UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

ALLIANT ENERGY CORPORATION and
WISCONSIN POWER & LIGHT COMPANY,

Plaintiffs,

v. Case No. 00-C-0611-S

AVE M. BIE,
JOSEPHY P. METTNER, and
JOHN H. FARROW, in Their
Official Capacities as Commissioners
of the Wisconsin Public Service Commission,

Defendants.

AFFIDAVIT OF SCOTT HEMPLING IN SUPPORT OF DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

STATE OF MARYLAND)
) ss.
COUNTY OF MONTGOMERY)

Scott Hempling states under oath and on personal knowledge:

1. I am an adult resident of the State of Maryland. I received a B.A. cum laude in Economics and Political Science from Yale College. I received a J.D. magna cum laude from Georgetown University Law Center. I am a member of the Bars of the District of Columbia and Maryland.

2. I am the principal in a law practice which provides legal and policy advice related to regulated industries. I have advised the state commissions of Arkansas, Arizona, Connecticut, District of Columbia, Indiana, Kansas, Massachusetts, Michigan, Missouri, Nevada, New

Hampshire, Ohio, Oklahoma, Rhode Island and Virginia; the consumer counsels of Connecticut, Indiana, Nevada, New Jersey, Pennsylvania and Texas; the legislatures of South Carolina and Vermont; municipal systems in Connecticut and Iowa; associations of competitive generators, consumer representatives and public power entities; and public interest organizations. I have authored articles which have appeared in The Electricity Journal and Public Utilities Fortnightly. I have presented testimony to committees of the U.S. House of Representatives and the U.S. Senate on many occasions; to committees of the state legislatures of California, Maryland, Minnesota, Nevada, North Carolina, South Carolina and Vermont; and to the state commissions of Illinois, North Carolina, Rhode Island, Texas, Vermont and Wisconsin. I am a frequent lecturer at professional conferences and training sessions, including sessions sponsored by the U.S. Department of Energy and the National Association of Regulatory Utility Commissioners. My qualifications are set forth in more detail in my resume which is attached as Exhibit One.

Introduction

3. Unique qualities of utility service create a significant state interest in effective utility regulation, one of the traditional police powers of the state. A state has a strong interest in seeing that customers receive safe and reliable electric service at a reasonable price, and that public utilities do not abuse the privileges and protections which the state has granted to them. These privileges and protections, and the importance of utility services to customers, distinguish utilities from unregulated businesses.

4. The special circumstances of public utilities create unique problems for a state, of at least three types. First, utility investment in nonutility businesses, for example, may lead to ratepayer subsidies of nonutility services, distraction of utility management, and increases in the

utility's cost of capital. Changes in utility ownership carry risks as well, as new management may have priorities other than local utility service and may lack the state-specific experience necessary to ensure reliable service at reasonable rates. Second, the acquisition of a utility by another company or person can affect the incentives of utility management, and lead to pressure for higher rates. Third, utility financing affects utility rates. As a capital intensive industry, the utility industry is highly dependent on access to the capital markets. Where the perception of the utility's financing declines, the compensation demand by providers of capital can increase, putting ratepayers at risk.

5. State utility regulation protects ratepayers from the risks presented by utility monopolies. It typically extends to all matters directly and indirectly affecting the quality and price of electric service. For utility regulation to be effective, it must address utility corporate structure; utility relationships with nonutility affiliates; and utility financing, ownership and control. These types of regulation provide the framework for effective rate regulation and quality of service regulation, because poor management decisions can put pressure on costs, leading to rate increases or service problems.

6. This affidavit describes in more detail the state interest in utility regulation, the risks associated with the utility actions that Wisconsin subjects to regulation, the common regulatory techniques for addressing the risks, and how Wisconsin law compares to those techniques. I conclude that Wisconsin's statutory provisions governing corporate structure further significant policy objectives typical of utility regulation statutes. Moreover, Wisconsin's regulation of utility investment in nonutilities, changes in utility ownership, and utility financing each has counterparts in federal and state jurisdictions. Put simply, Wisconsin’s regulatory techniques, as

provided for by the statutes under challenge in this case, are well-recognized methods for protecting consumers.

7. The remainder of this affidavit is organized into three main parts:

Part One: Analytical Framework and Statutory Background

Part Two: Unique Qualities of Utility Service Create a Significant State Interest in Effective Utility Regulation.

Part Three: The Special Problems of Nonutility Investment, New Ownership and Securities Issuances Require Special Regulatory Tools.

Part One:

Analytical Framework and Statutory Background

8. This Part I is organized into two sections. First, it explains the analytic framework of this affidavit, including this affidavit's relationship to the Commerce Clause challenge. Second, it describes those statutory provisions under challenge here that are the subject of my affidavit.

I. Overview of Analysis

9. This affidavit focuses on the three major regulatory techniques employed by the Wisconsin legislature as part of the public utility regulatory regime. The three are:

a. the nonutility asset cap forth in Wis. Stat. § 196.795(6m);

b. the 10% sales review set forth in Wis. Stat. § 196.795(3); and

c. the review of securities issuances required by Wis. Stat. § 201.03(1).

10. Counsel has informed me that a state law which is neutral in its application to in-state and out-of-state residents is consistent with the Commerce Clause of the U.S.

Constitution if any burden it imposes on interstate commerce is not "clearly excessive" relative to the local interest the law seeks to achieve. Courts frequently quote from the Supreme Court's description of this balancing test in Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970):

> "Where the state regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact with state activities."

11. The purpose of this affidavit is to explain that the three statutory provisions noted above serve a legitimate local interest.

II. Description of the Statutes Under Challenge

A. Nonutility Asset Cap

12. Wisconsin limits "the sum of the assets of all nonutility affiliates in a holding company system." Wis. Stat. § 196.795(6m)(b)(1). A "nonutility affiliate" is company in a holding company system which is not a public utility. Wis. Stat. § 196.795 (1)(j). (A "public utility" is defined by statute to include any person or company that "may own, operate, manage or control … all or any part of a plant or equipment, within the state, for the production, transmission, delivery or furnishing of heat, light, water or power either directly or indirectly to or for the public." Wis. Stat. 196.01(5)(a).) The asset cap provision states that, in general, the sum of the ineligible non-utility assets of a holding company system may not exceed 25% of the utility assets of that system, as the terms are defined in Wis. Stat. § 196.795(6m).

13. Included within the calculation of assets of public utility affiliates are the assets of

"foreign affiliates." A "foreign affiliate" includes a person that has three characteristics: (1) it operates as a public utility in another state, (2) it is an affiliated interest of a Wisconsin public utility, and (3) it is integrated with the Wisconsin public utility, as determined by the commission. Wis. Stat. § 196.795 6(m)(a)(3).

14. The asset cap does not limit holding company investments in businesses utilizing "eligible assets." Such assets are excluded from the calculation of both utility assets and nonutility assets. "Eligible assets" include assets that are used for --

> "a. Producing, generating, transmitting, delivering, selling or furnishing gas, oil, electricity or steam energy.
>
> b. Providing an energy management, conservation or efficiency product or service or a demand-side management product or service.
>
> c. Providing an energy customer service, including metering or billing.
>
> d. Recovering or producing energy from waste materials.
>
> e. Processing waste materials.
>
> f. Manufacturing, distributing or selling products for filtration, pumping water or other fluids, processing or heating water, handling fluids or other related activities.
>
> g. Providing a telecommunications service, as defined in s. 196.01 (9m)
>
> h. Providing an environmental engineering service."

Wis. Stat. § 196.795(6m)(a)(2).

15. None of the assets of a nonutility affiliate are included from the asset calculation if "[s]ubstantially all of the assets of the nonutility affiliate are eligible assets" and the bylaws or a resolution of the board of directors "specifies that the business of the nonutility affiliate is limited to activities involving eligible assets." Wis. Stat. § 196.795 (6m)(e)(2)(b).

B. Review of Changes in Ownership

16. Also at issue is the requirement for commission approval of the acquisition of 10% of the outstanding voting securities of a utility holding company. This provision, called the "takeover" provision, provides that

> "[n]o person may take, hold or acquire, directly or indirectly, more than 10% of the outstanding voting securities of a holding company, with the unconditional power to vote those securities, unless the commission has determined, after investigation and an opportunity for hearing, that the taking, holding or acquiring is in the best interests of utility consumers, investors and the public."

Wis. Stat. § 196.795(3).

17. A "holding company" is defined as

> "a. Any company which, in any chain of successive ownership, directly or indirectly as a beneficial owner, owns, controls or holds 5% or more of the outstanding voting securities of a public utility, with the unconditional power to vote such securities.
>
> b. Any person which the commission determines, after investigation and hearing, directly or indirectly, exercises, alone or under an arrangement or understanding with one or more persons, such a controlling interest over the management or policies of a public utility as to make it necessary or appropriate in the public interest or for the protection of the utility's consumers or investors that such person be subject to this section."

Wis. Stat. § 196.795(1)(h). Thus, acquisitions of 10 percent of the securities of a utility holding company are permissible, if the commission, after review and an opportunity for a hearing, has found that the acquisition is in the "best interest" of ratepayers, investors and the public.

C. Securities Issuance Review

18. Alliant also challenges the requirement that public service corporations, including certain holding companies, obtain authorization from the commission for securities issuances. Specifically, the statute directs the Wisconsin commission to deny authorization for securities issuances --

> "which are not [for] proper corporate purposes, or in an amount greater than is reasonably necessary for such corporate purposes, having in view the immediate requirements of the corporation and its prospective requirements over a reasonable period in the future, and other relevant considerations."

Wis. Stat. § 201.03(1). Thus, the commission must review the financing proposal to determine if the issuance "is reasonably necessary for ... [proper] corporate purposes," in light the corporation's immediate and future needs. The commission also may deny authorization for "other relevant considerations."

19. The advance review requirement applies to securities issuances of "public service corporations." A "public service corporation" is defined by statute as any corporation which is a public utility (except very small utilities). Wis. Stat. § 201.01. The advance review requirement also applies to holding companies which are themselves public utilities under the statute. Id.

20. The statute further declares that the term "public service corporation" includes holding companies that(1) are formed after November 28, 1985, and (2) have any nonutility affiliates that the commission has determined "do not and cannot reasonably be expected to do at least one of the items specified in § 196.795 (7)(a)." Id. There are four items specified in § 196.795 (7)(a); each item is a business activity having a connection to the business of its public utility affiliate. In order to avoid qualifying as a "public service corporation," thereby rendering

securities issuances subject to the advance review requirement, the business activities of a holding company's nonutility affiliates must all:

> "1. Substantially retain, substantially attract or substantially promote business activity or employment or provide capital to businesses being formed or operating within the wholesale or retail service territory, within or outside this state, of:
>
> a. Any public utility affiliate.
>
> b. Any public utility or member of a cooperative association organized under ch. 185 which reports or has reported information to the commission under the rules promulgated under s. 196.491 (2) (ag)
>
> 2. Increase or promote energy conservation or develop, produce or sell renewable energy products or equipment.
>
> 3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources[, or]
>
> 4. Develop or operate commercial or industrial parks in the wholesale or retail service territory of any public utility affiliate."

Thus, where the commission determines that a nonutility affiliate "do[es] not and cannot reasonably be expected to do at least one of the [four] items" listed above, the commission must treat the holding company as a public service corporation and regulate its securities issuances.

Part Two:

Unique Qualities of Utility Service Create a Significant State Interest in Effective Utility Regulation

21. In this part I provide background on the traditional police powers that states exercise over their public utilities. There are three subparts:

> **Section I** explains how the utility's unique status creates in the state a powerful interest in effective regulation.
>
> **Section II** explains that the need for state public utility regulation is broad, extending to prices, services, and a full range of other matters with the potential for affecting rates and service.
>
> **Section III** provides an overview of the structural regulation of public utilities, the policies supporting it, and the relationship between structural regulation and local utility service.

22. In Part Three below, I will discuss the specific regulatory tools used in Wisconsin that are the subject of this litigation.

I. Safe, Reliable, and Affordable Electric Service is a Traditional and Significant State Interest

23. This part explains that states have a significant interest in effective regulation of utilities and their affiliates. First, I explain the state interest in the utility's primary responsibility of providing electric service. Second, I describe the state interest in controlling the economic power that is conferred upon public utilities by the state grant of protection from competition within its retail service territory. Finally, I describe how the state interest in effective utility regulation compares to regulation of nonutilities.

A. The State Interest in Safe, Reliable, and Affordable Service

24. Electric utilities provide services critical to the health, safety and general welfare of the public. The services provided are affected with a significant public interest -- reliable and affordable electric service is needed to keep the heat and lights on, hospitals and schools running, and the economy going. Thus, every state has a comprehensive regulatory regime with which it oversees its public utilities. As the Supreme Court has noted, "the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States." Arkansas Electric Coop. Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375, 377 (1983).

25. The state's strong interest in the provision of electric services is inherent in the very notion of a "public service" utility company itself. A company devoted to a "public service," like providing electricity, receives certain benefits under the law (e.g., a government-sanctioned protection from retail competition and government-set prices designed to assure the utility a reasonable opportunity to earn a fair return on prudent investment).

26. Having granted to the utility protection from competition over the provision of an essential service, the state has a strong interest in

> "avoiding any jeopardy to service of the state-regulated captive market.... State regulation of natural gas sales to consumers serves important interests in health and safety in fairly obvious ways, in that requirements of dependable supply and extended credit assure that individual buyers of gas for domestic purposes are not frozen out of their houses in the cold months."

General Motors Corp. v. Tracy, 519 U.S. 278, 305-06 (1997). To protect this interest, the state engages in comprehensive regulation of price, service "and a number of ancillary matters, including the firm's financial practices, its relations with other public service companies, and

mergers and other corporate changes." Baltimore Gas and Electric Company v. Public Service Commission of Maryland, 760 F.2d 1408, 1424 n.14 (4th Cir. 1985)(internal quotations and citation omitted).

27. State regulation thus plays a pivotal role in protecting the welfare of utility ratepayers. Based on my experience advising state commissions on the regulatory policies underlying the statutes under review in this case, those policies (described in more detail in below) are critical to the welfare of retail consumers.

28. This significant state interest in effective public utility regulation has been recognized frequently by federal courts. For example:

> 1. Pacific Gas & Electric Co. v. Public Utilities Comm'n, 475 U.S. 1, 19 (1986)(recognizing that, in First Amendment jurisprudence, "[t]he State's interest in fair and effective utility regulation may be compelling").
>
> 2. West Virginia State Board of Education v. Barnette, 319 U.S. 624, 639 (1943) ("The right of a State to regulate, for example, a public utility may well include, so far as the due process test is concerned, power to impose all of the restrictions which a legislature may have a 'rational basis' for adopting.");
>
> 3. New Orleans Pub. Serv., Inc. v. City of New Orleans, 798 F.2d 858, 862 (5th Cir. 1986) ("The regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise.");
>
> 4. American Elec. Power Co. v. Kentucky Public Service Comm'n, 787 F.2d 588 (1986) (noting that "[t]here is little question ... that the regulation of consumer electric rates is an important state interest");
>
> 5. Minnesota Gas Co. v. Public Service Com., Dep't of Public Service, 523 F.2d 581, 583 (8th Cir. 1975)(holding that private contracts related to utility services are subject to state regulatory powers, and stating that "[r]egulation of public utility rates has long been held an area of public interest subject to State police

power legislation. It is an implied condition of all private contracts in such areas of public interest that the agreement is subject to frustration by subsequent legitimate exercises of the State's police power. Thus, private parties cannot by contract insulate themselves from State rate regulations adopted thereafter.")(citations omitted).

6. Application of Otter Tail Power Co., 451 N.W.2d 95, 107 (N.D. 1990) ("A state's interest in public utility regulation in furtherance of the public good is substantial and ranks among the most important functions traditionally associated with the police power of the States.")(internal quotation omitted).

B. The State Interest in Controlling Utility Power

29. State government interest in utility service arises not just because reliable, reasonably priced electricity is a paramount state concern, but also because states have an interest in supervising and controlling businesses upon which they have conferred special rights related to protection from retail competition. As a New York court once observed, state laws for the regulation of utility monopolies are "intended to prevent, on the one hand, the evils of an unrestricted right of competition and, on the other hand, the abuses of monopoly." People ex rel. New York Edison Co. v. Willcox, 207 N.Y. 86, 93 (1912).

30. There are several reasons why states have conferred protection from retail competition to public utilities. Many public utility services historically or currently are characterized by scale economies or "natural monopolies." This concept means that it is more efficient for a single large firm, rather than multiple smaller firms, to serve a particular level of demand. In this context, states conferred protection from competition on public utilities; and, to prevent abuses associated with the exploitation of the resulting franchise, subjected them to the supervision and control of state regulatory commissions. The Supreme Court provided an explanation of the developments leading to comprehensive state regulation in a 1997 decision:

> "[T]he States' ... experiments with free market competition in the manufactured gas and electricity industries ... dramatically underscored the need for comprehensive regulation of the local gas market.... [I]n the latter half of the 19th century ... the States generally left any regulation of the industry to local governments. ... The results were both predictable and disastrous, including an initial period of "wasteful competition," followed by massive consolidation and the threat of monopolistic pricing. The public suffered through essentially the same evolution in the electric industry. Thus, by the time natural gas became a widely marketable commodity, the States had learned from chastening experience that public streets could not be continually torn up to lay competitors' pipes, that investments in parallel delivery systems for different fractions of a local market would limit the value to consumers of any price competition, and that competition would simply give over to monopoly in due course. It seemed virtually an economic necessity for States to provide a single, local franchise with a business opportunity free of competition from any source, within or without the State, so long as the creation of exclusive franchises under state law could be balanced by regulation and the imposition of obligations to the consuming public upon the franchised retailers.
>
> When federal regulation of the natural gas industry finally began in 1938, Congress, too, clearly recognized the value of such state-regulated monopoly arrangements for the sale and distribution of natural gas directly to local consumers.
>
> ***
>
> To this day, all 50 States recognize the need to regulate utilities engaged in local distribution of natural gas. Ohio's treatment of its gas utilities has been a typical blend of limitation and affirmative obligation."

General Motors Corp., 519 U.S. at 288-94 (citations and footnotes omitted; emphasis added).

31. As a result of their local monopolies, public utilities are often called "common carriers" in reference to their public responsibilities. As the Supreme Court explained more than a century ago, as common carriers, public utilities "exercise a sort of public office, and have duties to perform in which the public is interested." Munn v. Illinois, 94 U.S. 113, 130 (1877).

"[W]hen private property is devoted to a public use, it is subject to public regulation." Id. Thus, as the sole provider of vital generation, transmission, and distribution services, public utilities have special powers -- powers which must be controlled by regulation to assure that their use is consistent with the public's interests.

C. The State Interest in Regulating State-Protected Monopolies, as Compared to Competitive Businesses

32. As beneficiaries of government protection from retail competition, public utilities are distinct from businesses operating in competitive markets. This distinction is relevant to explaining the state's significant interest in distinctive regulatory techniques. Indeed, the distinction drew the attention of the U.S. Supreme Court in the General Motors case.

33. Addressing a Commerce Clause challenge to an Ohio energy tax from which Ohio natural gas public utilities were exempt, the Court addressed the threshold question of whether competitive sellers of natural gas and the state-regulated gas public utilities are "similarly situated for constitutional purposes." 519 U.S. at 299. The Court reviewed the history and current conditions of the natural gas industry, discussing the industry's natural monopoly characteristics, the establishment of federal regulation and Congress's own recognition of state utility regulations, and the state's interest in the health and safety of its citizens. Ultimately the Supreme Court ruled that the unique economic circumstances and industry history differentiate public utilities from other businesses.

34. That public utilities are not "similarly situated" to nonutility companies is no surprise to practitioners of regulation. The exclusive control of a product on which the public depends sets public utilities apart from other industries, and brings with it a need for a comprehensive regulatory regime, as discussed next.

II. To Protect the Consumer, State Public Utility Regulation Must Reach Into Many Aspects of Utility Service and Utility Corporate Structure

35. To be effective, state regulation must address a number of interconnected issues related to pricing, service, financial structure, contracts, federal regulation, corporate structure and other matters. As the Supreme Court observed in General Motors, supra, state public utility regulation consists of "a blend of limitation and affirmative obligation." This mix of regulatory limitation and affirmative obligation is implicit in the concept of a public utility itself:

> "[T]he very notion of a public service company presupposes 'distinctive public constraints ... administered by a government agency that supervises the availability and quality of the firm's services, the price to be charged for such services, and a number of ancillary matters, including the firm's financial practices, its relations with other public service companies, and mergers and other corporate changes.'"

Baltimore Gas & Electric, 760 F.2d 1408, 1424 n.14 (quoting G.E. Jones, "Origins of the Certificate of Public Convenience and Necessity: Developments in the States," 1870-1920, 79 COLUM. L.R. 426, 426 (1979)).

36. In recognition of the scope and complexity of utility regulation, most state laws confer broad jurisdiction to state regulatory commissions. A typical statute will vest the state commission with general powers -- for example, the "complete power and jurisdiction to regulate all public utilities in the state...." Michigan Stat. Ann. § 460.6. Most state statutes also provide express power on the Commission, for example, "to regulate all rates, fares, fees, charges, services, rules, conditions of service, and all other matters pertaining to the formation, operation, or direction of such public utilities." Id.

37. Regulation generally falls into three main categories: rate regulation, quality of

service regulation, and structural and financial regulation. Rate regulation is the critical task of determining the prices consumers will pay and the rewards the utility will receive. Quality of service regulation includes the state regulator's task of making sure that the local utility provides service reliably and safely. The provisions at issue here relate directly to structural and financial regulation, although structural regulation indirectly affects rate regulation and quality of service regulation. I discuss structural regulation next.

III. Structural Regulation Is Critical for an Effective Regulatory Regime

38. Structural regulation involves oversight of utility corporate structure, relationships with affiliates, mergers, financing and related matters. Structural regulation provides critical support to both rate regulation and quality of service regulation, because poor management decisions in any of these areas can put pressure on costs, leading to rate increases or service costs. Consider this statement from the Supreme Court of Arizona, explaining that state commission rules governing the formation of utility holding companies

> "arguably prevent utilities from endangering their assets through transactions with their affiliates. If such transactions damage a utility company's assets or net worth, the company will have to seek higher rates for survival. Thus, transactions with affiliated corporations could have a direct and devastating impact on rates."

Arizona Corp. Comm'n v. State of Arizona ex rel. Woods, 171 Ariz. 286, 295, 830 P.2d 807 (1992)(affirming state commission authority under general ratemaking statute to promulgate structural regulations).

39. As the Arizona court recognized, regulatory oversight of the utility's corporate structure, its financing, and its nonutility investments is necessary for effective rate regulation. Structural regulation is necessary to minimize uncertainty and risk. In ratemaking, benchmarks

for cost and efficiency are difficult to establish. Moreover, there is a real differential in resources between regulators and the regulated industries. State regulatory agencies often are underfunded and understaffed relative to the magnitude of their regulatory tasks and of the companies they regulate. Structural regulation thus can facilitate more effective regulation with fewer resources. Upfront review reduces the need for after-the-fact oversight and correction.

40. The Supreme Court of New Mexico recognized this point when it rejected a utility's contention that state commission rules requiring prior approval of the formation of a holding company were not authorized by New Mexico's law. The Court explained that the utility's "interpretation of [state law] would strip the Commission of its ability to protect ratepayers from the adverse effects of the holding company restructuring until the impact has occurred...." Public Service Co. of New Mexico v. New Mexico Pub. Serv. Comm'n, 747 P.2d 917, 920 (N.M. 1987)(affirming state commission's rejection of utility's proposal to form a holding company based on its "determination that the holding company structure would impair the Commission's ability to supervise [the utility] to ensure reasonable rates and services").

41. Moreover, after-the-fact assessments necessarily involve the regulator deeply in the assessment of specific costs and specific business activities; thus structural regulation lessens the regulatory burden. For example, when a utility or related business invests in a competitive industry, regulators must ensure that the business risks are not so high as to raise the utility's costs of capital, and thus must analyze the business risks themselves. Also, the commission must assure that the rates it sets for noncompetitive utility services do not subsidize any competitive costs (that is, recover from customers of noncompetitive service any costs associated with the provision of competitive services); thus the commission must scrutinize all interaffiliate

transactions, and any sharing of resources between the competitive and noncompetitive parts of the corporate family. By limiting nonutility investments, the regulatory task is reduced.

42. There are several structural regulatory techniques available to preclude or limit the risk to utility rates and service of a particular utility action. For example, many states require regulatory approval for transactions involving the transfer of a monopoly franchise (e.g., a certificate of public convenience and necessity) to a new owner. Similarly, utilities typically must obtain regulatory approval before entering into significant financing arrangements through stock issuances or otherwise. Finally, regulation may consist of a mix of structural review and after-the-fact regulation. For example, a state might allow utilities to engage in certain nonutility investments but not others; regulators still must oversee the nonutility activities to protect ratepayer interests.

43. In sum, it is common for states to limit what the utility may do with its corporate structure and to require regulatory approval before certain actions may be taken. I explain in more detail below how the regulatory techniques adopted by Wisconsin and under challenge in this case are common in the utility industry and in other industries.

Part Three:

The Special Problems of Nonutility Investment, New Ownership and Securities Issuances Require Special Regulatory Tools

44. The utility-related events that are the subject of this affidavit -- utility investments in nonutility businesses, changes in ownership, and securities issuances -- present special problems for the regulatory objectives of ensuring safe, reliable, and affordable electric service and

restraining the abuse of market power. This Part Three describes those problems and their regulatory solutions. For each of the three types of utility-related events, I describe the problems and risks associated with the event and the conventional regulatory techniques for mitigating those risks. Then I compare Wisconsin's regulatory policies to the conventional techniques. I conclude that each of the Wisconsin statutes serves its regulatory purpose and is typical of the regulation applied by other jurisdictions.

I. Utility Investments in Nonutility Businesses

45. In this section, I discuss (a) the problems and risks that arise when a utility providing noncompetitive services also participates in competitive nonutility markets, (b) the regulatory techniques used to address those problems and risks, and (c) how Wisconsin's "asset cap" falls within the regulatory norm.

A. A Utility's Investment in Nonutility Businesses Subjects Its Captive Customers to Business Risks

46. The entry of a public utility company or its holding company into business sectors outside the core business of public utility service creates special risks to captive ratepayers -- those who depend on a utility for an essential service and cannot shop elsewhere. This risk arises from the tension between the noncompetitive and competitive sides of a utility holding company's business. The competitive business side has an incentive to rely on resources provided by the noncompetitive side of the business, so that costs are recovered from captive customers rather than charged to competitive customers who can price-shop.

47. As explained further below, ratepayers of utilities face at least three categories of risk when their utility, or its holding company, invests in nonutility businesses.

1. Inappropriate Interaffiliate Relations

48. Where competitive and noncompetitive businesses occur in the same corporate family, there is an incentive and opportunity for the noncompetitive businesses to cross-subsidize the competitive businesses. Cross subsidization occurs when (a) costs are shifted from the nonregulated business (where prices are limited by competitive market forces) to the regulated business (where costs are recovered from nonshopping customers through regulated rates), or (b) the competitive businesses fail to compensate adequately the noncompetitive business for benefits provided. In the noncompetitive context, ratepayers by definition have no alternatives; therefore, the supplier can raise prices by passing through costs. In the competitive context the opposite is true: in the event of a price increase, customers can turn to alternatives. An entity operating in both worlds can maximize profits by shifting costs from customers who have alternatives to those who do not.

2. Management Distraction

49. Nonutility investments can distract management from the priority task of providing safe, reliable and affordable utility service. Where the investments succeed, the management will tend to give that sector more investment attention. Where the investments appear to be failing, management will tend to put more effort in to avoid failure. Either way, management's attention is diverted from the core task of serving captive ratepayers. As the Texas Commission stated in a decision involving the failed diversification efforts of El Paso Electric (EPE):

> "The financial losses are enormous and will be felt by EPE for a long period of time....The subsidiary operations also impacted EPE's management. The record reflects that a significant amount of time, energy, and resources of EPE's management have been committed to working with, and ultimately disposing of, the subsidiaries. Because of the immediacy of the problems, EPE's

> management has been forced to address the complicated situation in finding necessary cash to maintain operations, all of which have taken time away from concentrated efforts on the utility operations."

Application of El Paso Electric Co. for Authority to Change Rates, 1990 Tex. PUC LEXIS 188, *30 (Aug. 22, 1990).

50. In addition to management preoccupation with non-utility activities, there is the risk that management or other key employees may leave the utility to work for the non-utility affiliate. The loss of high-value utility employees to the nonutility businesses deprives the utility customers of benefits which they would have in the absence of the loss. The problem feeds on itself because the upwardly mobile employees view the noncompetitive affiliate as a more desirable place to work and encourage their peers to view the situation similarly. Further, there can be a tendency to train the employees at the noncompetitive affiliate, where the costs can be recovered from captive ratepayers under regulated rates.

51. Utility management faces many new challenges: regional transmission organizations, open access transmission, nuclear waste disposal, and industry consolidation resulting from mergers and acquisitions. The business is changing, rapidly and dramatically. A manager focusing on non-utility problems is not focusing on the utility business. During such rapidly changing times, ratepayers need managers whose priority is to pursue the best course for the ratepayers.

3. Cost of Capital

52. Traditionally, investors have viewed the utility business as having lower risk than other industrial businesses, because the customer base is insulated from competitors and because regulators set rates to allow a reasonable opportunity for recovery of the utility's costs. That

lower risk has translated into lower costs of capital for the utilities. As the utility or its holding company invests in nonutility businesses, however, risk increases. Moreover, if the nonutility businesses are not successful, the costs of capital will increase even further. Thus, the larger the investment in nonutility businesses, the greater the risk of an increase in the cost of the utility's capital. The Wisconsin commission has described this risk:

> "The combination of [the holding company] WICOR's dividend policy and its business objectives, which include acquisition as a major goal, puts pressure on Wisconsin Gas Company to provide an ample flow of cash to WICOR. Thus, the needs of WICOR could inappropriately become the "driver" in determining the amount of the Wisconsin Gas dividend.
>
> "We earlier stated that prior dividend payouts have not jeopardized Wisconsin Gas Company's financial health. However, if WICOR were to continue to rely heavily upon Wisconsin Gas Company's dividends in the future, without regard to Wisconsin Gas Company's financial needs, there is great potential for harm to Wisconsin Gas Company and its ratepayers. The harm that could result is an increase in the long-term overall cost of capital for the utility due to a reduction in its current credit standing.
>
> "One way, but not necessarily the only way, that this increased cost of capital would be manifested is a downgrading of the utility's bond rating. Therefore, if WICOR did adopt such a dividend policy and business plan it could benefit WICOR's shareholders, but at the expense of Wisconsin Gas Company ratepayers...."

WICOR, Inc., 83 P.U.R.4th 639 (Wisc. Pub. Serv. Comm'n, May 21, 1987).

53. An example of an increase in the utility cost of capital is the failed effort to invest in a savings and loan company by Pinnacle West, a utility holding company which owned a utility called Arizona Public Service (APS). After the savings and loan company suffered severe financial difficulties, the holding company proposed filing for bankruptcy to keep from pouring money into its financially distressed affiliate. As a result of its parent's impending bankruptcy,

APS' bonds were downgraded to near junk bond status. The Pinnacle West failure is described in Tucson Electric Power, 167 P.U.R. 4th 211 (1996).

54. Thus losses in competitive ventures can lower a utility's financial standing. As the California Public Utilities Commission has explained, regulatory limitations on nonutility investments address fundamental concerns for "protecti[on] of the financial integrity of the regulated entity (i.e., new unregulated ventures should not impair the utility's ability to raise capital, its bond rating, etc.) and the avoidance of any subsidization by the regulated entity (and thus its ratepayers) of the unregulated business." Southern California Edison Co., 1990 Cal. PUC LEXIS 847, *38; 37 CPUC2d 488, 116 P.U.R.4th 365 (Sept. 25, 1990) (limiting the ability of utilities to hold ownership interests in unregulated qualifying facilities).

55. Pinnacle West was not the only example of a failure of a nonutility investment. There are many others. The El Paso Electric case involved a utility (EPE) that was the parent company of a number of non-utility subsidiaries. One of EPE's real estate subsidiary's holdings included a hotel and a business development subsidiary. Application of El Paso Electric Co., supra at*27. These subsidiary operations, however, were "a complete failure" with total losses of $195 million.

56. Another example involves Tucson Electric Power's (TEP) formation in the 1980s of a holding company which invested into non-utility areas such as car leasing, real estate, security investments, hotels, and motels. The non-utility areas flourished for a period of time; however, most of the nonutility businesses turned sour toward the end of the 1980s. In addition, in the early 1980s, TEP had an excess of generating capacity. As a result, TEP formed a new subsidiary, Alamito Company, to handle TEP's wholesale business to market the excess capacity.

As a result of its various nonutility ventures and its one-sided contracts with Alamito, TEP could not pay all of its bills and creditors attempted to force the utility into Chapter 11 reorganization. TEP eventually settled with creditors on a financial restructuring plan approved by the state commission.

B. To Identify and Limit the Business Risks, Wisconsin Uses Conventional Structural Techniques Common to Federal and State Statutes in Diverse Industries

1. The Benefits of Structural Limitations

57. To leave the utility's or holding company's nonutility activities unconditioned is to make the utility or its holding company the exclusive decisionmaker on how much nonutility risk to take on. But the utility and its holding company cannot balance objectively the shareholder risk with the ratepayer risk. The captive customers' interest differs from the shareholders' interest. The utility customers are not willing partners in the nonutility business. They cannot profit from these efforts, but they can lose through higher rates and declines in service quality. Moreover, shareholders who become uncomfortable with the utility's nonutility businesses can sell their shares and leave; the utility's ratepayers must remain. Consequently, an independent, objective source of consumer protection is necessary.

58. An entire body of regulatory law and practice has developed to protect against the inherent risks that utility entry into competitive businesses carries for captive consumers. Many states regulate nonutility investments, often utilizing several regulatory techniques. These techniques include limits on total nonutility investment, and comprehensive regulatory oversight to protect ratepayers from any nonutility investment that is permitted. Such regulatory techniques are common not only in the electric industry, but also in other industries providing

essential services, such as banking, insurance and telecommunications.

59. There are two major categories of structural regulation: (1) pre-investment conditions that limit how much and into what businesses a utility or its holding company may expand; and (2) post-investment regulatory review and oversight of nonutility investments and of interaffiliate transactions between a utility and its related businesses. Examples of the latter category of state laws regulating business dealings once nonutility investments are permitted include: 35A Maine Stat. § 713 (prohibiting cross-subsidies; establishing complaint process). Kansas § 66-1402 (requiring state commission approval of affiliate contracts under public interest standard). 220 Illinois ILCS 5/7-101 (providing for regulation of transactions between utilities and affiliated interests); and Iowa Code § 476.78 (2002) (prohibiting cross-subsidization).

60. Structural conditions limit the overall risks of nonutility investment, and reduce the need for post-investment regulation. Structural remedies serve an important role in reducing customer risk since after-the-fact regulation is not a reliable means of protecting customers from the risks of nonutility investments. As the Washington commission succinctly, while after-the-fact regulation can help to protect ratepayers, "[i]n the real world, ratepayers are unavoidably involved in diversification." Pacific Power & Light Co., 1985 Wash. UTC LEXIS 45, *37 (Aug. 2, 1985).

61. The Wisconsin commission has described the different options for reducing the risk to utility ratepayers of utility investment in nonregulated activities. Rejecting other regulatory options, such as a restriction on the payment of dividends from the utility to its holding company, in favor of a structural limitation, the Commission explained that

> "a less restrictive condition, such as an investment limitation, is justified.... An investment limitation would restrict [the holding company's (WICOR's)] ability to invest in nonutility operations, and therefore would reduce the pressure for funds from the utility as well as achieve other necessary goals.
>
> A reasonable investment limitation will allow WICOR to pursue its nonutility plans while partially achieving two important objectives for maintaining Wisconsin Gas' financial integrity. First, the investment limitation will help reduce pressure on Wisconsin Gas to pay out additional funds during a period in which the utility has need for such funds. Second, the investment limitation may assist in reducing the degree of financial risk from possible nonutility losses.
>
> By affecting the size and pace of nonutility investment, potential adverse impacts on the utility may be diminished and management attention focused on the need to advantageously position Wisconsin Gas in a changing industry. Limiting the investment in nonutility affiliates by WICOR at this time will insulate Wisconsin Gas to some extent from these problems which could result if WICOR's nonutility operations were allowed to grow at an unrestricted rate."

WICOR, Inc., 83 P.U.R.4th 639 (Wisc. Pub. Serv. Comm'n, May 21, 1987).

2. Wisconsin's Structural Limitations Are Comparable to Limitations Imposed in Other Jurisdictions and in Other Industries

62. The Wisconsin provisions allow the utility to seek benefits from entry into unregulated businesses, while reducing the ratepayer risk from that entry. The essential elements of the Wisconsin provisions resemble the structural provisions on nonutility investment found in state and federal law.

63. Regulations created by statute or by agency rule or decision commonly limit the overall investment of a regulated business in new businesses. In general, they restrict investment by limiting (a) the type or line business for which investment is permitted (or prohibited), and/or (b) the total investment the regulated entity may make.

64. Line of Business Restrictions. Examples of this first type of investment limitation include the following:

1. The Public Utility Holding Company Act of 1935 restricts certain holding companies to "a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system." Section 11(b)(1), 15 U.S.C. § 79k(b)(1). Holding companies subject to this provision may not diversify beyond energy-related businesses which are related to their core function of electric service.

2. Federal banking law limits the types of investments by bank holding companies. Under 12 U.S.C. § 1843(a), a bank holding company may not acquire direct or indirect ownership or control of any voting shares of a company which is not a bank. To avoid this prohibition on non-banking activities, a bank holding company can choose to become a "financial holding company." However, even a financial holding company may engage only in activity that the Federal Reserve Board has determined is (a) financial in nature or incidental to financial activities or (b) complementary to financial activities and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. 12 U.S.C. § 1843(k)(1).

3. Line-of-business restrictions also appear in telecommunications regulation. Around the time of the AT&T breakup, for example, the Federal Communications Commission adopted a regulation prohibiting carriers from offering customer premises equipment (CPE) as part of transmission service. A court later upheld the prohibition as "a permissible regulatory tool" for ensuring that "no cross subsidization or unfair competition occurs." Computer and Communication Ind. Assoc. v. FCC, 693 F.2d 198 (D.C. Cir. 1982).

4. The Telecommunications Act of 1996 ("Act") imposed structural limitations on telephone utility entry into nonregulated markets. Section 272 of the Act, 47 U.S.C. § 272, for example, prohibits a Bell operating company from

engaging in certain manufacturing activities (see also 47 U.S.C. § 273h) or providing certain long distance services unless it does so through a separate affiliate that "operates independently" of the utility affiliate.

65. Total investment restrictions. Legislatures or commissions have established limits on total investment in nonutility businesses, in terms of dollars and in terms of percentage of total business assets. Examples include:

a. California, through its Public Utilities Commission, prohibited a utility holding company from investing more than fifteen percent (15%) of its total capital assets in nonutility subsidiaries without notifying the commission. Application of San Diego Gas & Electric Company for authorization to exchange all issued and outstanding common stock pursuant to a plan of reorganization, Decision No. 86-03-090, 1986 Cal. PUC LEXIS 198 (March 28, 1986).

b. In a 1996 decision, the Arizona Corporation Commission denied the utility its request to form a holding company, but permitted the utility to invest in nonutility businesses, subject to a cap on total investments in nonutility businesses of $25 million. Tucson Electric Power Co., Decision No. 59543, 167 P.U.R.4th 211 (Feb.22, 1996). In explaining the conditions under which it would approve a holding company reorganization, the commission stated that one of "the primary conditions [of its approval of a holding company formation] would be a restriction on the size of any investment as well as a restriction on the total amount of diversification." Id.

c. Under federal banking law, a bank's investment in tangible personal property such as vehicles, manufactured homes, equipment or furniture may not exceed 10 percent of the bank's assets, while "investments to promote the public welfare" (e.g., investment in housing in low and moderate income communities or jobs) cannot exceed an amount "equal to the sum of 5 percent of the association's capital stock actually paid in and unimpaired and 5 percent of the [bank's] unimpaired surplus fund," unless the banking regulator (the U.S. Comptroller) allows otherwise (and even then, aggregate investments cannot exceed ten percent of stock paid in and 10 percent of unimpaired surplus fund). 12 U.S.C. § 24, Section 16 of the Glass-Steagall Act.

66. Wisconsin's nonutility investment statute includes aspects of both types of limitations on nonutility investments: limitations on the nature of utility investment in nonutilities and on total investment. The statute allows unrestricted investments into certain energy-related businesses -- those it defines as "eligible facilities" -- but places a cap on investments in other nonutility businesses. Similar to the federal Public Utility Holding Company Act, 15 U.S.C. § 79a et seq. (described further below), the Wisconsin provision allows investments into businesses reasonably related to its core utility businesses. The statute thus embodies the Wisconsin legislature's reasonable determination that certain types of nonutility investments (in "eligible facilities") are desirable or less risky and thus should not be limited.

67. On the other hand, like the caps imposed by other states on nonutility investments, the Wisconsin provision represents a compromise between the potential benefits of nonutility investment and the risks posed. Rather than preclude nonutility investment altogether, the statute permits it. Finally, the cap adopted by Wisconsin is consistent with the caps imposed in other states and on other industries. Several of the examples of total nonutility investment limitations are less than Wisconsin's 25% percent limitation, and none of the limitations allows more than 25% nonutility investment.

II. Changes in Ownership

68. In this section I discuss the problems and risks that arise when a new entity acquires control of a utility. I describe and provide examples of the regulatory techniques used to address those problems and risks. I conclude by explaining how Wisconsin's "takeover" statute falls within the regulatory norm. The section is organized into two parts:

a. A Change in Ownership or Control of a Utility Entails

Regulatory Risks

b. To Identify and Limit the Risks of Ownership Changes, Wisconsin Uses the Common Technique of Requiring Prior Regulatory Approval

A. A Change in Ownership or Control of a Utility Entails Regulatory Risks

1. Fitness of the New Owners

69. The electric industry is a critical part of our nation's infrastructure. Its control must be in the hands of utilities that are capable and accountable. The state seeks to assure that the utility experience and expertise in the production and procurement of electricity, in regulatory relations and in customer service, all satisfy the state's objectives. Many skills are involved: engineering, operational, managerial, economic and financial, political and public relations. The state obtains assurance that these skills will be made available by imposing conditions on the utility's right to serve.

70. The state grants to the utility the privilege of serving a retail customer base free of direct competition. In return the utility accepts an obligation to maintain a reasonable quality of service at reasonable cost. It is the task of utility regulation to enforce the utility's obligation. The state, through its public service commission, does not have the utility's full set of skills -- the engineering, operational, managerial, economic, financial, political and public relations skills. Because of this differential in skill set and resources, the state cannot depend on constant oversight and assessment of each utility action. Instead the state must assure itself at the outset that the utility has the requisite skills and motivations. Having done so, the state then can rely on periodic checks -- in rate cases, inquiries and, occasionally, after-the-fact investigations of things gone wrong -- to ensure that the fundamentals remain in place.

71. In light of the substantial influence that a 10 percent stake can vest in the owner, as discussed below, the advance review plays a necessary and logical role. To omit advance review is to put more burden on post-acquisition regulation. Thus, advance review is a species of the more general regulatory practice of assuring quality of service, a practice deeply rooted in the state's role of assuring the health and safety of its citizens. The traditional, legitimate oversight of utility service quality does not become illegitimate when exercised before a change in ownership.

2. Price Risks

72. Under certain circumstances, the sale of a significant block of stock creates price risks for the utility's customers. Advance review by the state commission creates an opportunity to mitigate those risks.

73. Consider a situation where a new significant shareholder has purchased its block of stock at a premium; that is, at a price above book value. Such a shareholder will have an incentive (given the high price it paid), and the opportunity (given its significant ownership share), to pressure management to increase profit to make the investment worthwhile. In a context where customers are captive to the utility, increases in profit arise from cutting utility costs, raising utility rates, or finding new investment opportunities outside of the existing utility. While harm to customers is not a necessary result of such a purchase, it is a risk. For that reason, the state has an interest in reviewing the terms of such a sale in advance to assure that the cost to the purchaser bears a reasonable relationship to the value of the company share purchased.

74. One version of the sale of a large block of stock is the sale of the entire company to another company, where the acquiring company buys out the existing shareholders for cash.

Often, the purchase price is at a premium over book value. The sale of control at a premium has long been a concern of regulators. Allowing the acquirer to recover the costs of the premium in regulated rates replaces an objective cost basis for utility rates (i.e., rates should reflect reasonable costs of utility services), with a subjective cost basis (i.e., rates would reflect what the acquirer paid). Since the acquirer would be willing to pay whatever amount he was assured of recovering in rates, the ratemaking process becomes not only subjective, but circular: a potential acquirer's decision to purchase, and the price he would be willing to pay, would be based on the acquirer's ability to persuade the regulator to have ratepayers pay for the purchase costs, rather than on objective measures of appropriate utility costs.

75. State commissions protect consumers from excess premiums in various ways. Some decline to allow recovery of the premium in rates, thereby discouraging the acquirer from paying a premium. Others limit rate recovery of the premium to an amount equal to the cost reductions flowing to ratepayers from the merger, thus protecting the ratepayers from any cost increase (since the cost of the premium is offset by the cost reductions), and also inducing an acquirer to limit the premium paid to reasonably foreseeable cost reductions. Reviewing the transaction in advance allows the Commission to determine whether the transaction will be able to meet these tests and to reject the transaction if it does not. Were the change of control to occur without review, followed by a rate case in which the new owner seeks recovery of the premium, the Commission may be unable to disallow the premium from rates, for fear of weakening the utility financially. The advance review of the change of control thus preserves the ability of the state to guard against transactions that would affect customers adversely.

76. It is possible that the stock purchase by a new influential owner, even at a premium,

could decrease costs to the utility. To acknowledge this possibility is not to eliminate the underlying ratepayer concern: when a new significant source of influence enters the company, costs can go up or down. It is inarguable that the direction of the cost change will be uncertain. It is that uncertainty that the regulator seeks to manage by reviewing the sale of stock in advance.

3. Foreign Acquirers

77. The introduction of foreign owners raises distinct issues. Addressing these issues upfront is one of the benefits resulting from a state's advance review of a sale of a significant portion of stock to a new owner. Three categories of benefits of such advance review are discussed next.

a. Access to Books and Records

78. Regulation requires regular review of costs, financial arrangements and infrastructural readiness. Careful review requires accurate data. Regulators therefore need ongoing access to the books and records of the utility; and, for some purposes, the books and records of its affiliates and/or holding company.

79. Data -- in the form of financial books and records -- are usable by the regulators only if they are accessible. Foreign ownership of domestic utilities raises issues related to the physical availability of records; the physical availability of personnel; currency clarity; and language clarity.

80. Regulatory access to books and records is common. For example:

a. The Public Utility Holding Company Act (PUHCA), section 15, 15 U.S.C. § 79o ("Accounts and records") establishes book and recordkeeping requirements for utility holding companies and their affiliates and subsidiaries.

b. PUHCA section 32, 15 U.S.C. § 79z-5a, enacted as part of the Energy

Policy Act of 1992, prohibits certain affiliate transactions unless the state commissions with jurisdiction over the holding company's operating utilities have determined that they have "sufficient regulatory authority, resources and access to books and records of the electric utility company and any relevant associate, affiliate or subsidiary company."

c. The Federal Power Act, section 301, 16 U.S.C. § 825, requires every public utility to "make, keep and preserve for such periods, such accounts, records of cost-accounting procedures, correspondence, memoranda, papers, books and other records as the Commission may by rules and regulations prescribe...."

d. State laws include similar provisions: Maine law, for example, provides that all public utilities provide the commission with "[a]ll information necessary to perform its duties and carry into effect this Title." 35-A Me Rev. Stat. § 112. Arizona requires that

> "[e]very public service corporation ... furnish to the commission, in the form and detail the commission prescribes, tabulations, computations, annual reports, monthly or periodical reports of earnings and expenses, and all other information required by it to carry into effect the provisions of this title and shall make specific answers to all questions submitted by the commission."

Az Stat. § 40-204.

New Mexico similarly authorizes the state commission to require that the utility or its employees provide it with "any books, records, accounts or documents" whenever such provision is "reasonably required and pertinent to any matter under investigation before the commission." N.M. Stat. Ann. § 62-6-17(a).

81. Because of the centrality of data to the regulatory process, it is reasonable for the regulator to assure these conditions of accessibility exist before a transfer of company control occurs. Advance review of significant changes in stock ownership is an efficient means of obtaining that assurance.

b. Interaffiliate Transactions

82. Acquisition of a U.S. utility by a foreign holding company is likely to result in a corporate structure in which interaffiliate transactions take place. Interaffiliate transactions will create risks as long as two current features of the utility, presently prevalent, remain: (1) certain utility services remain noncompetitive services; and (2) entities that provide noncompetitive services are permitted to provide competitive services, directly or through an affiliate.

83. Under these circumstances, interaffiliate transactions create the risk that noncompetitive affiliates will underpay, or overcharge, the utility affiliate for goods and services, thus causing the customers of the utility to bear costs they would not bear in the absence of the interaffiliate transaction. Where the utility is controlled by foreign interests, these problems of interaffiliate transactions grow more complicated in at least two ways. First, currency differences and changing exchange rates will make the interaffiliate price hard to determine. Second, where the transaction involves nonprice benefits or costs, distance, language and communication complexities will make such benefits and costs difficult to detect and evaluate.

84. As with the other issues discussed above, the advance review of a change in control is a reasonable means of examining and conditioning the utility's plans for interaffiliate transactions.

c. Determination of Cost of Capital

85. A utility's cost of capital is affected by risk. There are many types of risks. One is the risk that management's technical performance will fall below regulatory expectations and provoke penalties. Another is that the utility's financial performance will fall below

expectations. In either case, investors concerned about performance will demand a higher return on their capital to compensate for their concerns.

86. The acquisition of a significant portion of a utility by another person means that shareholders of the utility are affected by the risks associated with the acquirer. Where the acquirer is a foreign entity, these risks deserve special attention. A typical U.S. investor is likely to be less familiar with the risks associated with a foreign acquirer, such as its business practices, the ways in which those business practices are viewed by the acquirer's foreign regulator, and the nature of the foreign regulatory process (e.g., what types of penalties are imposed on what types of performance lapses). Moreover, like any business entity, the foreign entity will be subject to political risks -- including the risk that the company's product or its mode of production will become a source of controversy. The typical U.S. investor is less familiar with foreign political risks than with U.S. political risks. All else equal, this difference in familiarity will cause the U.S. investor to demand a higher return to compensate for the unknown risk. There are also currency risks, and the risk that the general political and trade relationships between the U.S. government and the foreign government, if friendly at the time of the acquisition, will become unfriendly, with possible consequences for the acquirer's and the utility's business prospects.

87. The challenge for the regulator of the U.S. utility is to determine the cost of capital associated with providing service to the local customers such that they do not bear any cost of capital associated with the foreign acquirer's foreign operations and risks, since these foreign operations do not benefit the utility.

88. Where foreign risks are unusual and/or difficult to quantify, calculation of cost of capital for ratemaking purposes becomes more complicated. The new types of foreign risks, and

the potential complexity of the corporate and capital structures used by the foreign acquirer, will likely be less familiar to the state regulator as compared to a domestic acquisition situation. It is reasonable for the state regulator to assess this complexity before approving an acquisition; otherwise the regulator could face, post-acquisition, a set of rate case issues that it finds itself unable to resolve, either because of the complexity or because the solution might be more damaging than the problem. The regulator reasonably will want to assure itself, before the acquisition is consummated, that it will have the capability to regulate the post-acquisition company capably.

B. To Identify and Limit the Risks of Ownership Changes, Wisconsin Uses the Common Technique of Requiring Prior Regulatory Approval

89. Regulatory review of changes in utility ownership occurs in many jurisdictions and in many industries. In the usual case, the acquisition of a public utility requires the approval of multiple regulatory bodies, both federal and state. Illustrations are easy to find, as shown in the subsections below. The first three examples address ownership changes in the electric industry. The final subsection demonstrates that Wisconsin's review statute is typical of the many examples of regulatory review of ownership changes.

1. Federal Public Utility Holding Company Act

90. In 1935 Congress was concerned about a history of acquisitions by multistate holding companies for the sole purpose of financial gain, rather than operational efficiencies. At the time many acquisitions were motivated solely by opportunities for profiteering and concentrating market power. The acquisitions resulted in complex holding companies that state regulators could not effectively regulate for the protection of captive utility customers. See generally PUHCA section 1, 15 U.S.C. § 79a (describing congressional findings and purpose of

PUHCA), Am. Power & Light Co. v. SEC, 329 U.S. 90, 100-03 (1946)(describing pre-PUHCA holding company abuses). Congress concluded that such holding company "activities extending over many States are not susceptible of effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies." Section 1(a), 15 U.S.C. § 79a(a).

91. PUHCA therefore subjected many acquisitions of utilities, or of their holding companies, to advance review by the Securities and Exchange Commission, with the triggering point for some acquisitions as low as a 5% change in ownership. Thus PUHCA section 9(a)(2), 15 U.S.C. § 79i(a)(2), requires SEC review where the result of an acquisition would be to make the acquirer an "affiliate" of two or more public utilities. PUHCA section 2(a)(11), 15 U.S.C. § 79b(a)(11), in turn, defines an affiliate as a person owning or controlling 5% of voting ownership.

92. An acquisition triggering review under PUHCA section 9, 15 U.S.C. § 79i, must meet the many standards of section 10, 15 U.S.C. § 79j. For example:

a. Congress adopted geographic restrictions on the growth and extension of holding companies by requiring, in PUHCA Section 10(c)(1), 15 U.S.C. sec. 79j(c)(1), that acquisitions be consistent with Section 11. As noted above, Section 11(b)(1), in turn, limits each holding company to, with some exceptions, a single integrated system and those businesses which are incidental or necessary to the operations of that single system. PUHCA section 11(b)(1), 15 U.S.C. § 79k(b)(1).

b. Congress required that utility acquisitions positive benefits. Section 10(c)(2), 15 U.S.C. § 79j(c)(2)(requiring that the proposed acquisition "serve the public interest by tending towards the economical and efficient development" of an integrated utility system).

c. Congress prohibited acquisitions of utility assets where the

> acquisition "tend towards interlocking relations or the concentration of control of public-utility companies, of a kind or to an extent detrimental to the public interest or the interest of investors or consumers." Section 10(b)(1), 15 U.S.C. § 79j(b)(1).

2. Federal Power Act

93. Section 203 of the Federal Power Act, 16 U.S.C. § 824b, requires Federal Energy Regulatory Commission (Commission) approval before a public utility may dispose of jurisdictional assets worth over $50,000. The Commission may approve such a disposition only if "consistent with the public interest." Under this provision, the Commission has analyzed numerous mergers for their effect on competition, rates, and regulation. Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act (Policy Statement), 61 Fed. Reg. 68,595 (Dec. 30, 1996).

3. State Regulation of Changes in Electric Utility Ownership

94. Most states regulate changes in ownership of the public utilities subject to their jurisdiction. State laws vary in how they regulate ownership changes, but they share the general objective of ensuring that utility ownership is consistent with the interests of the public and ratepayers. Examples include the following:

95. **a. Arizona**. Arizona law requires utilities to obtain state commission approval before any disposition of any facilities "necessary or useful in the performance of its duties to the public." Ariz. Code § 40-285. Arizona law also gives the state commission authority over acquisitions resulting in a utility holding company. Ariz. Admin. Code § 14-2-803(C). The regulations state that the Commission may "reject the proposal [for the acquisition of the public utility's stock by a holding company] if it determines that it would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or

impair the ability of the public utility to provide safe, reasonable and adequate service." Id. The Arizona Supreme Court upheld the regulations in Arizona Corp. Comm'n v. State of Arizona ex rel. Woods, 171 Ariz. 286, 830 P.2d 807 (1992).

96. **b. California**. California requires state commission approval before an entity may "acquire or control either directly or indirectly" a public utility. Calif. Pub. Util. Code Section 854. The Commission must find that acquisitions (a) provide economic benefits that are equitably allocated between ratepayers and shareholders, (b) do not adversely affect competition, (c) are consistent with the public interest. Id.

97. **c. Illinois.** Illinois law requires commission approval of a "reorganization" of a utility. A reorganization is defined to include a transaction resulting in a change in "the ownership or control of any entity which owns or controls a majority of the voting capital stock of a public utility." 220 Ill. Comp. Stat. 5/7-204. The Illinois commission must determine if the "reorganization will adversely affect the utility's ability to perform its duties." Id. The statute delineates a number of factors that the Commission must consider, including factors relating to service, rates, competition, interaffiliate relations, and regulation.

98. **d. Iowa**. An Iowa statute requires state commission approval for all reorganizations, including acquisitions, sales, leases or other dispositions of all or a "substantial part" of the public utility's assets. Iowa Code §§ 476.76 & 476.77 (2002). The statute also applies to the "purchase or other acquisition or sale or other disposition of the controlling capital stock of any public utility, either directly or indirectly." Iowa Code § 476.76. In considering an application, state regulators may consider whether it will have reasonable access to books and records, and effects on capital structure, service, ratepayers and the public interest. Iowa Code § 476.77.

99. **e. Maine**. Maine law requires state commission authorization of any reorganization that involves the "creation, organization, extension, consolidation, merger, transfer of ownership or control, liquidation, dissolution or termination, direct or indirect, in whole or in part, of an affiliated interest ... accomplished by the issue, sale, acquisition, lease, exchange, distribution or transfer of voting securities or property." 35A Me. Rev. Stat. § 708. The reorganization must be "consistent with the interests of the utility's ratepayers and investors." Id. A five percent interest is sufficient to create an affiliated interest. 35-A Me. Rev. Stat. § 707 (affiliated interest).

100. **f. Maryland**. Maryland law requires state commission approval for acquisitions of 10% of the capital stock of a utility, which acquisitions are permissible only if the stock is acquired as collateral security. Md. Pub. Util. § 6-101(c)(4).

101. **g. Minnesota**. Minnesota requires prior approval of the state commission before any sales, acquisitions, mergers or related asset dispositions. Minn. Stat. § 216B.50. The commission must find such transactions "consistent with the public interest." Id. Minnesota law also requires prior commission approval of any transactions between affiliated companies; a five percent interest is sufficient to create an affiliation. Minn. Stat. § 216B.48.

102. **h. Ohio**. Ohio's regulation of new ownership applies to changes in control of a electric utility or its holding company, "through the ownership of voting securities ... or otherwise." Oh. Code § 4905.402. Control is presumed to exist with the indirect or direct power to vote 20% of the total voting power of the utility or utility holding company. Approval depends on a demonstration that "the acquisition will promote public convenience and result in the provision of adequate service for a reasonable rate, rental, toll, or charge." Id.

4. Wisconsin's Regulation of Changes in Ownership

103. The Wisconsin "takeover" law at issue in this case is typical of the many federal and state regulatory provisions addressing changes in ownership.

104. Wisconsin law places a limit on the amount of ownership of a utility holding company a person may acquire without prior regulatory approval. Given the public's dependence on a sole supplier of an essential product, the regulator must assure the utility's capability and commitment to provide that product. That capability and commitment is related to the utility's strategic business goals. If those goals conflict with the public's needs, there is a risk that the public's needs will not be met. For example, if an influential shareholder has as a goal the maximization of short-term profits rather than long-term customer satisfaction, the utility's practices may emphasize cuts in infrastructure improvement that might lower net income today but increase reliability in the future. It is the regulator's obligation to identify any such conflicts and take actions necessary to reduce or eliminate them.

105. Consider also Wisconsin's 10% trigger level for the review. The triggering percent under the statutes discussed above ranges from 5% to 20%. Whether a utility has strategic conflicts will depend in part on who controls or influences its decisionmaking. The threshold of 10% is a reasonable boundary for signifying influence over important corporate policies. As the examples above demonstrate, other statutes have recognized that control of a minority interest, if significant, can translate into influence over corporate policies. Still other states do not establish a percent of control that triggers review, but rather require approval, for example, where the acquisition will result in "the power to direct the management policies." Arizona Admin. Code § 14-2-803(C). The judgment that 10% ownership of voting securities is enough to exercise

control over the utility is a reasonable one.

106. The standard for approval adopted by the Wisconsin legislature -- "the best interests of utility consumers, investors and the public" -- also is typical of many approval statutes and regulations. The Federal Power Act makes approval contingent upon a similar "public interest" finding. Section 10 of PUHCA also includes a public interest standard. 15 U.S.C. § 79j. Most of the state laws cited above adopt a public interest or similar standard for approval. E.g., Cal. Pub. Util. Code § 854 (establishing public interest standard and providing criteria for public interest determination); Iowa Code § 476.76 (same); Oh. Rev. Code § 4905.402 (public convenience standard).

107. These regulatory policies concerning utility ownership apply to a utility holding company just as they apply to a utility. The dominant characteristic of a holding company is that it owns securities by which it can control or substantially influence the policies and management policies of its public utility subsidiaries. Since holding companies control the utilities, new ownership of the holding company has an impact on rates and service.

III. Securities Issuances

108. This section of my affidavit addresses Wisconsin's requirement for prior review of certain stock issuances by utilities and utility holding companies. First, I explain that securities issuances affect the utility's cost of capital and its overall financial stability. I also explain why the risks posed by utility securities issuances are appropriately addressed prior to an issuance, rather than afterwards. Second, I provide examples of other securities issuance provisions in federal and state law, and I compare those provisions to the Wisconsin securities approval provision challenged in this case. The section is organized into two parts:

a. Regulators Must Review Utility Securities Issuances Because Such Issuances Entail Risks and Affect Rates

b. Wisconsin's Provision Requiring Prior Approval of Utility Securities Issuances Is a Common Regulatory Technique

A. Regulators Must Review Utility Securities Issuances Because Such Issuances Entail Risks and Affect Rates

109. Utility rates are affected by the securities issuances of the utility and the utility's related companies. The reason is that the utility's costs include the cost of capital: the cost of attracting and compensating equity holders, and the cost of borrowing funds. Procuring investment dollars, in the form of equity or debt, involves issuances of securities. Thus the rates established by the regulator for a utility are affected by that utility's securities practices.

110. Utilities must access the capital markets regularly. Electricity production is a capital intensive business, requiring long lead times for planning and construction. Moreover, conventional cost-based ratemaking frequently does not allow recovery of plant construction costs until construction is complete. Long-term borrowing is essential. Also, because the entire customer base uses electricity for a month before being billed, the utility must finance its short term operations. Without access to capital, the utility would be unable to finance its working capital, its maintenance and operational responsibilities, and its long-term investments in physical infrastructure.

111. Access to capital markets depends in part on those markets' perception of the quality of the securities issuances of the utility and its holding company. Effective utility regulation requires that the utility regulator take those actions necessary to assure that the capital market's perception of the company is positive. Most importantly, this function of regulation cannot be performed very successfully after the fact, because by then the reputational damage

will already have been done. Moreover, the review conducted by the financial markets is insufficient to protect against the risks of securities issuances. Below I highlight the inadequacies of relying solely on (a) ratemaking review and (b) financial markets review.

1. Ratemaking is an inadequate means of addressing the risks of securities issuances

112. After-the-fact rate review of securities issuance, by itself, is an inadequate means of protecting the ratepayer's and public's interest in utility access to capital. As a Michigan court once explained,

> "[S]ecurities regulation [of a public utility] was intended to, and does, protect interests which rate regulation alone could not effectively control, because it serves both the interests of investors in, and creditors of, a company organized and operating and issuing securities under the laws of this state and the interests of ratepayers in efficient and uninterrupted service at reasonable rates."

Indiana & Michigan Power Company v. Public Service Commission, 405 Mich. 400, 410, 275 N.W.2d 450, 453 (1979).

113. Disallowing capital costs associated with an ill-designed securities issuance does not correct the securities problem; in fact the disallowance may weaken the utility further, thus causing capital markets to demand more costly returns to compensate for a higher perceived risk. With pre-issuance review, the errors can be avoided rather than corrected.

114. In addition, a utility regulator may be reluctant to require companies to bear the costs of their risks, if this cost-bearing burden were so large as to render the company unable to meet its obligations and expenses. The risk of this type of event can discourage state commissions from requiring companies to bear the costs of their own risks. Given the inherent uncertainty of "back-end" accountability, "front-end" accountability in the form of advance

review of financial risks remains even more critical.

2. Financial market "review" is an inadequate means of addressing the risks of securities issuances

115. Some have argued that securities regulation is unnecessary because financial markets conduct reviews. However, this position has several flaws. To begin, market review may be incomplete or biased. Each element of the financial community is likely to focus on only that part of the financial picture relevant to it, such as the likely return on equity or the risks to bondholders associated with particular bonds. Some of those who review financial transactions have a stake in the transaction. Most importantly, no reviewer from the financial community shares the regulator's statutory duty to protect the public interest.

3. Conclusion

116. As the preceding discussion bears out, neither rate regulation nor financial review is a sufficiently effective tool to protect ratepayers from the risks of an improper securities issuance by a utility. Pre-issuance review is essential to ensure that ratepayer interests are protected.

117. Finally, no one would suggest that the ratemaking process, by which costs are scrutinized and disallowed when unreasonable, is unconstitutionally burdensome, either generally or as applied to the costs of a securities issuance. Logically, if it is not unduly burdensome to review securities issuances after the fact, in determining whether to allow rates to reflect their costs, it is not unduly burdensome to review them before the fact. In fact, arguably, pre-issuance review reduces the regulatory burden by adding certainty. The utility issuers would learn whether an issuance is inappropriate beforehand, and with that knowledge seek to correct the problems ahead of time, rather than issue the securities and suffer a rate disallowance when it is too late to do anything about it.

B. Wisconsin's Provision Requiring Prior Approval of Utility Securities Issuances Is a Common Regulatory Technique

118. This part of my affidavit shows that Wisconsin's statutory provisions for securities issuances promote the same policies as the securities issuances provisions of many federal and state laws. Below I provide illustrations of securities approval requirements applicable to electric utilities under federal law and under the laws of other states. The final subpart then considers the similarities and differences between these laws and Wisconsin's law.

119. Although many of the examples below focus their advance review of securities issuances by utilities while Wisconsin's review applies expressly to certain holding companies, application of the review requirement to utility holding companies is justified on policy grounds. The dominant characteristic of a holding company is the ownership of securities by which it can control or substantially influence the policies and management of one or more utility operating companies in a particular enterprise. Since holding companies control the utilities, the financial health and reputation of the holding company, and the extent of management distractions on the part of the holding company, can affect the utility's ability to serve.

1. Federal Regulation of Securities Issuances

120. There are two key federal statutes governing electric utility securities issuances: the Federal Power Act and the Public Utility Holding Company Act. Each is discussed next.

a. Federal Power Act

121. Section 204 of the Federal Power Act, 16 U.S.C. § 824c, requires that utilities obtain permission from the FERC prior to issuing securities:

> "No public utility shall issue any security, or assume any obligation or liability as guarantor, indorser, surety, or otherwise in respect of any security of another person, unless and until, and

> then only to the extent that, upon application by the public utility, the Commission by order authorizes such issue or assumption of liability. The Commission shall make such order only if it finds that such issue or assumption (a) is for some lawful object, within the corporate purposes of the applicant and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the applicant of service as a public utility and which will not impair its ability to perform that service, and (b) is reasonably necessary or appropriate for such purposes."

16 U.S.C. § 824c. As explained by the U.S. Supreme Court, the mandate that Section 204 of the FPA imposes upon the Federal Energy Regulatory Commission is a "broad and impressive one." Gulf States Utilities v. Federal Power Commission, 411 U.S. 747, 756 (1973).

b. Public Utility Holding Company Act

122. In 1935, Congress found that the public was being harmed by speculative and unsound securities issuances. Prior to the enactment of PUHCA, holding companies issued securities based on inflated capital structures, fictitious or unsound asset values, pyramidal structures, and other market manipulations. Congress thus enacted PUHCA to address the adverse consequences to the public "when ... securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from inter company transactions, or in anticipation of excessive revenues from subsidiary public-utility companies." PUHCA section 1(b)(1), 15 U.S.C. § 79a(b)(1).

123. Congress adopted several regulatory techniques to oversee financing by public utilities, their holding companies and affiliates. Congress required strict SEC regulation of security issuances by holding companies required to “register” under PUHCA section 4, 15 U.S.C. § 79d. Without SEC approval, a holding company or its subsidiary may not issue or sell

any stock, or exercise any privilege or right to alter the priorities, preferences, voting power, or other rights of the holders of an outstanding security of the company. PUHCA section 6(a), 15 U.S.C. § 79f(a). (There are various exceptions to this requirement, including for private offerings, short-term securities, and others.)

124. In reviewing a holding company or its subsidiary's filing for approval, the SEC must ensure, under PUHCA section 7(d), 15 U.S.C. § 79g(d), that:

> (1) the sale of the security does not jeopardize the security structure of the holding company system;
>
> (2) the sale is reasonably adapted to the issuer's earning power;
>
> (3) financing is necessary or appropriate to the economical and efficient operation of the issuer's business;
>
> (4) commissions paid are reasonable;
>
> (5) the security is a guaranty of, or assumption of liability on, a security of another company, the declarant is not taking an improper risk; and
>
> (6) conditions of the issuance or sale are not detrimental to the public interest or the interest of investors or consumers.

125. If a state informs the SEC that state laws applicable to the transaction have not been complied with, the SEC must reject the transaction. PUHCA section 6(g), 15 U.S.C. § 79f(g).

2. State Law Securities Issuance Provisions

126. Most states conduct some kind of review of utility securities issuances. The importance of a pre-issuance review process by state regulators as a legitimate regulatory technique is recognized in federal statutes, including Sections 6 and 7 of PUHCA, 15 U.S.C. 79f and 79g (requiring the SEC to ensure that securities issuances comply with state law regulating such issuances), and FPA section 204(f), 16 U.S.C. § 824c(f) (exempting securities issuances

from otherwise mandatory review when utility's securities issuances are regulated by a state commission).

127. The state statutes below are illustrative of state securities issuances. They share several common features: (1) specification of the purposes for which securities may be issued; (2) delineation of the factors for commission consideration in reviewing a proposed securities issuance, including justness and reasonableness of the cost of the issuance to the utility, compliance with applicable securities regulations, impact on the company's financial structure and general compatibility with the public interest; and (3) a prohibition on using securities for any purpose other than that specified in the commission order approving issuance.

128. **a. Arizona**. Arizona law allows a "public service corporation" to issue "stocks and stock certificates, bonds, notes and other evidence of indebtedness" with terms of more than one year only with approval of the state commission. Ariz. Stat. § 40-301. To authorize the transaction, the state commission must find that it is "for lawful purposes which are within the corporate powers of the applicant, are compatible with the public interest, with sound financial practices, and with the proper performance by the applicant of service as a public service corporation and will not impair its ability to perform that service." Id. Proceeds from the sale cannot be used for any purpose other than that specified in the order approving the sale without the commission's consent. Arizona law also explicitly provides the state commission authority to condition issuances "as it deems necessary." Ariz. Stat. § 40-302.

129. **b. Arkansas.** Arkansas law provides state commission "supervision and control" over all "organizations or reorganizations" of public utilities, Ark. code 23-3-101, and over all issuances of securities or other indebtedness. Ark. code 23-3-103. The statute specifically

recognizes that the power of a public utility to issue stocks is a "special privilege" and therefore, the supervision of the right "is and shall continue to be vested in the state." Id.

130. **c. Illinois.** Illinois law requires prior commission authorization for a public utility to issue stocks and stock certificates, and bonds, notes and other evidences of indebtedness payable at periods of more than 12 months after the date thereof. (The Illinois statute applies only to a specified range of stock issuances. See 220 Ill. Code § 5/6-102.) In addition, the public utility must obtain from the commission "an order authorizing such issue and stating the amount thereof and the purpose or purposes to which the issue or the proceeds thereof are to be applied, and that in the opinion of the Commission, the money, property or labor to be procured or paid for by such issue is reasonably required for the purpose or purposes specified in the order." 220 Ill. Code § 5/6-102.

131. **d. Indiana.** Numerous sections throughout Ind. Code § 8-1-76 et seq. impose a variety of duties upon the commission to inquire into the details of proposed long-term financing arrangements of public utilities before granting approval therefor. The statutes set forth numerous factors to be considered by the commission and include enumeration of the types and kinds of evidence which the commission may consider in making its determination. Ind. Code § 8-1-2-79 and 80.

132. **e. Maine.** Maine's statute provides that "[n]o public utility may make an issuance ... unless it has made a written application, setting forth information the commission may require and has secured from the commission an order authorizing the issue and the amount of the issue and stating that in the opinion of the commission the proceeds of the issuance of the stocks, bonds, notes or other evidences of indebtedness is required in good faith for purposes

enumerated in section 901." 35A Maine Stat. Ann. § 902. In determining whether to grant its authorization, the commission may consider the reasonableness of the purpose or purposes for which the proceeds of the issue will be applied, other resources which the utility has available or may have available for those purposes, the justness and reasonableness of the estimated cost to the utility of the issue and the effect of the issue upon the utility's capital structure. 35-A Maine Stat. Ann. § 901.

133. **f. Maryland**. Maryland law regulates stock issuances of Maryland public service companies. The law requires public service companies to obtain state commission authorization prior to issuing all types of securities payable more than 12 months after issuance. Md. Pub. Util. Code § 6-101, 6-102. The statute identifies various purposes for which securities issuances are permissible, including utility acquisition of property, construction or improvement of facilities, discharge or refund of utility obligations, maintaining or improving service or reimbursing money. Md. Pub. Util. Code § 6-102. The statute gives the state commission the discretion to authorize an issuance if "the Commission finds that the act is consistent with the public convenience and necessity." Md. Pub. Util. Code § 6-101.

134. **g. Minnesota.** Minnesota law requires public utilities to obtain prior approval before issuing a security. Minn. Stat. § 216B.49. In deciding on approval, the commission is directed to "ascertain that the amount of securities ... bear[s] a reasonable proportion ... to the value of the property, due consideration being given to the nature of the business of the public utility, its credit and prospects, the possibility that the value of the property may change from time to time, the effect which the issue shall have upon the management and operation of the public utility, and other considerations...." Id.

135. **h. Ohio**. Ohio requires commission authorization for a public utility to issue stocks, bonds, notes, and other evidences of indebtedness for purposes including acquiring property, constructing or improving facilities and reorganizing or readjusting debt or capitalization or acquiring the stock of another public utility within Ohio or an adjoining state. Ohio Stat. § 4905.40. The Ohio commission must review stock issuances to determine: whether the purpose to which the issue or any proceeds of it shall be applied was or is reasonably required by the utility to meet its present and prospective obligations to provide utility service; whether the amount issued is just and reasonable; and the impact of issuances on the present and prospective revenue requirements of the utility.

3. Wisconsin's Regulation of Securities Issuances

136. Wisconsin's statute requiring approval of securities issuances by holding companies and public utilities shares many features with its federal and other state counterparts. Its requirement that the securities issuance be for "proper corporate purposes" and in an amount "reasonably necessary to support those purposes" resembles many federal and state securities review statutes. The Federal Power Act requires securities issuances to be for "some lawful object, within the corporate purposes" of the utility. 16 U.S.C. § 824c. Moreover, the Wisconsin commission's statutory authority to consider other "relevant considerations" also resembles numerous other securities review statutes. Again, the FPA requires the FERC to consider the issuance's "compatib[ility] with the public interest" before approval. 16 U.S.C. § 824c.

Conclusion:

The Challenged Provisions are an Integral Part of the Bundle of Privileges and Responsibilities Associated With Providing an Essential Service

137. As explained in Part Two, electricity is vital to the welfare of consumers and the economy. As beneficiaries of government-granted protection from retail competition, utilities must be subject to a comprehensive system of state and federal regulation.

138. Part Three described the public policy purposes and benefits of the three challenged regulatory provisions addressed in this affidavit. Common to the purposes and benefits of these regulatory provisions is their intimate connection to the unique attributes of utility regulation. The state has made a decision to make its residents dependent on a single supplier of retail electric service. This decision puts its residents in a position of vulnerability not shared by customers in competitive markets: vulnerability to cost increases and quality shortfalls, which in competitive markets the customer could avoid by shifting to another supplier.

139. While putting its residents in a position of vulnerability, the state simultaneously has put its utility in a position of privilege: the privilege of serving a captive customer base, free of the risks of competition. Having caused customer vulnerability by protecting the utility from retail competition, the state logically seeks to limit the privilege so as to reduce the vulnerability. The challenged provisions are simply that: conditions on the privilege of serving a captive market, unhampered by competition. In return for enjoying the privilege of an assured customer base arising from the prohibition on entry by competitors, the utility and its holding company owner accepts conditions deemed by the legislature useful in reducing the risk of harm to customers who are captive to the utility.

140. In fact, the prohibition on competition to provide retail service is itself a burden on commerce. It is a burden justified by the state's interest in avoiding the inefficiencies that might arise from having multiple providers of a service which it has chosen to protect from competition -- the service of providing electricity at retail. A Wisconsin utility is thus a direct beneficiary of an insurmountable burden placed on Alliant's prospective competitors to provide retail service. It would be inconsistent to allow the incumbent Alliant to benefit from the insurmountable burden placed on Alliant's prospective competitors to provide retail service, while striking as excessively burdensome the conditions imposed on Alliant to assure that its business activities are consistent with the public interest.

Exhibit One