

# REGULATION OF PUBLIC UTILITY HOLDING COMPANIES

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## EXECUTIVE SUMMARY

*We found that the Office of Public Utility Regulation (OPUR) staff were knowledgeable of the Public Utility Holding Company Act of 1935 (PUHCA or Act) and eager to assist companies with regulatory issues. The staff worked effectively with each other and regulated companies to resolve issues and prioritized tasks appropriately.*

*Although OPUR strove to meet company deadlines, we found that OPUR does not generally establish target dates for issuing notices and orders, which resulted in delayed Commission approval of company transactions. Additionally, Commission responses to 60-day action letters were not timely.*

*We also found that the number of accountants and financial analysts in OPUR may not be sufficient to address significant increases in workloads. We recommend that OPUR update or eliminate obsolete rules and forms, ensure compliance with Commission orders, establish target dates for completing tasks, more proactively monitor exempt companies and provide additional guidance to registered holding companies (registrants) on PUHCA compliance issues. We also identified several suggestions to enhance OPUR's operational effectiveness.*

*Congress has considered the repeal of PUHCA since 1983. These recommendations may no longer be relevant if PUHCA is repealed.*

*OPUR generally agreed with the report's recommendations.*

## OBJECTIVES AND SCOPE

Our objective was to evaluate the operational effectiveness and efficiency of OPUR's activities, including its oversight of companies subject to regulation, the examination process and office organization.

During the audit, we interviewed OPUR staff, outside counsel and industry groups, and surveyed a sample of registrants. We reviewed relevant documentation, including a sample of orders, notices, no-action letters and 60-day action letter files<sup>1</sup>. We also observed an on-site examination of a regulated company. The audit was

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<sup>1</sup> A description of 60-day action letters is found on page 6.

performed from May 2003 to August 2003 in accordance with generally accepted government auditing standards.

## BACKGROUND

### Public Utility Holding Company Act

OPUR is part of the Division of Investment Management and administers PUHCA. PUHCA generally bars non-utilities from owning utilities and prohibits public utility holding companies from owning utilities in different parts of the country. The Act was designed to protect consumers and investors against abuses by holding companies.

A holding company under PUHCA is defined as a company that directly or indirectly owns 10% or more of a gas or electric public utility. Companies that come within this definition must register with the Commission or apply for an exemption under the Act.

Registrants typically operate in multiple states and are subject to Commission regulation. This regulation focuses on the corporate structure of the holding company system, affiliate transactions between subsidiaries of the holding company system, and the system's capital structure. OPUR examines annual and periodic reports of registrants and their subsidiaries, approves company transactions, performs on-site examinations of these companies, and issues no-action letters.

Most holding companies that qualify for an exemption do so because both the holding company and its utility subsidiaries operate solely or largely within a single state. OPUR currently exercises little oversight over exempt companies.

### Examination Program

The examination program allows for periodic on-site inspections of the registrants (currently 28) on a five-year cycle. Thus, OPUR performs five or six examinations a year.

The examinations focus on the methods used to allocate costs of goods and services among associate companies, cost determination procedures, accounting and billing policies, quarterly and annual reports of the registrants, and operational efficiencies.

By identifying misallocated expenses and inefficiencies, consumer savings from examinations approximated \$31.8 million in fiscal year 2002.<sup>2</sup> OPUR approximated the current annual cost of examinations to be \$1.035 million.

### Repeal

The Commission has testified in favor of repealing PUHCA at various congressional hearings and supported its repeal since 1983. During our audit Congress was again considering the repeal of PUHCA. These recommendations may no longer be relevant if PUHCA is repealed.

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<sup>2</sup> According to the Commission's 2002 Annual Report, page 65.

## AUDIT RESULTS

We found that OPUR staff were very accessible to the registrants, allowing them to informally discuss proposed no-action issues and other concerns with OPUR. Overall, the OPUR staff were knowledgeable of PUHCA and eager to assist companies with regulatory issues. OPUR staff were also collegial, worked effectively with each other and regulated companies to resolve issues and prioritized tasks appropriately.

Although OPUR strove to meet company deadlines, we found that OPUR does not generally establish target dates for issuing notices and orders, which resulted in delayed Commission approval of company transactions. Additionally, Commission responses to 60-day action letters were not timely.

We also found that the number of accountants and financial analysts in OPUR may not be sufficient to address significant increases in workloads. We recommend that OPUR update or eliminate obsolete rules and forms, ensure compliance with Commission orders, establish target dates for completing tasks, more proactively monitor exempt companies and provide additional guidance to registrants on PUHCA compliance issues. We also identified several suggestions to enhance OPUR's operational effectiveness.

Our recommendations are described in further detail below.

### STAFF RESOURCES

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OPUR has eighteen attorneys (seventeen full-time equivalents), four accountants/financial analysts and two administrative support staff (see Appendix A). During the review, several staff informed us that staffing resources were inadequate to handle current workloads, resulting in insufficient time for rulemaking, monitoring exempt companies and other tasks.

If provided additional hiring authority, OPUR would like to hire two additional accountants/financial analysts and two additional attorneys.

#### Accountants/Financial Analysts

The number of accountants/financial analysts has remained at approximately four since 1983, despite significant increases in related workloads. For example, examinations, which primarily require accounting and financial analysis skills, recently increased to five or six a year from two a year. The number of registrants increased from 14 to 28 between December 1999 and September 2002. In addition, foreign utility companies are now subject to examinations, requiring further expansion of the examination program. OPUR commenced its first foreign utility company examination in September 2003.

Attorneys work on examinations and review financial statements, for cross-training purposes and also because OPUR lacks a sufficient number of accountants/financial analysts. Several staff stated that more accountants/financial analysts are needed. More accountants/financial analysts would enable OPUR to expand its examination program and address increased workloads.

## Recommendation A

If positions become available, OPUR should hire staff with accounting or financial analysis backgrounds.

### Attorneys

The office has traditionally hired attorneys to perform most of its functions. We did not find evidence that workloads increased commensurate to the number of additional attorneys (eight) that were hired between 1983 and 2003, although we did not extensively analyze this issue.

Some attorneys informed us that they experienced “down time” while waiting for assignments, such as reviewing company requests for Commission approval of certain actions. OPUR has little control over when companies file many of these requests.

Some staff said that more attorneys are not needed while others said more attorneys are needed to draft rules.

This discussion is for informational purposes. We are not making a related recommendation with respect to additional attorneys.

## RULES AND FORMS

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The Commission has issued 110 rules to implement PUHCA. Many of these rules and related forms are outdated, ineffective or contain requirements that do not currently serve a useful regulatory purpose (*e.g.*, U-R-1, U-3A-3-1, U-3-A2; U-13-E-1, U-5-B, and U-12(I)-B, among others)<sup>3</sup>. Although aware of this issue, OPUR has not updated many of these rules and forms. According to OPUR management, it lacks sufficient staff for these updates and the possibility of a repeal of PUHCA has caused retention problems and affected staff morale.

We believe that OPUR should update the rules and forms in order of priority, considering the costs and benefits of such updates. OPUR may wish to consider the following options:

- Hold a series of meetings with interested parties (*e.g.*, the PUHCA bar, industry groups and registrants) to solicit ideas on what updates are needed to the rules and forms.
- Issue a concept release soliciting comments from interested parties regarding suggestions for revisions to existing rules, updates to forms and elimination of requirements.
- Decide internally which rules need to be updated and assign rule updating tasks to OPUR staff. OPUR staff could prepare the first draft of revised rules and forms.

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<sup>3</sup> The Commission is able to revise or eliminate all of the forms listed except U-12(I)-B, which is required by statute.

Some rules and forms are currently under review for modification but OPUR has not set any timeframes for completing the updates. Management informed us it would take several years to update all of the outdated forms and rules.

### **Recommendation B**

OPUR should decide which rules and forms need to be updated and eliminated and update (or eliminate) them in priority order, considering the options above. OPUR should establish timeframes for completing these tasks.

#### *Rule 24 Orders*

Rule 24 allows OPUR to request additional information from a regulated company through an order. OPUR issues approximately 40 orders containing such requests per year.

OPUR management stated that companies comply with virtually all of its orders. However, OPUR also informed us that it has no means of ensuring compliance with Rule 24 orders.

OPUR management stated that an Access database designed to track Rule 24 requests would be useful.

### **Recommendation C**

OPUR should track responses to information requests contained in Rule 24 orders (*e.g.*, by establishing an Access database), as resources permit.

## **TIMELINESS**

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Based on a sample of 51 filings<sup>4</sup> reviewed in fiscal years 2002-2003, OPUR took an average of 98 days to publish a notice in the Federal Register (from the day it received the related filing). The number of days it took OPUR to issue the related order (from publication of the notice) was 73 days. Typically, notices must be published in the Federal Register for 25 days prior to issuing an order. Additionally, companies must be in compliance with all state and federal requirements before OPUR can issue an order.

Although OPUR staff strive to meet company deadlines, on occasion, companies have foregone lower interest rates as result of delayed Commission approval of certain transactions.

To ensure consistency, an important agency criterion, OPUR's senior management review and approve many filings and no-action letter requests. This has resulted in processing delays. Additionally, although OPUR prioritizes filings containing deadlines (*e.g.*, for companies that need approval of certain transactions by a particular date) and generally meets the deadlines, filings with no deadlines may

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<sup>4</sup> The original sample comprised the Commission's 60 most recently issued orders, based on the Office of the Secretary's June 2003 listing. Nine orders were deleted from the sample due to incomplete information (see recommendation K).

not be processed timely. Processing delays also result when companies send incomplete filings or request that OPUR delay issuing notices or orders.

Delays in reviewing and making a decision on applications have also led to regulation by inaction. For example, OPUR's reluctance to make decisions on certain complex issues has resulted in inaction for lengthy periods of time (*e.g.*, two years). During this time, the company at issue is permitted to engage in the activity in question.

According to OPUR staff, many filings that OPUR receives are complex or novel, requiring additional review and research. For these reasons, processing all notices and orders within a set timeframe may be difficult.

Two senior staff said that OPUR should issue a notice in response to a routine filing within two weeks, provided the filing is complete and the staff agree it is routine. Several staff believed that establishing target dates for completing tasks could shorten processing times. We believe timeliness could be improved as follows:

- Assign all filings to staff within a set time (*e.g.*, within one week of receipt). Sometimes OPUR takes several weeks to assign filings.
- Complete initial reviews of all filings within a set time (*e.g.*, within two weeks of assignment).
- Set target dates for issuing notices and orders, on a case-by-case basis, upon completing the initial review.
- Track the number of days to issue notices and orders, from the date the filing is complete. (OPUR began tracking this in September 2003.)
- Document the cause of delays and corrective actions.

### **Recommendation D**

OPUR should establish timeframes for assigning, reviewing and issuing notices and orders, as discussed above. OPUR should also track the number of days to issue notices and orders, from the date the filing is complete.

#### *60-Day Action Letters*

Companies may request Commission approval of certain actions using a streamlined review known as the 60-day action letter process. OPUR has delegated authority to approve these requests. OPUR has 60 days to respond from the date it receives the request, provided that the related filing is "complete" (*i.e.*, it contains all required information). There may be several additional data requests before a filing is considered complete. If OPUR fails to respond to a complete filing within 60 days of receipt, the company is permitted to engage in the requested action. Therefore, OPUR needs a procedure to ensure that it responds within 60 days.

Based on a sample of 72 responses<sup>5</sup> issued under the 60-day process between 1991 and 2003, only 32 responses were issued within 60 days. OPUR's average response

<sup>5</sup> The original sample comprised the 88 60-day action letter items listed on OPUR's inventory report dated April 25, 2003. Sixteen items were deleted from the sample due to incomplete information.

time was 101 days. This timeframe, however, does not reflect when the 60-day letters were complete; OPUR did not record these dates. OPUR also did not explain in its files why responses took longer than 60 days. Therefore, we were unable to determine the cause of OPUR's apparent failures to meet the 60-day deadline.

### **Recommendation E**

OPUR should record the date when each 60-day action letter is complete and ensure it responds within 60 days of receiving a complete 60-day action letter filing.

## **EXEMPT COMPANIES**

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There are two types of exempt companies: those that must file annual reports (Form U-3A-2) with the Commission to show that continued exemption is warranted and those that are exempt by order. The latter type are not typically required to make any filings with the Commission, pursuant to the order. Currently, 83 companies are of the former type and 44 are of the latter.

The Commission has the authority to revoke an exemption if the circumstances that gave rise to the exemption no longer exist or if it finds that continuation of the exemption would be detrimental to the interest of investors or consumers. A company is required to notify the Commission when a change in status makes it no longer exempt.

OPUR does not generally review annual exempt company filings to determine if such companies continue to warrant their exempt status. OPUR management indicated that OPUR lacks the resources to review these filings. Furthermore, Form U-3A-2 is outdated and does not request the information necessary for OPUR staff to determine whether a company should remain exempt.

Similarly, we found that OPUR does not monitor whether companies exempt by order continue to warrant their exempt status. OPUR is currently re-evaluating this policy.

### **Recommendation F**

As resources permit, OPUR should monitor exempt companies (Form U-3A-2 filers and companies exempt by order) to ensure they continue to warrant their exempt status.

## **EXAMINATIONS**

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### *Communications*

While we found the examination program to be generally effective, we identified ways in which OPUR could increase its effectiveness. For example, OPUR could include a checklist and a "plain English" description of compliance requirements, as

well as a list of frequent examination findings,<sup>6</sup> on OPUR's website. Companies we surveyed said this information would be useful.

### **Recommendation G**

OPUR should issue additional guidance to registrants regarding the examination process and compliance requirements by posting an examination checklist, a "plain English" description of key requirements, and a list of frequent examination findings on the OPUR website.

#### Timeliness

OPUR's goal is to complete each examination within 9 months of commencing the on-site examination (fieldwork) of the company under review. Four out of the five most recently completed examinations met this timeframe, while one took approximately 10 months. On average, it took OPUR 8 months to complete each of these examinations.

However, as of September 2003, three of the six open examinations have been open more than nine months since commencing the fieldwork. One has been open for more than two years while the other two have been open for at least 1 year.

### **Recommendation H**

OPUR should establish time goals for completing the three overdue examinations and monitor their achievement.

## **OFFICE ORGANIZATION**

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We identified several suggestions for enhancing OPUR's operational effectiveness, as discussed below.

#### Commission Memos

OPUR staff sometimes need to refer to OPUR's action and advice memoranda to the Commission for reference or research purposes. OPUR has storage binders that are accessible to the staff for these items but many of the memos were not stored in the binders. The staff that draft them typically retain these memoranda in their office.

### **Recommendation I**

OPUR should ensure that all action and advice memoranda are available to all OPUR staff (*e.g.*, stored in their designated binders or on a shared computer drive).

#### Templates

OPUR staff also informed us that templates (*i.e.*, standard form documents) would be useful for drafting notices, orders and action and advice memoranda. The

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<sup>6</sup> OPUR distributed its list of frequent examination findings to registrants at its 2003 annual meeting. The purpose of this meeting is to discuss OPUR's examination process, industry trends, concerns and other PUHCA issues.

templates would help ensure consistency in document organization (*e.g.*, fonts, spacing) and standard (boilerplate) language.

### **Recommendation J**

OPUR should establish templates for repetitive documents (*e.g.*, notices, orders and memoranda to the Commission) and save them on a shared computer drive accessible to OPUR staff.

#### *Inventory Reports*

OPUR maintains an inventory of items that are awaiting notice and order by the Commission, as well as quarterly reports of items that have been completed.

OPUR's inventory report did not consistently provide the dates when notices and orders were issued. Further, OPUR did not consistently remove completed items from its inventory or record these items in its quarterly report of completed items.

An OPUR official suggested that the branch chiefs could ensure the accuracy of OPUR's inventory and quarterly tracking reports.

### **Recommendation K**

OPUR should assign responsibility for ensuring the accuracy of its inventory and quarterly reports to its branch chiefs and provide them with the necessary information to perform this task.

#### *Correspondence Tracking*

On occasion, OPUR has lost correspondence and requests for action mailed in hard copy from regulated companies. This has led to processing delays. We also found that incoming mail is not regularly date stamped or logged in as received.

### **Recommendation L**

OPUR should date stamp and log into a tracking system (*e.g.*, a spreadsheet or Word Document) a brief description and receipt date of incoming mail pertaining to OPUR's regulatory mission.

#### *Document Retention*

OPUR staff generally maintain their own files relating to certain OPUR correspondence (*e.g.*, notices, orders, no-action letters, 60-day action letters, Commission action and advice memoranda). The types and extent of documentation maintained by the staff vary. Staff have not received written guidance describing what documents should be maintained in their files. Additional guidance would be especially useful to new staff.

### **Recommendation M**

OPUR should develop guidance describing the types of documentation that should be retained in staff files.

### Document Storage

Because of a lack of space, the staff stored supporting documentation for filings and certain correspondence (*e.g.*, no action letters) in their offices. Due to a recent move, however, OPUR now has adequate filing space. Central filing of documents would improve their accessibility and retention.

### **Recommendation N**

OPUR should store supporting documentation and correspondence (*e.g.*, no action letters) in a central location.

### Data Back-up

Some OPUR staff did not use the Commission's F: drive to back-up electronic copies of documents. Files saved on the F: drive are regularly backed-up by the Office of Information Technology and thus would be available in the event of a contingency (such as the destruction of OPUR's office).

### **Recommendation O**

OPUR staff should save all electronic files on the Commission's F: drive.

## **SURVEY**

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We surveyed ten registrants and received responses from three. We asked registrants to rate OPUR in terms of its timeliness, effectiveness in administering PUHCA, the reasonableness of OPUR's decisions on requested actions, and its effectiveness in conducting examinations and helping companies comply with PUHCA.

Registrants surveyed provided the following comments, which we are providing to OPUR for its information and possible action. These comments do not necessarily represent the opinion of the OIG.

- OPUR is very accommodating and helpful with ongoing and special requests.
- OPUR staff are amiable, cooperative and responsive.
- There is a lack of consistent and uniform guidance on the governance [cost] allocation issue. There is very little uniformity concerning what costs should be allocated to subsidiaries and what costs should be retained by the holding company. OPUR's policies in this area seem very inconsistent, confusing and subjective.
- 60 Day Letters – it would be helpful if OPUR could do a preliminary review and let us know about any issues as soon as possible rather than waiting until the end of the 60-day time period.
- Examinations – it would be helpful if the examination staff could send its list of routine data requirements (*e.g.*, organization charts, U-13-60s) 60 days prior to the first initial request deadline. Company

specific, detailed requests could then more easily be addressed in the typical three-week turnaround deadline.

- Examinations - it would be useful if OPUR devised an examination plan describing the topics under review and shared it with companies subject to review. This would help us to be more prepared and ensure the availability of key staff.
- It would be helpful if OPUR gave the registrants more lead time to respond to the 70 or so initial examination requests. One month is not sufficient.
- OPUR staff verbally asked several questions that we provided written answers. It was clear that OPUR did not read all of the initial examination request answers.

#### Management Response to Survey

OPUR disagreed that there is a lack of consistent and uniform guidance regarding governance [cost] allocation issues. OPUR contends that it has consistently raised the same solution to cost allocation issues where the type of service is very similar between registrants. Furthermore, OPUR issued guidance in June 2001 to registrants describing corporate governance costs. The majority of corporate governance findings result in reallocations between parent holding companies and its subsidiaries.

Such findings, however, are proprietary and confidential, and recommendations are designed to fit the specific component of cost that comprises the service being rendered.

### **Recommendation P**

OPUR should review the above comments and take action, as appropriate.

**OPUR Staffing Levels: 1983 - 2003**

<b>Year</b>	<b>Attorneys</b>	<b>Financial Analysts</b>	<b>Accountants</b>	<b>Support Staff</b>	<b>Total Number of Staff in OPUR</b>
1983	9	4	0	4	17
1984	9	4	0	4	17
1985	8	3	0	3	14
1986	9	3	0	3	15
1987	10	3	0	3	16
1988	9	3	0	2	14
1989	9	3	0	2	14
1990	12	3	1	2	18
1991	16	3	1	2	22
1992	16	3	1	2	22
1993	15	3	2	2	22
1994	16	3	2	2	23
1995	16	3	2	2	23
1996	17	2	1	2	22
1997	18	1	1	2	22
1998	18	1	1	2	22
1999	18	1	1	2	22
2000	18	1	1	2	22
2001	18	1	3	2	24
2002	17	1	3	2	23
2003	17	1	3	2	23

Figures based on full-time equivalent staffing levels.

Source: OPUR