

## UTILITY HOLDING COMPANIES

By

Douglas W. Hawes

Clark Boardman Co., Ltd. 1984

Reviewed by

*John A. Myler\**

Utility diversification has become an ardently debated topic in the last several years. Nowadays, seminars about newly emerging industries are heavily attended by utility executives. Press reports and studies of utility diversification abound. And utility regulators hold and articulate varying opinions about the degree of desirable diversification by utilities. Hawes' book contains several superb chapters on diversification and set forth clear expositions of the issues so troubling to some and so encouraging to others. It's certainly not surprising that Hawes treats diversification issues because, as he points out, it is because of a desire to diversify that most holding companies involving utilities are organized.

However, Mr. Hawes' book is not an attempt at an exhaustive treatment of the arguments for and against diversification by utilities into non-regulated commercial endeavors. The author's indicated purpose is to "provided utility managements, their professional advisors, regulators and others with a basic understanding of the modern utility holding company: how it is formed, its purposes, functions, operation and regulation." Reading that purpose fairly, he succeeds admirably.

Written in a style always clear, Hawes inserts the occasional graceful turn of a phrase (one utility had a "tax insult added to a rate of return injury.") By using, for example, the same provision of the Public Utility Holding Company Act (PUHCA) in different chapters to provoke discussion of various, although related topics, Hawes reinforces in the reader's mind the meaning of the PUHCA and its relevance. The visual impact of the pages is also good. In an effort limit distractions caused by footnotes, only textual footnotes are provided at the bottom of the page while citational notes are placed at a chapter's end.

Chapter 2's expressed purpose is to provide "a sufficient historical perspective to give the reader a background against which to view the present-day utility holding company movement." Of necessity, the historical discussions of utility holding company development and operation would have to be brief, but perhaps not quite as brief as actually provided. Hawes describes briefly the origins and structure of the three major electric utility holding companies, The Electric Bond and Share Group, The (Samuel) Insull Group, and the United Corporation, along with charts indicating their major corporate elements. With regard to the problems suggesting the need for the PUHCA, Hawes is succinct, moving rapidly to and through the FTC's investigation of public utilities, and President Roosevelt's successful reliance on Benjamin Cohen, Sam Rayburn *et al.* to write and obtain the passage of the 1935 Act. Its implementation by the SEC in the 1935-55 period, when

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214 registered holding companies were trimmed down by the agency to 25, involving the divestiture of 839 subsidiaries with assets aggregating \$13 billion, is described by Hawes.

After neatly summarizing how Section 11, the "heart" of the 1935 Act, was used by the agency to accomplish this cleaning of the stables, the author contrasts corporate intent behind the establishment of the modern holding company with that behind the establishment of the holding companies of the 20's and 30's. Having highlighted the abuses of yesterday and suggesting why they are unlikely to be repeated, Hawes concludes that diversification, now normally the reason for establishing a utility holding company, should be judged objectively.

Chapter 3 is the substantive "heart" of Hawes' book. It outlines the '35 Act, its requirement for registration with the SEC, the resultant exposure to the integration and simplification processes provided by section 11 of the Act, the criteria for exemption therefrom, and the power of the SEC to nullify, under a "public interest" standard, a claimed exemption. The chapter also gets us into diversification from the viewpoint of federal regulation — *i.e.* SEC allowance of diversified activities by both registered companies and exempt companies. Further, we learn of the "watchdog" provision, section 9(a)(2) of the Act, which limits acquisition of utilities, basically under the "two-bite," or 5 percent, rule. As he does throughout, Hawes summarizes recent and relevant regulatory proceedings arising under the statute. Finally, the chapter outlines recent unsuccessful efforts to amend or repeal the '35 Act.

The longest chapter (4) is that devoted to state regulation of utility companies and utility holding companies. Beginning with the 1972 and 1982 reports of the National Association of Regulatory Utility Commissioners (NARUC) on utility diversification, Hawes identifies the major conclusions and recommendations of each, repeats and moves on to a discussion, and an illustrative listing, of individual states' powers over utility holding companies. Hawes is at his best in this chapter — reducing to clear unemotional language the concerns about utility diversification expressed in lengthy tomes by regulators, and the equally-lengthy responses by proponents of diversification. For example, Hawes provides, in four pages, an incisive summary of the questions, about the effect of the existence of holding companies on state oversight jurisdiction, expressed by state regulators, and the responses offered by utilities. The chapter goes on to cover how state regulators have imposed conditions upon approval of the formation of a holding company, and how states exercise authority over the holding company itself, both generally and with specific discussions of dividends, tax allocation and spinoffs.

Chapter 5 is an informative series of checklists constituting a how-to, mechanical approach to establishing a holding company. The reader becomes able to identify the "reverse phantom subsidiary merger" as the leading vehicle for establishing holding companies and is provided exposition of the corporate law, tax, accounting, and miscellaneous ancillary issues relative to the formation and operation of the holding company. Hawes also provides helpful appendices to the book's text, including a series of various checklists and sample documents for use in the establishment of a holding company, *e.g.* a checklist of regulatory, legal, financial, accounting, tax, and management issues, a sample request for an IRS ruling on the tax consequences of formation of a holding company, a sample "White Paper"

explaining plans to form a holding company, a sample proxy statement and plan of merger, and a sample statement to the SEC claiming exemption from the '35 Act.

Chapter 6, "Diversification — Yea or Nay," is notable for a succinct side-by-side exposition of the arguments over diversification that have traditionally posed regulators against utilities desiring to diversify. In a little over 5 pages, Hawes distills the arguments advanced by both sides and the respective responses, he also adds the opinions of selected experts like Dr. Alfred E. Kahn, the Cabot Consulting Group, Irwin Stelzer, *et al.* to the brew. The bottom line? Hawes does everyone a service by noting "the strong pull of the middle ground on the diversification issue." That is, diversification is neither a panacea nor a sin.

Chapter 7, "Diversification Strategy," adds little substance to what has gone before and serves mainly as a reminder that there is substantial serious literature on the development of corporate strategies.

Chapter 8, "Financing Diversification," discusses the particular aspects of diversification financing through: (1) the utility and its subsidiaries or (2) the holding company. Regarding the former, Hawes chronicles the difficulties of several companies (Orange and Rockland, and The Brooklyn Union Gas Company) in obtaining approvals by state regulators. Regarding the latter, Hawes discusses the ways in which holding companies, with no general access to utility funds, may establish financing on the basis of utility common stock.

Chapter 9, "Allocation of Costs," seems unfortunately limited in scope, considering the recent stream of complaints that utilities are, either directly or indirectly, unfairly using their power to obtain ratepayers' monies to cross-subsidize unregulated business ventures. Hawes' treatment of cost allocation methods seems particularly theoretical, with heavy emphasis on the "double leverage" theory of cost of utility equity capital, while dismissing concerns about cross-subsidization as present with or without diversification. In view of recent Supreme Court decisions in antitrust law suggesting a growing reliance of that Court on pragmatic economic analysis of marketplace efficiencies,<sup>1</sup> this chapter would have been an ideal place to indicate the literature to be consulted.

"Affiliate transactions," covered by Hawes in Chapter 10, are obviously important in light of traditional ratemaking efforts to assure flow-through only of expenses reasonably incurred. State regulators' concerns that "unreasonable" expenses are not passed through are duly noted and the standards used to weigh the pricing of transfers of services or products to a utility from an affiliate are broken down to three basic approaches: cost as an allowance for return on capital, market price, and price allowing a rate of return comparable to similar companies. The SEC's arrival at a definition of cost (cost of capital on a "utility return basis") also is noted.

"Service" companies are the subject of Chapter 11. The provision of services — management, engineering, financial, etc. — to utilities by holding companies had by 1935 become quite normal if not universal. Today, such services are still provided but on a more limited basis. Hawes provides the reader with an overview of how federal and state regulation applies to this particular aspect of holding company operations,

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<sup>1</sup> See *e.g.*, *Jefferson Parish Hospital District No. 2 v. Hyde*, 104 S.Ct. 1551 (Mar. 27, 1984).

with more emphasis given to section 13 of the '35 Act than state statutes.

In Chapter 12, "Utility Takeovers," the author sets the stage for a series of summaries of takeover attacks involving utilities by outlining the manner in which the '35 Act operates. The discussed takeovers start with the 1965 Penzoil tender offer for United Gas Corporation and end with the current effort by National Utilities, Inc. to acquire New Jersey Resources. Hawes provides analysis of the takeover strategies utilized and the operation of significant provisions of federal and state law in the struggles. With regard to state law, Hawes breaks down the few state provisions addressing the issue of utility takeover into three basic categories: (1) direct prohibition against ownership of more than a specified percentage of a public utility without prior PSC approval, (2) prohibition of one utility owning another without PSC approval, and (3) indirect requirements of approval.

Overall, Hawes' book serves well as a compendium of issues relevant to the creation of a holding company where a utility is involved, and to the holding company/utility interplay when the utility may be impacted by the holding company structure. Further, the historical discussions of the problems encountered by holding companies of old lend credence to the author's belief that the holding company form is neither inherently bad nor good.

## OIL AND GAS LAW IN A NUTSHELL

By  
John S. Lowe  
West Publishing Company 1983

Reviewed by  
*Richard P. Noland\**

While skeptics might doubt the premise of his title — that it is possible to distill the principles of oil and gas law into a nutshell — Professor Lowe has managed to produce a readable summary of this area of the law in this useful little volume. His purpose is to provide a succinct and comprehensive outline of the development of oil and gas resources, ranging from the rules governing ownership and transfer of oil and gas rights to federal taxation of transactions involving such rights. As a reference work, *Oil and Gas Law in a Nutshell* should be of value to the energy practitioner who finds a basic knowledge of oil and gas law helpful in his or her practice.

The book is divided into four major parts. The first part, which deals with the nature and protection of oil and gas rights, describes how oil and gas law gradually developed out of existing common law concepts relating to property rights into a distinct body of law in response to society's needs to exploit these important sources of energy. In this section, Professor Lowe explains how the basic rule of capture governing development of oil and gas reserves — which modified existing common law rules in order to encourage production of oil and gas by providing protection to owners of mineral rights against liability to neighboring landowners — has been limited over time in various ways in order to achieve certain purposes deemed useful to society. For example, the doctrine of correlative rights, a corollary to the rule of capture, excludes waste or wasteful production techniques from the immunity against liability afforded by the law of capture on the theory that waste is inconsistent with encouragement of production. Professor Lowe also explains how state conservation laws, including well spacing rules, production regulations, and compulsory pooling provisions, were enacted to provide additional limits on the rule of capture. Other chapters describe the different kinds of oil and gas interests — fee interests, mineral interests, leasehold interests, royalty interests, etc. — and their characteristics, and explain how such interests may be protected against trespass.

In the second major part of the book, Professor Lowe outlines the basic rules governing conveyances of oil and gas interests, and describes at some length several of the major interpretative problems that have arisen in connection with transfers of oil and gas interests. Generally, he attempts to summarize majority and minority judicial views on these issues, and sometimes offers specific drafting suggestions as to how to avoid major problems. He also uses diagrams effectively to help illustrate complicated factual situations. A particularly useful chapter in this part of the book deals with the rules governing joint ownership of oil and gas rights, including methods of obtaining the right to develop mineral resources in the case of

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fractionalized interests.

The third part of the book discusses the problems most frequently encountered by the typical oil and gas practitioner — problems arising out of oil and gas leases. Here, Professor Lowe describes the essential provisions of modern oil and gas leases (the granting clause, the term clause, and the drilling-delay rental clause) as well as typical “defensive” provisions normally found in today’s oil and gas leases in order to protect the lessee, such as dry hole clauses, pooling and unitization provisions, shut-in royalty clauses, etc. This section also contains a helpful discussion of implied covenants in oil and gas leases as well as rights and obligations arising out of lease transfers.

The final part of the book relates to various tax and business matters involving oil and gas. This section includes a brief overview of certain basic principles governing oil and gas taxation, although the discussion is, of necessity, somewhat superficial. It also contains a chapter outlining the major provisions typically found in oil and gas contracts today, such as price escalation, deregulation, and market-out clauses, take-or-pay provisions, and other clauses in gas contracts that are often the subject of dispute in regulatory proceedings before the FERC.

*Oil and Gas Law in a Nutshell* also includes, as appendices, various forms, including a mineral deed form, a conveyance of nonparticipating royalty interest form, and oil and gas lease forms commonly used in two states, as well as a glossary of oil and gas terms. The glossary of oil and gas terms, in particular, should be of value to the lawyer who does not regularly practice in the field of oil and gas law, but occasionally encounters such terms in an energy regulatory practice.

Like most books in the West Publishing Company’s Nutshell Series, Professor Lowe’s book is thorough, well organized, and readable. Given the complexity of the subject, the discussion is, inevitably, often quite general, so a serious practitioner in the area will typically find the book only a starting point for resolving many oil and gas issues. As an introduction to oil and gas, however, *Oil and Gas Law in a Nutshell* should be a helpful addition to the energy lawyer’s bookshelf.

## INSIDE NATURAL GAS

Edited by  
Myra C. Strauss  
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The first issue of a new monthly, called *Inside Natural Gas*, appeared in August 1984. Called "the" journal for producers, pipelines, distributors, and end users, the publication has an impressive board of contributing authors,\*\* including several well-known lawyer-participants in the seminars sponsored by Executive Enterprises, Inc.

The essays cover a wide gamut of subjects relating to an industry passing through a very difficult phase of its existence: trends of prices of natural gas and alternate fuels, guidelines to negotiating and drafting gas purchase agreements, transportation rates, special marketing programs, and legislative proposals.

The articles are directed toward a lay audience knowledgeable in the industry. The expert FERC practitioner may not find it very useful, but lawyers who deal with natural gas problems only occasionally may find insights which help focus on the difficulties requiring professional attention.

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\*\*Many of the members of the board also are members of The Federal Energy Bar Association.