding Company Act of 1935 (PUHCA or the act) to protect consumers and investors from abuses by holding companies with interests in gas and electric utilities.<sup>1</sup> PUHCA, which is administered by the Securities and Exchange Commission (SEC), subjects public utility holding companies (holding company) to federal regulation. PUHCA defines a holding company, in part, as an entity that the Commission determines to exercise such a “controlling influence” over the management and policies of a public utility or holding company that it is necessary or appropriate in the public interest or for the protection of consumers and investors for the entity to be regulated as a holding company. PUHCA regulates several activities of registered holding companies, including the acquisition and issuance of securities, purchases and sales of utility assets, and transactions among affiliated companies. Also, PUHCA allows qualified holding companies to be exempt from regulation under the act by either applying for an SEC order or, in some circumstances, self-certifying that they satisfy the criteria for exemption annually.

Over the past two decades, several interested parties, including SEC, have advocated the repeal or amendment of PUHCA. To that end, several bills, and most recently the Energy Policy Act of 2005, have been introduced to either repeal or substantially amend the act.<sup>2</sup> PUHCA's critics note that the act is outdated and has largely accomplished its goals of protecting investors and consumers. The act's critics also maintain that the act

---

<sup>1</sup>Public Utility Holding Company Act of 1935, ch. 687, Title I, 49 Stat. 803 (1935) (codified as amended at 15 U.S.C. §§ 79 – 79z-6 (2000)).

<sup>2</sup>See, for example, H.R. 6, 109<sup>th</sup> Congress (2005) and S. 10, 109<sup>th</sup> Congress (2005); H.R. 6, 108<sup>th</sup> Congress (2003); H.R. 1627, 108<sup>th</sup> Congress (2003); H.R. 1644, 108<sup>th</sup> Congress (2003); H.R. 4503, 108<sup>th</sup> Congress (2004); S. 14, 108<sup>th</sup> Congress (2003); S. 475, 108<sup>th</sup> Congress (2003); S. 1005, 108<sup>th</sup> Congress (2003); and S. 2095, 108<sup>th</sup> Congress (2003).

---

restricts the flow of capital into public utilities and obstructs ongoing efforts to restructure the utility industry. However, others have expressed concern that repealing PUHCA could cause the type of abuses that the utility sector experienced prior to PUHCA's enactment, such as financial manipulations and anticompetitive practices, to reoccur.

Several recent events have led to concerns about SEC's administration of the act. For example, questions have been raised as to why SEC has approved a number of mergers involving geographically dispersed utility systems, despite PUHCA's requirement that each holding company system be physically interconnected or capable of physical-interconnection and operate in a single region or area. Questions have also been raised as to how SEC reviews exempt holding companies to determine whether they satisfy the criteria for exemption from the act and how investors that have received no-action letters—or assurances that SEC staff will not recommend any enforcement action to the Commission—have been able to avoid regulation as holding companies, despite making substantial investments in and acquiring a number of rights over operational matters of public utilities or holding companies.

This report responds to your August 2004 request that we review issues relating to SEC's administration and enforcement of PUHCA. Specifically, our objectives were to determine (1) the nature and the extent to which SEC regulates registered holding companies and the results of its regulation, (2) the extent to which SEC reviews claims of exemption—filed as either self-certifications or applications for SEC orders—and the results of these reviews, (3) SEC's process for issuing no-action letters, and (4) how SEC determines whether companies have a controlling influence over public utilities or holding companies.

To address our objectives, we reviewed selected SEC workpaper files, pending applications, and recent orders. We conducted structured interviews with representatives of randomly selected registered holding companies and representatives of companies that have received PUHCA no-action letters since 2001, as well as with all SEC staff attorneys and accountants that have worked in the Office of Public Utility Regulation for over 6 months. We also interviewed senior SEC staff from the Office of Public Utility Regulation and officials from the Offices of the Chief Counsel within SEC's Divisions of Corporation Finance and Investment Management, SEC's Inspector General, the Commodity Futures Trading Commission (CFTC), the Federal Energy Regulatory Commission (FERC), interested industry groups, and other knowledgeable parties. In addition,

---

we interviewed knowledgeable officials from the three major credit rating agencies, as well as officials from selected state utility commissions throughout the United States.

We conducted our work from August 2004 to July 2005 in Washington, D.C., and New York, N.Y., in accordance with generally accepted government auditing standards. Appendix I describes the objectives, scope, and methodology of our review in more detail.

---

## Results in Brief

SEC reviews applications of registered holding companies seeking SEC approval to engage in transactions regulated under the act. In addition, SEC conducts periodic examinations of registered holding companies, which focus on how costs are allocated within the holding company system and the effectiveness of internal controls. Currently, SEC tries to examine five holding company systems per year but plans to increase the frequency of these examinations to seven to eight per year. SEC officials estimated that steps taken by these companies to correct deficiencies identified in PUHCA examinations have resulted in consumer savings of over \$450 million since fiscal year 1999, with most of the savings attributable to one holding company's reallocation of its tax benefits in fiscal year 2004. In addition, some registered holding companies we spoke with identified PUHCA forms and regulations that are outdated and may need revision. SEC staff is aware of some of these concerns and is currently developing recommendations for regulatory changes that could impact registered holding companies. Some actions that SEC has taken in recent years have led interested parties to conclude that SEC interprets PUHCA flexibly by allowing holding companies to have complex corporate structures and exposing them to more risk. SEC has indicated that a certain amount of flexibility in interpreting PUHCA is necessary in a changing utility industry to protect consumers and investors. Similarly, some industry participants have also observed that PUHCA restricts SEC's ability to respond to developments in the utility industry. Industry participants also raised concerns about the length of time SEC needs to process applications. For example, 8 of the 13 holding companies we spoke with indicated that SEC issues notices and orders in response to PUHCA applications either somewhat slowly or very slowly, although none identified any financial consequences as a result of SEC's delays. Although SEC improved its timeliness in processing some applications in fiscal year 2004, several registered companies pointed to inadequate staffing levels as a reason for SEC's slowness. Meanwhile, SEC staff attorneys and accountants attributed lengthy processing times to

---

multiple layers of internal review by senior staff, among other possible reasons.

SEC has not conducted a thorough review of all exempt holding companies to ensure that they continue to qualify for an exemption from PUHCA and do not need to be subject to SEC regulation under the act. However, SEC has recently made efforts to improve how it oversees exempt holding companies. Specifically, in 2004, the staff conducted a review of all 81 holding companies that claim exemption by self-certification, which could lead to the revocation of some exemptions. Nevertheless, SEC staff did not evaluate the utility activities of holding companies that are exempt by SEC order, as part of its review, because these companies are not generally required to regularly provide SEC with information about their utility activities. In fact, SEC cannot reliably estimate the number of holding companies that continue to operate under previously issued exemptive orders and continue to be entitled to such exemptions. For example, while the agency estimates that 50 holding companies are exempt by order, this figure does not include holding companies that received exemptive orders because they were incidentally or temporarily holding companies. SEC officials told us that the agency plans to continue to improve its oversight of exempt companies as time and staff resources allow. For example, SEC staff is currently reviewing the self-certification forms that companies submitted in 2005. In addition, the staff plans to recommend a number of changes to the self-certification form that could allow the form to serve a more useful regulatory function.

SEC staff responds to requests for no-action relief from PUHCA by performing legal analyses about proposed transactions and sharing its opinions internally about whether to grant no-action relief. In addition to internal discussions, SEC staff also corresponds regularly with counsel for the requesting entities to help them clarify and focus their requests. This approach is similar to those of other SEC offices and CFTC, which also issue no-action letters.

SEC has historically evaluated the presence of controlling influence over the management or policies of a holding company or public utility on a case-by-case basis, considering factors such as the relationship between the holding company and the public utility, the nature of intercompany contracts, and whether there will be adequate oversight to protect consumers and investors. However, these cases all involved holding companies that own 10 percent or more of the voting securities of a public utility or a holding company. Although SEC has not yet declared an investor

---

owning less than 10 percent of the voting securities of such companies to be a holding company, SEC staff has granted no-action relief to these types of investors seeking assurances that they are not holding companies. The staff's analyses of these no-action letter requests typically include a review of consent rights to be acquired by the investor in the proposed transaction to determine whether controlling influence is present. Since 1986, staff has issued no-action letters to investors that have proposed investment structures that include a growing number of consent rights over operational matters concerning the invested entities. As a result, some interested parties have called for SEC to clarify which consent rights would cause an investor to exert the necessary controlling influence to require regulation as a holding company. However, SEC staff explained that more explicit guidance on permissible consent rights would not be feasible because investors could structure future transactions with new or different combinations of consent rights. Nevertheless, it may be beneficial for SEC staff and investors for SEC to issue general guidelines setting forth minimum standards that utility investors must satisfy for the staff to find that they do not exert a controlling influence. These guidelines could help clarify for the staff as to when it is appropriate to issue a no-action letter and for the industry on how SEC determines whether a controlling influence is present.

This report makes recommendations designed to improve SEC's oversight of registered and exempt holding companies, as well as to clarify the conditions under which SEC staff may issue no-action letters to utility investors. These recommendations include establishing target time frames for processing PUHCA applications and creating an action plan for establishing time frames for making improvements to existing PUHCA forms and developing a system to collect and analyze information contained in companies' PUHCA filings to enable SEC staff to better monitor the activities of registered companies. We recommend that SEC expedite its planned evaluation of the different legal options for requiring companies that are exempt by order to provide additional information on their operations and create a plan for conducting future reviews of companies claiming exemptions. We also recommend that SEC develop and publish guidelines that set forth the minimum standards that utility investors must satisfy for the staff to find that they do not exert the necessary controlling influence to require regulation as a holding company. Finally, we recommend that SEC conduct a study on the impact of its administration of PUHCA in the last decade. We requested comments on a draft of this report from the Chairman, SEC. SEC provided written comments that are reprinted in appendix II. SEC noted that the agency has

---

ongoing initiatives to improve its administration of the act and agreed with some of the recommendations, but did not address others. Further, SEC did not address whether it would develop action plans for other recommendations as we believe are necessary. SEC's comments are discussed in greater detail at the end of this report.

---

## Background

Prior to PUHCA, ownership of the nation's utilities was concentrated in a small number of holding companies. Many of these holding companies had developed complex, multistate structures, with highly diversified interests throughout the country. These structures triggered concerns that holding companies exploited consumers by charging excessive utility rates and investors by selling securities without providing adequate information on the conditions surrounding their issuance. The multistate character of these holding companies also obstructed effective state regulation of subsidiary utilities.

---

## Basic Provisions of PUHCA

In response to these concerns, PUHCA imposed a number of restrictions on registered holding companies to protect consumers and investors that include:

- *Integration and simplification*—Each holding company is generally limited to owning a single integrated public utility system, defined as a group of related operating properties confined in its operations to a single area or region, not so large as to impair the advantages of localized management, efficient operations and effective regulation. In addition, holding companies may only acquire nonutility businesses that are reasonably incidental or economically necessary or appropriate to the operations of an integrated utility system.<sup>3</sup>

---

<sup>3</sup>15 U.S.C. §§ 79b(a)(29) and 79k(b)(1).

- 
- *Issuance and acquisition of securities and assets*—SEC must approve the issuance of securities by a holding company or any of its subsidiaries. In particular, securities must be reasonably adapted to a company’s earning power. SEC must also approve the acquisition by a holding company of any securities, utility assets or other business interests.<sup>4</sup>
  - *Service company regulation*—Service, sales, and construction contracts between a subsidiary of a holding company and any other company in the same holding company system must be performed “economically and efficiently” and be “equitably allocated” among subsidiaries.<sup>5</sup>
  - *Upstream or intrasystem loans*—PUHCA also prohibits holding companies from receiving “upstream” loans from any of its subsidiaries.<sup>6</sup>

PUHCA allows holding companies that meet any of five statutory criteria to apply for an order of exemption from registration under the act. Under Section 3 of the act, SEC must exempt a holding company from any provision of the act if it meets one of the following criteria:<sup>7</sup>

- It and all of its utility subsidiaries from which it derives any material part of its income are predominantly intrastate in character.
- It is predominantly an operating public utility company and operates in the state in which it is organized and contiguous states.
- It is only incidentally a holding company.
- It is only temporarily a holding company.

---

<sup>4</sup>15 U.S.C. §§ 79g(d) and 79i(a)(1).

<sup>5</sup>15 U.S.C. § 79m(b).

<sup>6</sup>15 U.S.C. § 79l(b).

<sup>7</sup>However, SEC may deny an exemption if it finds that an exemption would be detrimental to the public interest or the interest of consumers and investors. 15 U.S.C. § 79c(a).

- 
- It is not principally a public utility business within the United States nor does it derive any material part of its income from public utility companies operating within the United States.

Holding companies can be exempt from registration under any of these provisions by applying for an SEC order. Alternatively, under Rule 2 of the act, companies that meet either of the first two criteria may claim exemption by making an annual self-certification filing on SEC Form U-3A-2 and be recognized as exempt without further action from SEC.<sup>8</sup>

Except for Section 9(a)(2) of the act, exempt companies are generally not subject to SEC's continuing regulatory supervision.<sup>9</sup> Under Section 9(a)(2), any affiliated company—including an exempt holding company—of a holding company or a public utility must obtain SEC approval before it acquires any security of an affiliated holding company or public utility.<sup>10</sup>

---

## Information on Holding Companies

Section 2(a)(7) of PUHCA provides two definitions of a holding company. First, the act defines a holding company as a company that owns or controls 10 percent or more of the voting securities of a public utility or another holding company.<sup>11</sup> The act also defines a holding company as an entity that the Commission determines, after notice and an opportunity for a hearing, to exercise such a “controlling influence” over the management or policies of a public utility or holding company that it is necessary or appropriate in the public interest or for the protection of investors and consumers for the utility to be regulated as a holding company.<sup>12</sup> However, through an investment structure known in the utility industry as a “PUHCA pretzel,” some investors have obtained SEC staff assurances that the staff will not recommend enforcement action against them. Thus, these investors have not registered or claimed exemption from the act. Under this investment structure, investors purchase less than 10 percent of the voting securities—but a large percentage of the total equity through

---

<sup>8</sup>17 C.F.R. § 250.2 (2004).

<sup>9</sup>15 U.S.C. § 79i(a)(2).

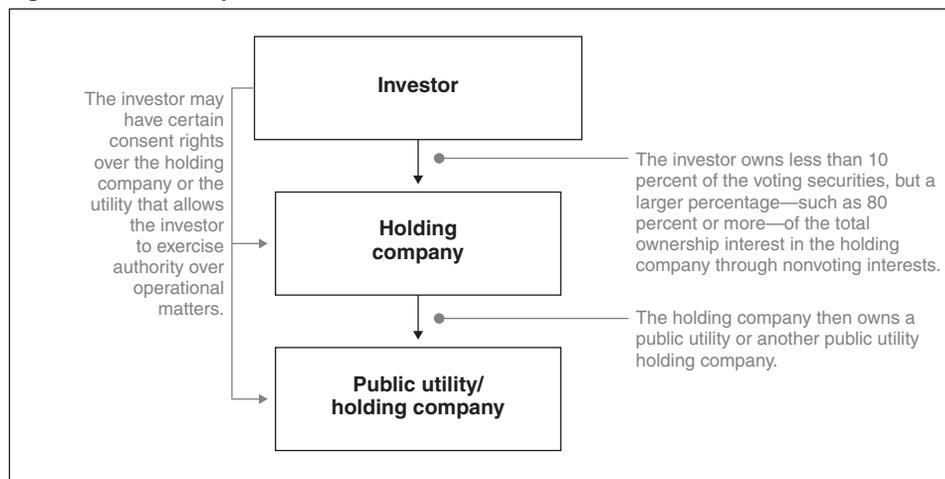
<sup>10</sup>PUHCA defines an affiliate company to include an entity that owns 5 percent or more of the voting securities of another company. 15 U.S.C. § 79b(a)(11).

<sup>11</sup>15 U.S.C. § 79b(a)(7)(A).

<sup>12</sup>15 U.S.C. § 79b(a)(7)(B).

nonvoting interests—of a holding company, which directly or indirectly owns a public utility. In addition, investors acquire a series of rights—called consent rights—which would require the investor’s consent before the invested entities could engage in various transactions, such as issuing securities or acquiring new assets. An example of this relationship is presented in figure 1.

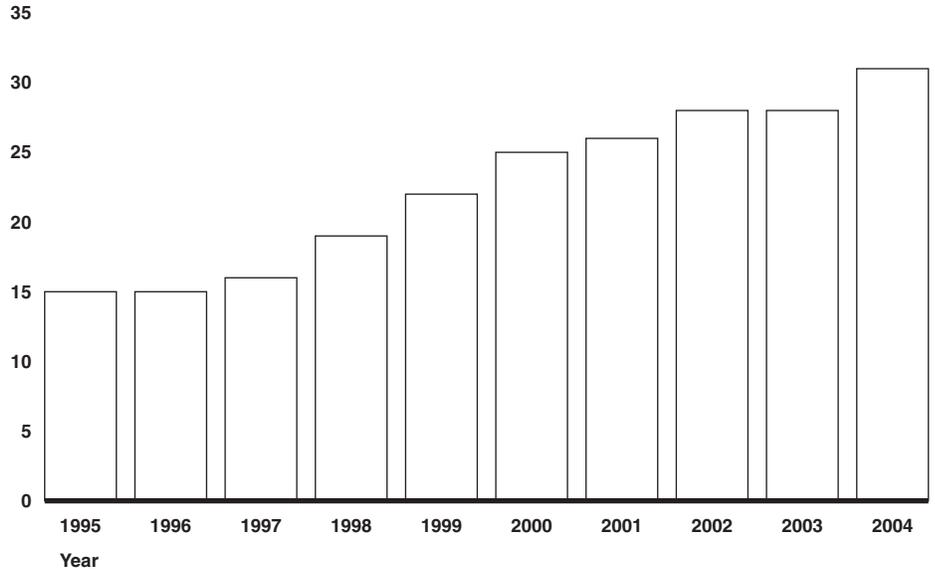
**Figure 1: An Example of a PUHCA “Pretzel” Structure**



Source: GAO.

As a result of heavy merger and acquisition activity within the utility sector, the number of holding companies that have registered under the act has more than doubled over the past decade, as shown in figure 2. As of December 31, 2004, 31 holding companies—which in turn owned an additional 25 intermediate holding companies—had registered under the act. This figure reflects a slight increase since December 2003, when 29 parent holding companies with \$653 billion in assets were registered under the act. By contrast, in June 1995, only 15 holding companies were registered under the act.

**Figure 2: Number of Registered Holding Company Systems, 1995-2004**



Source: SEC.

## Information on the Office of Public Utility Regulation

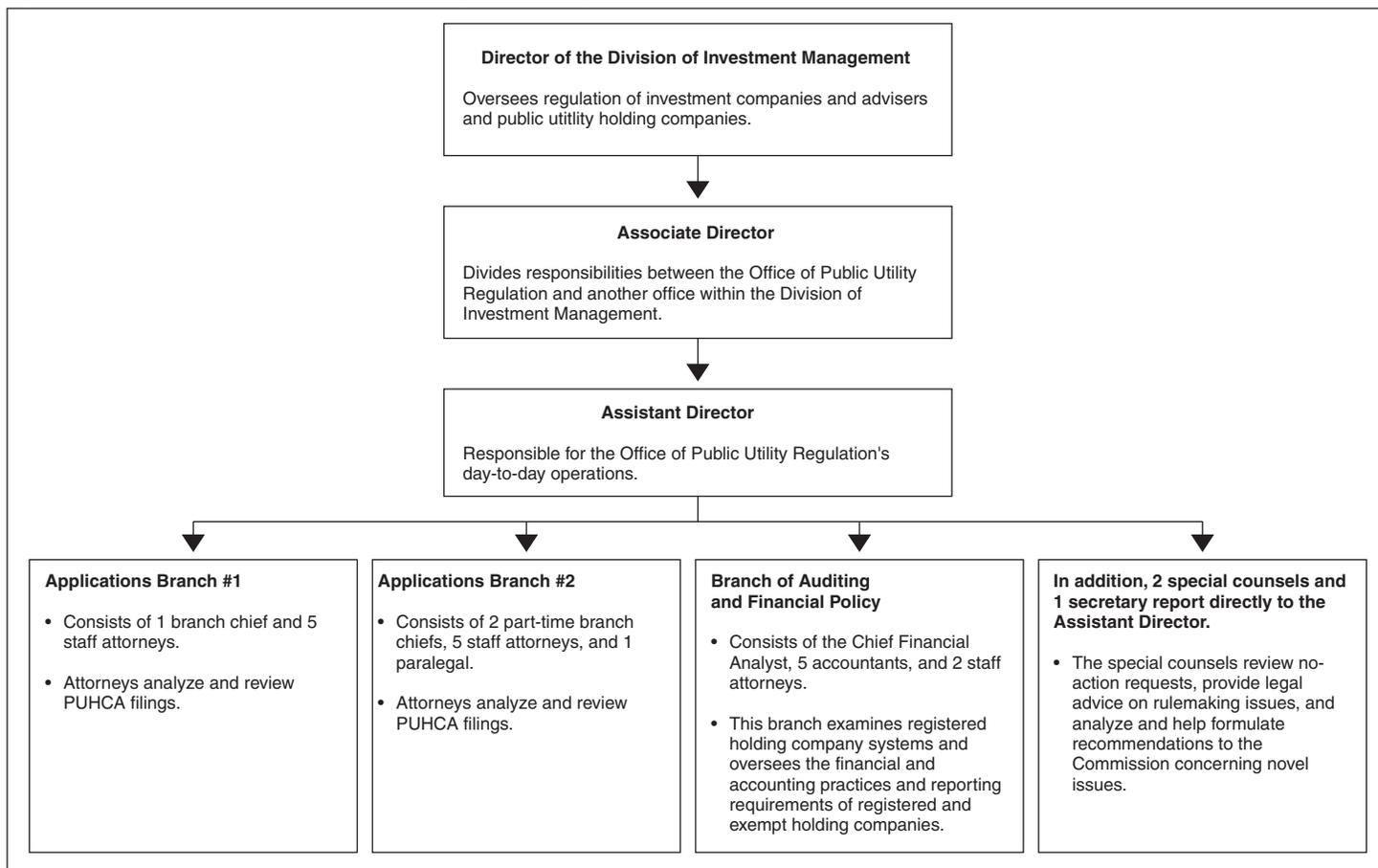
The Office of Public Utility Regulation, which is part of SEC’s Division of Investment Management, is responsible for administering PUHCA. SEC staff that works in this office reviews applications filed under the act, examines registered holding companies, and monitors industry activity, among other responsibilities. In addition, staff also issues “no-action letters,” or assurances that it will not any recommend enforcement action to the Commission against entities seeking to engage in activities that may raise questions under the act. No-action letters often provide creditors with assurance that an entity seeking financing will not later be subject to enforcement action under PUHCA.

As of January 2005, the Office of Public Utility Regulation had 25 full-time equivalents, including 17 attorneys, six financial analysts or accountants, and two support staff.<sup>13</sup> The office is divided into three branches: Applications Branch #1, Applications Branch #2, and the Branch of Auditing and Financial Policy. Each branch is headed by one or more

<sup>13</sup>These figures of full-time equivalents do not include the Associate Director or the Director of Investment Management.

branch chiefs, who report directly to the Assistant Director. The Assistant Director is responsible for overseeing day-to-day operations and reports to an Associate Director, who splits time between managing this office and another office within the Division of Investment Management. The Associate Director reports to the Director of the Division of Investment Management. The office also has two special counsels who review no-action requests, provide legal advice on rulemaking issues, and analyze and help formulate recommendations to the Commission concerning novel issues under PUHCA. Figure 3 provides an organizational chart of the Office of Public Utility Regulation.

**Figure 3: SEC's Office of Public Utility Regulation Organizational Chart**



Source: GAO analysis of SEC information.

---

---

## Other Utility Regulators

In addition to SEC, other federal and state government entities also have oversight responsibilities for utilities. Both FERC and relevant state utility commissions generally must approve both the issuance of any securities that will finance utility operations and the acquisition of utility assets by utility companies.<sup>14</sup> In addition, state utility commissions have jurisdiction over electric and gas utility companies that operate in their state. However, according to SEC, most state utility commissions do not have authority over the books and records of the holding companies of those utilities and have only limited authority to regulate affiliate transactions within holding company systems.

---

## Some Concerns Exist about the Effectiveness and Efficiency of SEC's Regulation of Registered Holding Companies

SEC regulates registered holding companies primarily by reviewing their PUHCA applications that seek SEC approval to engage in various transactions and conducting periodic examinations to identify improperly allocated costs and weak internal controls. SEC's current goal is to examine five holding company systems per year but plans to increase the frequency of these examinations. SEC officials estimated that these examinations have resulted in consumer savings of over \$450 million since fiscal year 1999 as a result of cost and tax benefit reallocations and improvements in the efficiency of 20 different holding company systems. However, roughly 72 percent of these cost savings were due to one company's reallocation of its tax benefits in fiscal year 2004. Some registered holding companies pointed out that several PUHCA forms and regulations are outdated and questioned the usefulness of some compliance requirements. Over the past decade, SEC has indicated that it is committed to interpreting PUHCA flexibly—i.e., in a manner that recognizes technological advances and other trends in the utility industry. However, some industry participants have indicated that PUHCA restricts SEC's ability to respond to developments in the utility industry. On the other hand, some interested parties have raised concerns that this flexible approach has allowed some holding companies to have complex corporate structures and exposed them to more risk. In addition, some holding companies perceived SEC to be slow in issuing notices and orders in response to PUHCA applications, but none identified any financial consequences as a result of SEC's delays. While SEC improved its timeliness in processing some applications in fiscal year 2004, some companies suggested inadequate staff resources as a reason for SEC's

---

<sup>14</sup>The authority of state utility commissions varies from state to state.

---

slowness in processing applications. By contrast, many SEC staff attributed lengthy processing times to multiple layers of internal review.

---

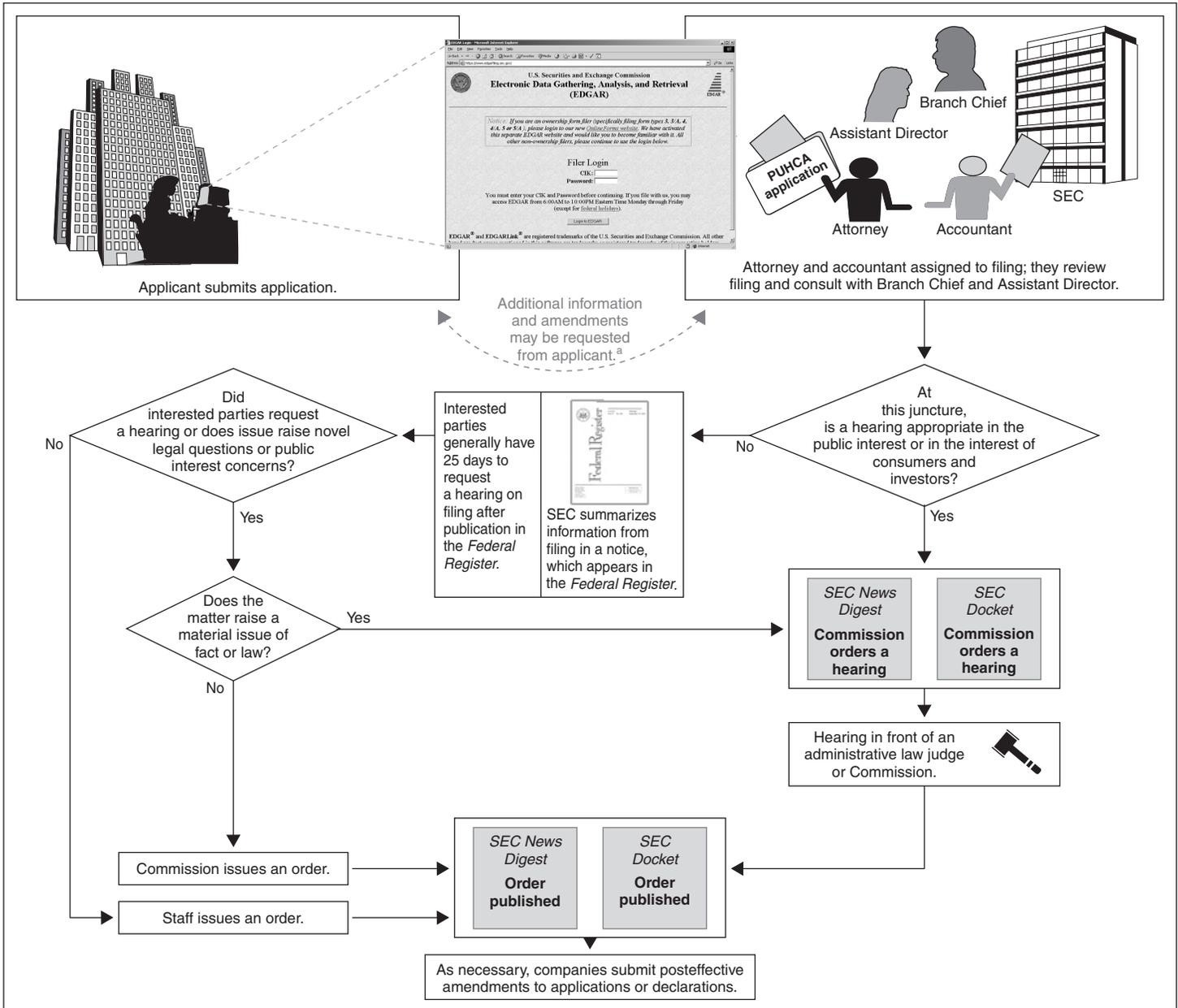
### SEC Reviews Applications of Registered Companies Using a Standardized Process

SEC reviews applications of registered holding companies seeking authority to engage in transactions that are regulated under PUHCA using a standardized process. SEC regulations provide the staff with delegated authority to issue notices and orders in response to applications that do not present novel legal questions and for which no request for a hearing has been received.<sup>15</sup> For transactions that also require approval from state commissions or other federal agencies, such as FERC, it is SEC's policy to wait until other regulatory bodies have approved the transaction before SEC will formally consider it. As shown in figure 4, upon receipt of a PUHCA application, senior SEC staff assigns a staff attorney and accountant to the filing. After internal consultations, staff may request additional information and amendments from the applicant. Staff will then summarize pertinent information from the application in a notice that appears in the *Federal Register*. After publication of the notice, interested parties have 25 days to request a hearing on the proposed transaction. If no requests for a hearing are received or the issue does not raise a novel legal question or public interest concerns, the staff will issue an order approving the proposed transaction. Otherwise, the Commission must issue the order or hold a hearing on the matter.

---

<sup>15</sup>17 C.F.R. §200.30-5. However, the Commission must issue orders for applications that raise novel legal questions or at the discretion of the Director of the Division of Investment Management.

**Figure 4: SEC's Process for Reviewing Applications Filed under PUHCA**



Sources: GAO (analysis); Nova Development (images).

<sup>a</sup>SEC may request additional information and amendments from companies after SEC issues a notice or order.

---

SEC may not reject a PUHCA application without providing the applicant with an opportunity for a hearing. Over the past several years, only two applications have resulted in hearings. Both SEC officials and some registrants acknowledge that, because of the time and expense involved in participating in a formal proceeding, holding companies will usually revise the terms of their original applications to resolve differences of opinion with SEC informally. In its review of financing applications, one of SEC's objectives is to protect the financial integrity of registered holding companies by, for example, requiring holding companies and their utility subsidiaries seeking financing authority to have an equity-capitalization ratio of at least 30 percent. This aspect of SEC's administration of PUHCA—that is, a review of the financial condition of a registrant—differs from its administration of other securities statutes, in which SEC reviews security issuances primarily by promoting full and fair disclosure and preventing and suppressing fraud.<sup>16</sup>

---

### PUHCA Examinations May Lead to Consumer Cost Savings

SEC also regulates registrants by conducting periodic examinations of their operations. These examinations focus on whether holding companies have proper internal controls to ensure financial integrity and whether costs are allocated equitably, economically, and efficiently among subsidiaries in the same holding company system. The examination manual issued in May 2003 indicated that the staff intends to examine up to five holding company systems per year so that all the registered systems would be examined on a 6-year cycle. The staff has taken steps to meet this goal by completing seven examinations between fiscal years 2003 and 2004. Moreover, with the recent hiring of two new staff, SEC plans to begin examining seven to eight holding company systems per year.

Examination teams generally consist of five examiners from the Branch of Auditing and Financial Policy, with additional staff attorneys assigned, as needed. The examination team will also invite staff from other regulatory bodies, such as FERC and the relevant state utility commissions, which may have different examination objectives than SEC, to work alongside the

---

<sup>16</sup>However, under Rule 15c3-1 of the Securities Exchange Act of 1934, SEC requires registered broker-dealers to maintain minimum net capital ratios that would allow them to meet obligations to customers and other market participants and to provide a cushion of liquid assets to cover potential market, credit, and other risks. 17 C.F.R. § 240.15c3-1.

---

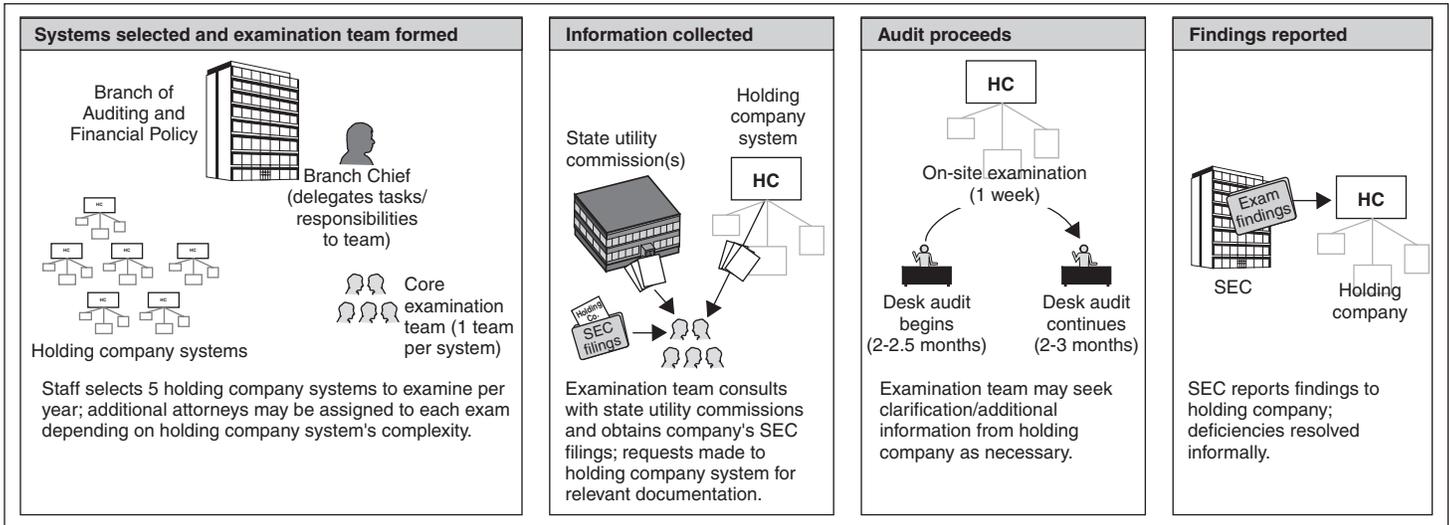
examination team.<sup>17</sup> The team will then review the public filings and other materials of the registered company it plans to examine. As shown in figure 5, the examination itself consists of three phases:

1. an initial desk audit, which lasts for up to two and a half months, during which the registered company will respond to a series of questions that SEC has about the company's operations and financial practices. In particular, these questions focus on how the holding company allocates costs among its subsidiaries and the internal controls that it has in place to ensure financial integrity;
2. a week-long, on-site examination during which examiners will interview internal and external auditors, as well as other key company officials; and
3. a post on-site desk audit, which lasts for 2 to 3 months. SEC will then report its examination findings to the holding company and seek to resolve deficiencies it discovered with the holding company. Examples of these deficiencies may include unfair or inequitable cost allocation procedures and inconsistencies in a company's PUHCA filings.

---

<sup>17</sup>FERC usually declines SEC's invitation. In addition, SEC will seek the holding company's permission before inviting state regulators to an examination, as most state statutes restrict states' authority over holding companies.

**Figure 5: Overview of SEC's Examination Program**



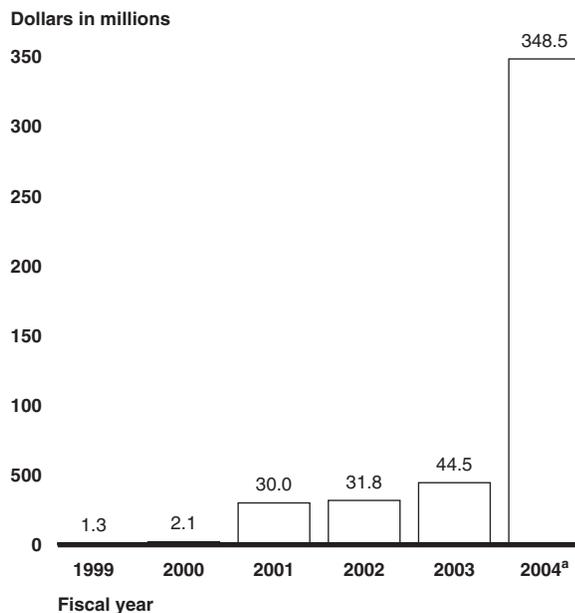
Sources: GAO (analysis); Nova Development (images).

Unlike other securities statutes, PUHCA does not provide SEC with administrative enforcement authority such as the ability to issue cease and desist orders. Instead, SEC must seek injunctive relief in federal district court. Nevertheless, SEC officials explained that the vast majority of holding companies voluntarily resolve any compliance deficiencies with SEC, as companies generally want to maintain positive relationships with their regulators.

According to SEC estimates, between fiscal years 1999 and 2004, consumers saved as much as \$458.2 million as a result of staff recommendations to reallocate costs and tax benefits within holding company systems and improve the efficiency of service company operations, as shown in figure 6. Over this period, SEC examination teams identified misallocated costs, tax benefits, and other inefficiencies within 20 holding company systems. However, according to one agency official, \$330 million—or 72 percent—of the total cost savings is attributable to one parent holding company's reallocation of its tax benefits to an intermediate holding company in fiscal year 2004. In addition, these figures may overstate the true benefit of PUHCA examinations to utility consumers. For example, SEC officials presume that the benefits of cost and tax benefit reallocations and other system improvements are passed down to consumers in the form of lower utility rates and that state utility

commissions consider these improvements when setting rates. However, SEC generally does not provide affected state commissions with copies of its examination findings. Instead, state commissions must request the findings from the holding companies themselves, which are not obligated to disclose them. As a result, according to SEC staff, state commissions may not be aware when setting utility rates of the savings that SEC examiners identified.

**Figure 6: SEC Estimates of Consumer Cost Savings as a Result of the PUHCA Examination Program**



**Total savings FY1999 - FY2004: \$458,219,00**

Source: SEC.

<sup>a</sup>Not including the \$330 million of reallocated tax benefits within one holding company system, SEC's estimate of consumer cost savings would be less than \$20 million in fiscal year 2004.

## Outdated Forms and Regulations May Decrease Efficiency of SEC's Regulation of Registered Companies

Some registered holding companies indicated that they have to complete PUHCA forms and follow regulations that are outdated and may not serve a

---

useful regulatory purpose.<sup>18</sup> Specifically, 10 of the 13 holding companies indicated that the annual report that registered holding companies must file requires them to disclose information that they already disclose to SEC under other securities statutes. A number of registrants also observed that it is not clear how SEC uses the information that companies provide in other filings, such as the quarterly report for energy-related or gas-related subsidiaries and the annual report for service companies. These holding companies observed that SEC rarely contacts them to clarify information in those filings, unless they are the subject of an examination. Similarly, in 2003, the SEC Inspector General also reported that many of the PUHCA forms are outdated, ineffective, or contain requirements that do not currently serve a useful regulatory purpose. In addition, some registered companies we spoke with indicated that Rule 70, which restricts the affiliations of members of a holding company's board of directors, may limit their ability to recruit and retain skilled directors.<sup>19</sup>

SEC officials are aware of some of these concerns and, as time and resources permit, plan to recommend a variety of regulatory changes that could impact registered companies. For example, officials indicated that they plan to simplify some forms to eliminate the filing of duplicate information that companies already submit in other SEC forms. One official also acknowledged that SEC may not review all companies' filings upon submission and told us that staff has discussed the possibility of developing a system that would collect relevant information contained in these filings. This type of system could help SEC better monitor the activities of registered companies on an ongoing basis and allow some PUHCA forms to serve a more useful regulatory purpose than they currently do. Officials also told us that they plan to recommend changes to Rule 70, which may be outdated in light of other securities acts and stock exchange rules that restrict the affiliations of company directors. Nevertheless, SEC officials indicated that they are limited from devoting significant time and attention to these initiatives due to available staff resources.

---

<sup>18</sup>SEC can only amend PUHCA forms through rulemaking initiatives.

<sup>19</sup>7 C.F.R. § 250.70.

---

---

## SEC's Flexible Approach in Administering Some Provisions of the Act Generates Both Support and Questions

Some interested parties and SEC have observed that the agency administers parts of PUHCA flexibly. For example, in the last several years, SEC has approved a series of mergers involving utility systems that are separated by hundreds of miles and are connected by small connector lines or transmission systems owned by other utilities, despite the act's requirement that utility systems be geographically integrated and operate in a single area or region.<sup>20</sup> SEC and some industry participants have stated that this flexibility is necessary to make the act relevant and protect consumers and investors in a rapidly changing industry, in which the geographic scope of energy service has greatly expanded. In addition, some industry participants have indicated that PUHCA restricts SEC's ability to respond to developments in the utility industry. Currently, SEC puts more emphasis on whether a merger or an acquisition will be economical and subject to effective regulation than on the integration requirements to recognize the changing environment of the utility industry. However, two public power organizations have raised concerns that SEC's interpretation of the integration requirements would effectively end enforcement of the act and encourage the formation of vast holding companies that the act was designed to prevent from recurring.<sup>21</sup> Recently, an SEC administrative law judge made an initial ruling that one such merger—between American Electric Power, an Ohio-based holding company, and Central and Southwest Corporation, a Texas-based holding company—did not satisfy PUHCA's single area or region requirement.<sup>22</sup> American Electric Power has petitioned for Commission review of this decision.

---

<sup>20</sup>Section 10(c)(1) and, by reference, Section 11(b)(1) of PUHCA require SEC to find that the utility operation to be acquired by a holding company, when combined with its existing utility operations, will result in a "single integrated public-utility system." See 15 U.S.C. §§ 79j(c) and 79k(b)(1). PUHCA defines a "single integrated public utility system" with respect to an electric utility, in pertinent part, as one that is physically interconnected or capable of interconnection and operates in a single area or region. See 15 U.S.C. § 79b(a)(29)(A). Examples of acquisitions that SEC concluded satisfied the "integration" requirement include mergers in 2000 between Northern State Power Company (Minnesota and Wisconsin) and New Century Energies (Colorado, New Mexico and Texas) to form Xcel Energy and between PECO (Pennsylvania) and Unicom Corporation (Illinois) to form Exelon. See *New Century Energies, Inc. and Northern States Power Company*, 2000 WL 1160583 (2000) (Approval Order) and *Exelon Corporation*, 73 S.E.C. 1336 (2000) (Approval Order).

<sup>21</sup>See *Statement of Position and Narrative Summary of Evidence and Legal Theories of the National Rural Electric Cooperative Association and the American Public Power Association*, File No. 3-11616, (Nov. 30, 2004).

<sup>22</sup>See *American Electric Power Company, Inc.*, Release No. ID-283, 2005 WL 1036365 (May 3, 2005).

---

Some interested parties have also raised concerns about the relaxation of restrictions on holding companies' ownership of nonutility subsidiaries. Through a series of statutory and regulatory amendments, both Congress and SEC have allowed registered holding companies to diversify into nonutility activities. For example, Congress amended PUHCA in 1992 to allow registered companies to own facilities called Exempt Wholesale Generators (EWGs), defined as companies engaged exclusively in the business of owning or operating facilities that generate and sell electricity at wholesale rates.<sup>23</sup> In addition, in 1997, SEC adopted Rule 58, which provides an exemption from the requirement of prior SEC approval before registered companies and their utilities may acquire interests in certain types of nonutility energy-related or gas-related companies, including energy trading companies.<sup>24</sup> As a result of these changes, the complexity of registered systems has grown tremendously. For example, in 1995, the 15 registered holding company systems consisted of less than 500 total companies. By contrast, the 29 systems that were registered, as of December 2003, consisted of over 6,500 total companies, including roughly 5,000 nonutility subsidiaries, as shown in table 1. While Congress and SEC have indicated that these changes were necessary to promote competition in the wholesale energy market and respond to the demands of a rapidly changing industry, some industry groups and credit rating agencies have stated that holding companies' diversification into unregulated activities has exposed registered companies to greater risks.

---

<sup>23</sup>See Energy Policy Act of 1992 § 711, 15 U.S.C. § 79z-5a (2000).

<sup>24</sup>17 C.F.R. § 250.58. Energy trading companies broker and market energy commodities, which involves selling electric power in the wholesale market by taking advantage of price differentials in back-to-back purchases and sales. Examples of other nonutility energy-related companies include, among others, companies that provide energy management or demand-side management services and sell electric and gas appliances. The exemption provided by Rule 58 with respect to the acquisition by registered holding companies of energy-related companies is limited to investments that do not exceed the greater of \$50 million or 15 percent of the holding company's total capitalization.

---

---

**Table 1: Complexity of Registered Holding Company Systems in 1995 and 2003**

	1995	2003
Parent holding companies	15	29
Intermediate holding companies	0	29
Electric or gas utility subsidiaries	106	147
Nonutility subsidiaries	229	4,999
EWGs	46	125
Foreign utility companies <sup>a</sup>	35	167
Inactive subsidiaries	55	1,012
<b>Total companies</b>	<b>486</b>	<b>6,508</b>

Source: SEC.

<sup>a</sup>Foreign utility companies, defined as utility companies that do not operate within the United States and do not derive any material income from U.S. sales, are generally exempt from the provisions of PUHCA.

SEC may also exercise flexibility when approving financing authority for financially troubled holding companies and their subsidiaries. For example, since fiscal year 2003, SEC has approved transactions for two companies, Allegheny Energy Inc. and Xcel Energy, Inc., and their subsidiaries to help them avert potential bankruptcy filings.<sup>25</sup> In both cases, although the companies were unable to meet SEC established thresholds for certain financial ratios,<sup>26</sup> SEC authorized various transactions, including the payment of dividends by the subsidiaries to their parent companies out of capital and unearned surplus. According to agency officials, SEC needs to weigh the costs and benefits of approving transactions for financially troubled companies very carefully. They stated that because bankruptcy proceedings would hurt investors and may ultimately lead to higher utility rates for consumers, SEC generally grants registrants the necessary financing authority to help them avoid bankruptcy. In addition, SEC officials explained that they monitor the activities of financially-distressed holding companies closely. Nevertheless, in the Allegheny matter, one

---

<sup>25</sup>See *Allegheny Energy, Inc., et al.*, Holding Co. Act Release No. 27579 (Oct. 17, 2002); *Allegheny Energy, Inc., et al.*, Holding Co. Act Release No. 27652 (Feb. 21, 2003), *Allegheny Energy, Inc., et al.* Holding Co. Act Release No. 27701 (Jul. 23, 2003); *Allegheny Energy, Inc., et al.*, Holding Co. Act Release No. 27963 (Apr. 29, 2005); and *Xcel Energy Inc.*, Holding Co. Act Release No. 276812 (May 29, 2003).

<sup>26</sup>Generally, SEC requires companies to maintain a benchmark equity-capitalization ratio of 30 percent.

---

interested party recently raised concerns about Allegheny's commitment to improving its financial condition and asked SEC to take further steps to ensure that Allegheny's utility customers are adequately protected or hold a hearing on renewing the company's financing authority.<sup>27</sup> However, in an April 2005 order that extended Allegheny's about-to-expire financing authority, the Commission denied the party's request for a hearing on the grounds that the request did not raise a material issue of fact or law in the context of the authority that the Commission did grant.<sup>28</sup>

---

### Some Parties Raised Concerns about Slowness in Processing Applications

Several industry participants raised concerns about what they perceived to be delays in SEC approving PUHCA applications. Specifically, 8 of the 13 registered holding companies we spoke with indicated that SEC issues PUHCA notices and orders either somewhat slowly or very slowly. Nevertheless, no holding company could identify an instance in which SEC delays had ever caused it to miss a deadline that had financial consequences. While staff collects data to track the status of applications to allow managers and the Commission to monitor the office's productivity, the agency has no formal performance goals for how quickly it should issue PUHCA notices and orders. As a result, we had no benchmark against which to determine whether SEC's review of PUHCA applications is timely.

In 2003, the SEC Inspector General also found that some PUHCA applications may not be processed in a timely fashion and recommended that staff establish time frames for processing applications by, among other options, setting target dates for issuing notices and orders, on a case-by-case basis.<sup>29</sup> However, SEC staff has not yet implemented the Inspector General's recommendation. According to agency officials, they are reluctant to establish strict time frames for issuing notices and orders because the complexity of applications can vary substantially. Nonetheless, the Inspector General's recommendation, if implemented, could help better manage how SEC processes applications while ensuring that the agency has flexibility to devote adequate time to reviewing novel applications.

---

<sup>27</sup>See *Comments and Request for Hearing of Harbert Distressed Investment Fund, LTD. Regarding Form U-1 and Declaration of Allegheny Energy Under the Public Utility Holding Company Act of 1935*, File Nos. 70-10251 and 70-10100 (Feb. 18, 2005).

<sup>28</sup>*Allegheny Energy, Inc., et al.*, Holding Co. Release No. 27963 (Apr. 29, 2005).

<sup>29</sup>U.S. Securities and Exchange Commission, "Regulation of Public Utility Holding Companies" (Audit 372). Oct. 20, 2003.

Nevertheless, SEC improved its timeliness in issuing some orders in fiscal year 2004. For example, as shown in figure 7, SEC issued orders in response to almost 36 percent of the applications it received in fiscal year 2004 within 3 months, compared with 22 percent in fiscal year 2003. However, some applications may remain pending for much longer periods of time. SEC officials told us that the amount of time needed to issue notices and orders can vary widely, depending on the complexity and completeness of the original application. Further, some applications remain pending for long periods of time because the companies do not formally withdraw applications for transactions that they do not plan to consummate.

**Figure 7: Time Elapsed between PUHCA Applications Submitted in Fiscal Years 2003 and 2004 and the Issuance of Related Orders**

	FY 2003 applications filed		FY 2004 applications filed	
	Number	Percentage of total	Number	Percentage of total
Less than 90 days	24	21.82	32	35.56
3 - 6 months	45	40.91	17	18.89
6 - 12 months	21	19.09	5	5.56
12 months or more	0	0.00	0	0.00
Withdrawn	13	11.82	4	4.44
Not noticed as of 12/20/04	7	6.36	32	35.56
<b>Total</b>	<b>110</b>	<b>100.00</b>	<b>90</b>	<b>100.00</b>

Source: SEC.

Note: As of December 20, 2004.

Industry participants and SEC staff attributed SEC's slowness in processing applications to both inadequate staffing levels and multiple layers of internal review. For example, 5 of the 13 registered companies we spoke with indicated that SEC's staffing levels are less than adequate to administer PUHCA. Many industry participants noted that the recent increase in the number of registered companies has strained existing staff resources and could result in delays in processing applications. SEC's Inspector General reported in 2003 that staffing resources were inadequate to handle current workloads, resulting in insufficient time for rulemaking

---

and monitoring exempt companies.<sup>30</sup> SEC has recently taken steps to increase staffing levels in the Office of Public Utility Regulation by granting staff authority to hire three new employees. However, the two new staff members that have been hired so far were assigned to the Branch of Auditing and Financial Analysis, which assists in processing applications, but does not have primary responsibility for them. In addition, 14 of the 20 staff attorneys and accountants we spoke with observed that the lengthy processing times might be due to the multiple levels of internal review by senior agency officials. Although these layers of review could help ensure consistency in SEC's notices and orders, which is an important agency criterion, they frequently cause bottlenecks. Some staff also attributed processing delays to companies submitting incomplete applications or not providing SEC with additional information in a timely manner.

---

## Exempt Company Oversight Has Been Limited, but Recent SEC Actions Are Designed to Strengthen It

SEC has not systematically monitored the activities and exempt status of all holding companies that are exempt from PUHCA. However, SEC is taking steps to improve its oversight of exempt companies. In 2004, SEC staff conducted a review of all 81 holding companies claiming exemption from PUHCA by self-certification. According to SEC officials, further action may be taken as a result of this review, including steps that could lead to the revocation of some claimed exemptions. Despite this effort, SEC's review did not include all of the approximately 50 holding companies that are exempt by order because these companies are not generally required to provide periodic information to SEC about their utility activities. In fact, SEC cannot reliably estimate how many companies that have received exemptive orders continue to be entitled to such exemptions. For example, while officials estimate that 50 holding companies are exempt by order, this figure does not include holding companies that received exemptive orders because they are only incidentally or temporarily holding companies. As time and resources permit, SEC staff plans to continue its efforts to better monitor whether exempt companies remain eligible for exemption, but has not established how it plans to implement these improvements. In addition to conducting another review of all companies claiming exemption by self-certification, SEC staff plans to develop recommendations for improvements to the self-certification form that these holding companies file.

---

<sup>30</sup>U.S. Securities and Exchange Commission, "Regulation of Public Utility Holding Companies" (Audit 372). October 20, 2003.

---

---

## SEC Only Recently Conducted a Review of Exempt Companies but Not Those Exempt by Order

While PUHCA provides SEC with broad authority to question and revoke the exemptions of holding companies that may be improperly claiming them, SEC has not undertaken a review of all holding companies that are exempt from PUHCA. As a result, the agency cannot ensure that all companies that have an exemption from PUHCA continue to qualify for an exemption and do not need to be subject to SEC's regulation under PUHCA. According to SEC officials, staff conducted reviews of the self-certification forms—called Form U-3A-2s—of holding companies that annually self-certify for exemption from PUHCA in 1998, 1999, and 2002. However, unlike the 2004 review, SEC could only devote limited resources in previous years to conducting these reviews. Moreover, in a 2003 report, the SEC Inspector General found that SEC does not generally review Form U-3A-2s to determine whether holding companies that self-certified for exemption continue to qualify for their exemption.<sup>31</sup>

SEC has recently improved how it oversees exempt holding companies. According to SEC officials, in 2004, a team of six SEC staff attorneys reviewed the Form U-3A-2s of all 81 holding companies that claim exemption from PUHCA by annual self-certification using a set of instructions on how to review the form. The instructions included a checklist to assist the attorneys in analyzing revenue information for the holding companies and their utility subsidiaries. The analysis of revenue information is a factor in determining whether a company can claim an exemption. According to SEC officials, as a result of this review, further steps may be taken, including steps that could lead to the revocation of some claimed exemptions.<sup>32</sup> SEC staff undertook this review, in part, as a result of a recent Commission decision that denied Enron Corporation's applications for exemption from PUHCA. This decision helped clarify the criteria that holding companies must meet to engage in out-of-state wholesale energy sales through their utility subsidiaries and be eligible for exemption from the act.<sup>33</sup> SEC officials told us that this decision had forced

---

<sup>31</sup>U.S. Securities and Exchange Commission, "Regulation of Public Utility Holding Companies" (Audit 372), Oct. 20, 2003.

<sup>32</sup>Under Rule 6, the Commission can take steps to revoke a company's exempt status if it determines that questions exist as to whether the exempt company continues to qualify for the exemption. 17 C.F.R. § 250.6.

<sup>33</sup>See *In the Matters of the Applications of Enron Corporation, Holding Co.* Act Release No. 27782 (Dec. 29, 2003).

---

at least two exempt companies whose utility subsidiaries sell wholesale energy to reconsider their exemptions.

Staff did not evaluate whether companies that are exempt by order continue to qualify for an exemption as part of its 2004 review. In fact, SEC has no formal process to ensure that these companies still qualify for their exemption and, therefore, are not subject to SEC oversight because they are not required to provide SEC with periodic information showing that the circumstances that gave rise to their exemptions continue to exist. In addition, SEC cannot provide reliable estimates of the number of companies that have received exemptive orders that continue to meet the statutory definition of a holding company. For example, officials estimate that 131 holding companies are exempt from PUHCA, of which 50 companies are exempt by order. However, these figures do not include holding companies that received exemptive orders because they are only incidentally or temporarily holding companies.<sup>34</sup> According to SEC officials, the agency exempted many companies from PUHCA that were only incidentally or temporarily holding companies in the 1930s and 1940s. However, because these companies do not regularly provide SEC with information about their utility activities, SEC may not know whether they still operate as holding companies or are still eligible for an exemption. SEC officials recognize this deficiency and plan to evaluate the different legal options for compelling companies that are exempt by order to provide SEC with additional information.

---

## SEC Increases Focus on Monitoring Exempt Companies

As time and resources permit, SEC plans to continue to take steps to improve its oversight of exempt companies. For example, SEC staff is currently reviewing the Form U-3A-2s that companies submitted in 2005, similar to its 2004 review. With the recent hiring of new staff, SEC has developed plans to better monitor the activities of exempt companies by regularly reviewing their credit ratings and public filings. While agency officials told us that they would like to formally review Form U-3A-2s as frequently as possible, they acknowledged that the demands of other office responsibilities limit them from conducting reviews of Form U-3A-2s annually. Also, the factors that SEC evaluates when reviewing self-certified exemptions may not change significantly from year-to-year.

---

<sup>34</sup>Under Sections 3(a)(3) and 3(a)(4), a company that is only incidentally or temporarily a holding company is eligible for an exemption. 15 U.S.C. §79c(a)(3)-(4).

---

In addition, SEC officials have indicated that they plan to recommend a number of changes to Form U-3A-2 that could allow it to serve a more useful regulatory purpose. In 2003, the SEC Inspector General found that this form is outdated and does not request the information necessary for SEC to determine whether a holding company should be exempt.<sup>35</sup> For example, the form requires holding companies and their subsidiary utilities to quantify their out-of-state electricity and natural gas transactions in terms of kilowatt hours and cubic feet, but not dollars. However, SEC has primarily looked at the revenue that these companies derive from out-of-state transactions when evaluating whether holding companies are predominantly intrastate. Because Form U-3A-2 does not directly require the submission of revenue data, SEC staff may have to obtain such data from other forms or ask the companies for it directly. SEC officials told us that they are aware of existing deficiencies with Form U-3A-2 and that they plan to develop a series of recommendations to the Commission for changes to the form that they would like to implement before the end of this year.

---

## SEC Conducts Analysis and Discussions When Considering PUHCA No-Action Requests, Similar to Processes in Other Government Entities

SEC staff conducts legal analyses and engages in internal discussions before responding to requests for no-action relief from PUHCA. In addition, staff frequently corresponds with counsel for the requesting entities to help them revise their requests. This process is similar to processes used in other SEC offices and another federal government agency that issue no-action letters.

---

## Staff Conducts Legal Analysis and Engages in Internal and External Discussions

Based on our review of the workpaper files of 10 of the 15 companies that obtained PUHCA no-action letters between 2001 and 2004, we found that SEC staff reviews the legal analyses offered in the no-action request and engages in internal discussions about whether to grant no-action relief to

---

<sup>35</sup>U.S. Securities and Exchange Commission, "Regulation of Public Utility Holding Companies" (Audit 372), Oct. 20, 2003.

---

the requester.<sup>36</sup> The legal analysis consists of staff examining the facts of the proposed transaction and conducting legal research to determine if the proposed transaction is allowable under the act. In addition, the staff discusses the facts and the legal research with other staff involved in reviewing the request. The staff also corresponds regularly with counsel for the requesting entities to help them focus and clarify their requests. In response to the staff's concerns, requesting entities generally submit multiple draft requests before staff is willing to issue a no-action letter. However, if the staff determines that it is not appropriate to issue a no-action letter in response to a request, the staff will then give the outside counsel an opportunity to withdraw the request, which counsel generally does.<sup>37</sup> SEC estimated that outside counsel withdraws approximately two PUHCA no-action letter requests each year. Nevertheless, SEC officials told us they were not aware of an instance in which the Commission had ever overturned a staff assurance contained in a no-action letter.

---

### Staff's Process for Responding to PUHCA No-Action Letter Requests Is Similar to Processes in Other SEC Offices and CFTC

SEC's process for responding to PUHCA no-action requests is similar to no-action letter processes in two other SEC offices and CFTC, the federal agency responsible for the regulation of commodity and financial futures and options.<sup>38</sup> Staff from these three entities also reviews no-action requests internally, performs legal analyses, and often engages in substantial discussions with the requesting entities to help them focus or revise their requests, before issuing a no-action letter or, alternatively, asking that they withdraw their request.

SEC issues relatively few PUHCA no-action letters compared with CFTC and another SEC office. For example, between 2001 and 2004, SEC staff issued an average of fewer than 4 PUHCA no-action letters per year. By contrast, CFTC issued an average of 21 no-action letters per year between 2001 and 2004 and the Office of the Chief Counsel in SEC's Division of

---

<sup>36</sup>As with PUHCA orders, SEC will not issue PUHCA no-action letters until other regulators, such as FERC or the relevant state utility commission, have approved the transaction, if such approval is necessary.

<sup>37</sup>However, we did identify one instance in which the staff issued a written denial of no-action relief from PUHCA. See Kaufman and Broad, Inc., SEC No-Action Letter, 1985 LEXIS 2344 (May 16, 1985).

<sup>38</sup>In addition to CFTC, we compared SEC's process for issuing PUHCA no-action letters with processes within SEC's Office of the Chief Counsel in the Division of Investment Management and SEC's Office of the Chief Counsel in the Division of Corporation Finance.

---

Corporation Finance told us it issued over 600 no-action letters in fiscal year 2004, of which 444 were for requests to exclude shareholder proposals from proxy statements. Staff attorneys are responsible for reviewing no-action letters at CFTC and in SEC's Office of the Chief Counsel within the Division of Corporation Finance. However, according to SEC officials, generally only senior SEC staff handles PUHCA no-action requests.

---

## SEC Evaluates Controlling Influence on an Individual Basis, but No-Action Letters Reflect an Expanding List of Allowable Consent Rights

SEC has historically evaluated investments by entities that raise concerns about controlling influence on an individual basis. In making these decisions, SEC has paid particular attention to the relationship between the holding company and the public utility, the potential for excessive charges to the utility through intercompany contracts, and the adequacy of regulatory oversight over the holding company and its public utility subsidiaries. To date, SEC has never formally declared an investor that owns less than 10 percent of the voting securities of a public utility or holding company to be a holding company. However, in the absence of formal Commission precedent, SEC staff has issued a series of no-action letters to entities seeking to acquire less than 10 percent of the voting securities of such companies.<sup>39</sup> In addition, over the past several years, SEC staff has granted no-action relief to investors that have proposed to exercise an increasing number of consent rights over certain operational matters of the invested entities. While some interested parties have indicated that SEC should clarify which consent rights would cause an investor to exercise such a controlling influence so as to necessitate regulation of the investor as a holding company under PUHCA, one SEC official told us that clearer guidance on this issue may not prevent investors from structuring future investments with new or different combinations of consent rights. However, general guidelines about minimum standards that an investor must satisfy for the staff to issue a no-action letter may help clarify how the staff interprets controlling influence.

---

<sup>39</sup>Investors would seek these letters because PUHCA requires holding companies to seek an exemption or register under the act.

---

---

## SEC Evaluates Controlling Influence on a Case-by-Case Basis

In past decisions, SEC has found that the presence of controlling influence needs to be evaluated on an individual basis and that the specific circumstances surrounding an investment need to be considered.<sup>40</sup> In making its decisions, SEC has focused on the past and current relationship between the holding company and the public utility, the nature of intercompany contracts, and whether investors and consumers will be subject to adequate regulatory oversight.<sup>41</sup> However, SEC has only ruled on controlling influence when considering applications from companies presumed to be holding companies by virtue of their 10 percent ownership that are seeking declarations that they are not holding companies. By contrast, PUHCA presumes that investors that own less than 10 percent of the voting securities of a public utility or holding company are not holding companies unless SEC determines that it is necessary or appropriate in the public interest or for the protection of consumers or investors to regulate the investor as a holding company. To date, SEC has not made such a determination. Therefore, SEC has no established precedent with respect to factors that have led SEC to conclude that a less than 10 percent investor exercised such a controlling influence over a holding company or public utility that it was necessary to subject the investor to the requirements of PUHCA.

Instead, companies with less than 10 percent of the voting securities of a public utility or holding company have sought no-action relief that they would not be considered holding companies under PUHCA. Since 1986, SEC staff has issued a series of no-action letters to entities seeking assurances that ownership of less than 10 percent of the voting securities of a holding company would not cause them to be holding companies themselves within the meaning of the act. These no-action letters have involved investors that have sought to acquire substantial interests in holding companies through limited partnership interests or nonvoting

---

<sup>40</sup> See *American Gas & Electric Co. v. SEC*, 134 F.2d 633, 642 (D.C. Cir. 1943).

<sup>41</sup> See, for example, *Koppers United Co. v. SEC*, 138 F.2d 577 (D.C. Cir. 1943); *Hartford Gas Co. v. SEC*, 129 F.2d 794 (2<sup>nd</sup> Cir. 1942); *Detroit Edison Co. v. SEC*, 119 F.2d 730 (6<sup>th</sup> Cir. 1941); *H.M. Byllesby & Co.*, 6 S.E.C. 639 (1940); *Allied Chemical & Dye*, 5 S.E.C. 151 (1939); *West Penn Railways*, 2 S.E.C. 992 (1937).

---

preferred stock.<sup>42</sup> However, to avoid coming within the definition of a holding company and thereby risk having to divest many of its nonutility investments, the investor will acquire less than a 10 percent interest in the voting securities of the holding company. To protect their investments, these investors will also acquire certain consent rights over the operations of the invested entities. These rights may include the power to approve security issuances and capital expenditures in excess of budgeted amounts, among others. In considering these requests, staff must determine whether these consent rights would enable the investor to vote in the direction or management of the affairs of such companies or cause an investor to exercise a controlling influence over the management and policies of a public utility or holding company.

---

## SEC No-Action Letters Have Allowed a Growing List of Consent Rights

In recent years, SEC staff has granted no-action assurances to investors that have proposed to exercise an increasing number of consent rights over their invested entities. The growth in the number and range of these consent rights has raised concerns by some parties that staff may be exercising too much discretion in determining whether controlling influence is present. The following example illustrates how SEC staff has granted no-action letters to investors that have proposed to exercise more substantial consent rights over operational matters. In a no-action letter from 1986, staff granted relief to two investors that proposed only the right to approve the admission of new partners into the limited partnership and to continue the limited partnership in the event of bankruptcy or withdrawal of the general partner.<sup>43</sup> By comparison, staff has recently granted no-action assurances in circumstances in which a single investor

---

<sup>42</sup>See, for example, *General Electric Capital Corp.*, SEC No-Action Letter, 2002 WL 837537 (Apr. 26, 2002); *Berkshire Hathaway Inc., et al.*, SEC No-Action Letter, 2000 WL 294900 (Mar. 10, 2000); *Nevada Sun-Peak Limited Partnership*, SEC No-Action Letter, 1991 WL 178782 (May 14, 1991); *Colstrip Energy Limited Partnership*, SEC No-Action Letter, 1988 WL 234462 (Apr. 25, 1988). A limited partnership is a business structure that allows one or more partners to enjoy **limited personal liability** for **partnership** debts while another partner or partners (called **general partners**) have unlimited personal liability. The general partner manages the day-to-day operations of the partnership.

<sup>43</sup>See *John Hancock Mutual Life Insurance*, SEC No-Action Letter, 1986 LEXIS 2559 (Jul. 23, 1986). In granting no-action relief, the staff concurred with the opinion of the investors' legal counsel that the investors, who owned an aggregate of 37.5 percent of the limited partnership, were merely passive investors and, as limited partners, were prohibited by both the partnership agreement and applicable state law from participating in the management or control of the partnership's business. The initial partnership proposed to acquire and operate a hydroelectric facility and thus became a public utility company.

---

could essentially veto proposed sales of significant businesses or assets of the operating utility, employment contracts with utility executives, changes to the holding company's annual operating budgets, votes of the holding company's ownership interests in the utility subsidiary, and issuances of additional securities by the holding company.<sup>44</sup>

Some interested parties have expressed concern about the number of consent rights that utility investors have acquired and have indicated that SEC should more clearly specify which consent rights would cause a utility investor to exercise a controlling influence. SEC staff observed that more explicit guidance on consent rights may not prevent similar investments in the future because in theory an infinite number and combination of consent rights exist that would allow an investor to exercise more or less control over an invested entity. If SEC specified that certain consent rights would cause an investor to exert a controlling influence and, therefore, be a holding company within the meaning of the act, subsequent investors in public utilities or holding companies may propose new or different combinations of consent rights over invested entities when they structure future transactions to avoid exercising a controlling influence. Thus a list of specific consent rights that would cause a utility investor to exercise a controlling influence may not address all possible combinations of consent rights. However, it may be appropriate for SEC to issue general guidelines setting forth minimum standards that utility investors must satisfy for the staff to find that they do not exercise a controlling influence over the management and policies of public utilities or holding companies. These guidelines could help clarify for the staff as to when it is appropriate to issue a no-action letter and for the industry on how SEC staff determines whether controlling influence is present.

---

## Conclusions

In administering PUHCA, SEC is charged with the difficult task of regulating a rapidly changing industry. Within the past decade, SEC has said that a flexible approach to administering the act is necessary to protect consumers and investors in this changing environment. Accordingly, SEC has approved a series of mergers between geographically-dispersed utility systems; it removed some restrictions on holding companies' diversification into some nonutility activities; and it issued no-action letters to utility investors that have proposed to acquire a growing list of consent

---

<sup>44</sup>See, for example, *General Electric Capital Corp.*, *supra* note 42; *Berkshire Hathaway Inc.*, *supra* note 42.

---

rights over operational decisions of public utilities and holding companies. However, it is unclear whether or how these collective decisions and actions have served the interests of utility consumers and investors. With this continuing uncertainty, it may be appropriate for SEC to conduct a study, in collaboration with other knowledgeable parties, to re-examine the collective impact of its recent decisions and actions in administering PUHCA on consumers, investors, and the public interest.

Regardless of the debate on SEC's interpretations of the act, there are steps that SEC can take to better manage the processes involved in administering the act. SEC devotes most of its available resources for administering PUHCA to handling applications from registered holding companies and has struggled to devote adequate resources to other responsibilities such as rulemaking, reviewing incoming PUHCA filings, and monitoring exempt companies. Consequently, SEC continues to administer the act with ineffective forms and without a comprehensive system to collect data and monitor the activities of both registered and exempt holding companies. Although SEC staff is aware of outdated forms and regulations that need revisions, it can only undertake planned initiatives as time and resources permit. Developing a formal strategy that prioritizes forms and regulations to be revised and establishes time frames for their referral to the Commission would improve the likelihood of timely completion of high priority initiatives. Further, systematically analyzing data from registrant filings could provide another tool for SEC staff to oversee registered companies. Despite the fact that many industry participants perceive that SEC processes PUHCA applications slowly, the staff has not implemented suggestions that it establish time frames for issuing notices and orders. Moreover, since most of today's holding companies are exempt from SEC's oversight under PUHCA, it is important that SEC monitor the activities of exempt companies and determine whether the continuation of exempt status for all exempt companies is in the best interest of the public, investors, and consumers. Finally, because the staff has granted no-action assurances to utility investors that are acquiring a growing number of consent rights over operational matters of holding companies and public utilities, clearer SEC guidance on the minimum standards that a corporate structure must satisfy may help inform the staff's determination about when a no-action letter is appropriate and clarify to investors which types of investment structures would cause them to be holding companies within the meaning of the act.

---

---

## Recommendations for Executive Action

As long as SEC continues to have the responsibility to administer PUHCA, we recommend that the Chairman, SEC, take the following two actions to improve the timeliness and quality of SEC's activities related to its oversight of registered holding companies:

- Implement the SEC Inspector General's recommendation for establishing time frames and target dates for assigning, reviewing, and issuing notices and orders on a case-by-case basis.
- Develop an action plan to establish and meet time frames for making improvements to existing PUHCA forms and developing a system to collect and analyze information contained in PUHCA filings to enhance SEC's ability to better monitor registered holding companies, while reducing the overall regulatory burden on these companies.

Although SEC has recently conducted a review of all companies exempt by self-certification, we recommend that the Chairman, SEC, further enhance SEC's monitoring of exempt companies by taking the following two steps:

- Expedite the evaluation of the different legal options and obtain the necessary legal authority for requiring companies that are exempt by order to provide additional information on their operations.
- Create a formal strategy to conduct comprehensive reviews of companies claiming exemptions on a periodic basis and expand the focus of these reviews to include companies that claim exemption by order.

In light of the growing number of consent rights that utility investors have acquired over operational matters of holding companies and public utilities, we recommend that the Chairman, SEC:

- Develop and publish general guidelines that articulate minimum standards that an investor seeking to acquire an interest in a holding company or public utility must satisfy in order to receive a no-action letter. Examples of these minimum standards could include that a majority of the members of the public utility's or holding company's board of directors not be affiliated with the investor or that any consent rights be limited to those necessary to protect the investor from unilateral action by a majority investor.

---

Finally, given the changes that are taking place in the utility industry and current debates about SEC's actions in administering PUHCA, including the agency's interpretations of the single area requirement and its interpretations of a controlling influence, we recommend that the Chairman, SEC:

- Conduct a study on the impact of SEC's administration of PUHCA in the last decade and, if necessary, make legislative proposals. The study should examine whether its decisions and flexible interpretations facilitate consumer and investor protection and enable companies to provide energy to the nation's consumers in an efficient and competitive manner. In conducting this study, SEC should gather the views of the utility industry, consumer groups, trade associations, investment banks, rating agencies, economists, and relevant state and federal regulators.

---

## Agency Comments and Our Evaluation

SEC provided written comments on a draft of this report that are reprinted in appendix II. SEC also provided technical comments, which were incorporated into the final report, as appropriate. SEC agreed with some of our recommendations but did not address others. SEC commented on the need to interpret PUHCA in a manner that reflects the changes in the utility industry without creating unnecessary risks for investors or utility customers. SEC did not specifically address the need to provide guidance on consent rights but agreed that there are areas in which the agency can offer further guidance and, in appropriate circumstances, reexamine prior interpretations of the act.

SEC agreed that it is important to continue to monitor the status of all exempt companies and particularly to monitor those companies' continuing entitlement to exemptions. However, SEC did not address the need for the creation of a formal strategy, but noted that staff is involved in an ongoing project to review and, where necessary, improve their ability to monitor the activities of all exempt holding companies.

SEC agreed that updating some of the forms that holding companies are required to file would make it more efficient for SEC to obtain the information necessary to regulate holding companies and also reduce the unnecessary burdens on these companies by eliminating duplicative or unneeded filing requirements. To this end, SEC staff will continue to make recommendations for updating the forms as necessary. However, SEC did not address the need to establish an action plan for such improvements. SEC also did not directly address our recommendation on establishing time

---

frames and target dates for reviewing and issuing notices and orders. We continue to believe that establishing such time frames would be beneficial for SEC's oversight of registered holding companies by improving the timeliness of the agency's activities.

Finally, SEC noted that the agency informally assesses its administration of PUCHA on a regular basis but agreed to seriously consider the possibility of doing a formal study.

---

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to the Chairman, House Committee on Energy and Commerce and other interested Members of Congress. We also will send copies to the Chairman of SEC and will make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or [jonesy@gao.gov](mailto:jonesy@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff that made major contributions to this report are listed in appendix III.



Yvonne D. Jones  
Director, Financial Markets  
and Community Investment

---

# Objectives, Scope, and Methodology

---

Our objectives were to determine (1) the nature and extent to which the Securities and Exchange Commission (SEC) regulates registered holding companies, (2) the extent to which SEC reviews claims of exemption—filed as either self-certifications or applications for SEC order—from the act, (3) SEC’s process for issuing Public Utility Holding Company Act of 1935 (PUHCA) no-action letters, and (4) how SEC determines whether companies have a controlling influence over public utilities or holding companies. However, as agreed with our requesters’ staff, we did not evaluate the arguments for or against PUHCA’s repeal.

To determine the nature and extent to which SEC regulates registered holding companies, we used a number of methodologies, including reviews of publicly available documents, structured and open-ended interviews, data analysis, and workpaper reviews. For example, we reviewed PUHCA, SEC’s associated regulations, and other publicly available documents to understand the various statutory and regulatory provisions that govern SEC’s responsibilities. We followed topical issues that affect SEC’s work by reviewing applications that were pending, as of December 2004, and recently issued orders available through SEC’s Web site, as well as industry press reports. We also attended and obtained documents filed as part of SEC’s 2005 administrative procedure involving the American Electric Power and Central and Southwest Corporation merger to monitor developments in that hearing.

Also, we conducted a series of interviews with SEC officials to understand and seek clarification on key points about how SEC regulates registered companies and topical issues involving registered companies. We asked utility experts and interested industry groups, including a past SEC official, the head of a PUHCA working group, the American Public Power Association, the National Rural Electric Cooperative Association, the Edison Electric Institute, the National Association of Regulatory Utility Commissioners, and Public Citizen for their views on SEC’s administration of the act. We spoke with officials from other regulatory bodies, including the Federal Energy Regulatory Commission (FERC), SEC’s Division of Corporation Finance, and representatives from four state utility commissions about the extent of their coordination with SEC on issues pertaining to PUHCA. We met with officials from the three major credit rating agencies and other Wall Street officials about the effect of SEC’s administration of PUHCA on the financial health of public utilities and holding companies. We also spoke with an official from SEC’s Office of the Inspector General to better understand the methodologies used and

findings presented in a recent Inspector General audit on the regulation of holding companies.

In addition, we conducted structured interviews with officials from a random selection of 13 of the 31 registered holding companies to solicit registrants' opinions about their regulator. We also conducted structured interviews with all 20 SEC staff attorneys and accountants with more than 6 months of on-the-job experience working on PUHCA to obtain their opinions about SEC's internal processes and procedures.

Furthermore, we reviewed SEC workpapers from two recent examinations to better understand SEC's processes and procedures for examining registrants. We then obtained and analyzed SEC data on consumer cost savings as a result of its examination program. In addition, we obtained and analyzed SEC data on the amount of time that has elapsed between the submission of PUHCA applications in fiscal years 2003 and 2004 and the issuance of related notices and orders to evaluate how quickly SEC processes applications.

To assess the extent to which SEC reviews claims of exemption from the act, we relied on structured and unstructured interviews and reviews of both publicly available documents and information collected from SEC. For example, we reviewed Section 3 of the act, which describes the statutory provisions under which SEC can exempt—and revoke the exemptions of—holding companies from PUHCA, as well as Rules 2 through 6, which implement the act's exemptive provisions. We also reviewed the administrative law judge's and the Commission's decisions *In the Matter of the Applications of Enron Corp.*, documentation of SEC's policy for reviewing Form U-3A-2s in 2004, and publicly available documents that discuss SEC's procedures and policies for reviewing claims of exemption to gain an understanding of the criteria that SEC uses to evaluate Section 3(a)(1) exemptions. We obtained and analyzed data from SEC on the number of exempt holding companies. We also obtained and analyzed a blank Form U-3A-2 from SEC's Web site to determine whether that form collects adequate information for SEC to monitor companies claiming exemption under Rule 2.

We spoke with SEC officials to understand SEC's process for reviewing Form U-3A-2s in 2004 and to get clarification on key points, such as the reason that some applications for exemptive orders are currently pending. As part of our structured interviews with 13 registered holding companies and 20 SEC staff attorneys and accountants, we inquired about their

opinions of SEC's processes for reviewing exemptions. We also spoke with FERC and state utility commissions to determine how SEC coordinates with other regulatory bodies in reviewing exemptions. As necessary, we spoke with other knowledgeable subject matter experts and industry groups about how SEC reviews claims of exemption to solicit the opinions of third parties.

To determine SEC's process for issuing PUHCA no-action letters, we spoke with a variety of government officials both inside and outside SEC. After speaking with SEC officials to understand SEC's process for issuing PUHCA no-action letters, we selected three other entities, both within and outside of SEC, that regularly issue no-action letters against which we could compare SEC's no-action letter process under PUHCA. These entities were the Office of the Chief Counsel within SEC's Division of Investment Management, the Office of the Chief Counsel within SEC's Division of Corporation Finance, and the Commodity Futures Trading Commission (CFTC). We then spoke with knowledgeable officials from each entity to understand their processes for issuing no-action letters. We also spoke with officials from the Federal Communications Commission and FERC about any comparable procedures at those agencies. However, officials at those two agencies were not aware of any no-action letters that they issue. In addition, we spoke with an official from SEC's Office of the Inspector General to better understand the methodologies used and findings presented in a recent Inspector General audit on the Division of Investment Management's no-action letters.

Further, we conducted structured interviews with representatives from a randomly selected sample of 6 of the 15 companies that have received PUHCA no-action letters between 2001 and the present to learn about their experiences in seeking no-action relief through SEC. In addition, we reviewed several no-action letters issued since 2001, all of which are available on SEC's Web site, and obtained and analyzed SEC workpaper files from 10 no-action letters issued between 2001 and 2004 to assess the amount and types of interaction that occur between the requesting entity and SEC staff prior to the issuance of a final letter. We also reviewed publicly available documents about no-action letters, including SEC releases and CFTC regulations, to gain an understanding of the criteria that agencies use when processing no-action letter requests.

To assess how SEC determines whether companies have a controlling influence over public utilities or holding companies, we performed a legal analysis of publicly available documents, including Section 2 of PUHCA,

---

past SEC orders and no-action letters related to controlling influence, and the Division Investment Management's responses to inquiries from the House Energy and Commerce Committee about SEC's administration of PUHCA. We also spoke with SEC officials to gain a more thorough understanding of the staff's interpretation of this provision of the act.

We conducted our work in Washington, D.C., and New York, N.Y., from August 2004 to June 2005 in accordance with generally accepted government auditing standards.

# Comments from the Securities and Exchange Commission



DIVISION OF  
INVESTMENT MANAGEMENT

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

June 21, 2005

Ms. Yvonne D. Jones  
Director, Financial Markets and  
Community Investment  
United States Government Accountability Office  
Washington, D.C. 20548

Dear Ms. Jones:

Thank you for the opportunity to comment on your draft report concerning the SEC's administration of the Public Utility Holding Company Act of 1935. The report provides a detailed summary of the structure and operation of the Commission's Office of Public Utility Regulation. The report also addresses, among other things, the savings produced by the Commission's examination program, the Commission's administration of the exemptive provisions of the Act and the Commission's approach to those provisions of the Act that determine whether one entity "controls" another.

Your report describes many difficult policy issues that the SEC has faced as part of its administration of the Act in recent years. These issues include, among others, the extent of merger activity permitted under the Act, the permissible geographic size of holding companies, the scope of the Act's exemptive provisions and the ability of utilities and utility holding companies to use novel structures to attract investors and capital into the utility industry. These issues have arisen for a variety of reasons, including amendments made to the Act, changes in the manner the utility industry is regulated by the Federal Energy Regulatory Commission and state commissions, technological change and, most fundamentally, the changing nature of the utility business.

In addressing these issues in recent years, the SEC has always attempted to interpret the Act in a manner designed to achieve the Act's goals while at the same time responding to the nature and needs of the utility industry as it exists now, rather than the form in which the industry existed when the Act was enacted in 1935. Specifically, the Act itself establishes two fundamental goals – protecting those who invest in the securities issued by holding company systems and protecting utility consumers. In making any decision under the Act, we always strive to achieve these goals. We also recognize the fundamental importance of the utility industry to our nation's economic success and to our national security. We therefore believe that we have an obligation to administer the Act in a way that reflects how changing technology, changing regulation and changes in the capital markets impact utilities and holding company systems. Indeed, we believe that if we did not respond to these changes, we might not only damage our nation's utility system, but we could also harm the very interests that the Act directs us to protect.

---

Appendix II  
Comments from the Securities and Exchange  
Commission

---

Ms. Yvonne D. Jones  
Page 2

While we believe that we have been largely successful in administering the Act in this fashion, we recognize, as the GAO report suggests, that there are areas in which we can offer further guidance and, in appropriate circumstances, reexamine prior interpretations of the Act. Indeed, given the fast pace of change in the industry, there is no way for us to successfully administer the Act without continually analyzing how the goals of the Act can be best achieved. We remain committed to providing this guidance to the industry and, most fundamentally, to interpreting the Act sensibly without creating unnecessary risks for investors or utility customers.

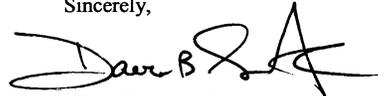
The draft GAO report also describes the approach that we have taken in recent years to reviewing the status of exempt holding companies under the Act. In particular, the draft report notes that, given current filing requirements, it is easier for us to monitor the activities of holding companies that claim exemption pursuant to Rule 2 under the Act as opposed to holding companies that have obtained their exemptions by Commission order. We agree that it is important to continue to monitor the status of all exempt companies, and particularly to monitor those companies' continuing entitlement to exemption. Staff in the Office of Public Utility Regulation are therefore involved in an ongoing project to review and, where necessary, improve our ability to monitor the activities of all exempt holding companies. This project will enable us to more efficiently maintain an appropriate distinction between exempt and registered holding companies.

Your report also notes that a number of the forms we require holding companies to file are due to be updated. While we do not believe that the current filing requirements have impaired our ability properly to administer the Act, we recognize that updating forms serves two important goals. First, by updating our forms, our processes for obtaining the information necessary to regulate holding companies will become more efficient. Second, updating our forms will also allow us to reduce unnecessary burdens on holding companies by eliminating filing requirements that are either duplicative or unneeded. Our staff is thus continuing to develop recommendations for updating our forms as necessary.

Finally, the GAO report recommends that the SEC undertake a study to systematically review the changes that have occurred in the utility industry during the past ten years and the manner in which our administration of the Act during that period has affected the utility industry, its investors and the customers of its utilities. We agree that it is always important to review our administration of the Act, particularly in times when the industry is changing rapidly, and to assess the success of our past policy decisions. We believe that we perform this assessment informally on a regular basis. In light of your recommendation, however, we will seriously consider the possibility of doing a more extended and formal study.

We appreciate the GAO's attention to these issues.

Sincerely,



David B. Smith, Jr.  
Associate Director

# GAO Contact and Staff Acknowledgments

---

---

**GAO Contact**

Yvonne D. Jones (202) 512-8678

---

**Staff  
Acknowledgments**

In addition to the individual named above, Jon Altshul, Marc Molino, Omyra Ramsingh, LaSonya Roberts, and Karen Tremba made key contributions to this report.

---

## GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

---

## Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site ([www.gao.gov](http://www.gao.gov)). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to [www.gao.gov](http://www.gao.gov) and select "Subscribe to Updates."

---

## Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office  
441 G Street NW, Room LM  
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000  
TDD: (202) 512-2537  
Fax: (202) 512-6061

---

## To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: [www.gao.gov/fraudnet/fraudnet.htm](http://www.gao.gov/fraudnet/fraudnet.htm)

E-mail: [fraudnet@gao.gov](mailto:fraudnet@gao.gov)

Automated answering system: (800) 424-5454 or (202) 512-7470

---

## Congressional Relations

Gloria Jarmon, Managing Director, [JarmonG@gao.gov](mailto:JarmonG@gao.gov) (202) 512-4400  
U.S. Government Accountability Office, 441 G Street NW, Room 7125  
Washington, D.C. 20548

---

## Public Affairs

Paul Anderson, Managing Director, [AndersonP1@gao.gov](mailto:AndersonP1@gao.gov) (202) 512-4800  
U.S. Government Accountability Office, 441 G Street NW, Room 7149  
Washington, D.C. 20548