Thirty Years of Electricity Mergers: Concentration and Complication No One Intended

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The essays "Diverse Strategies, Common Purpose: Selling Public Franchises for Private Gain" and "Missing from Utility Merger Markets: Competitive Discipline and Customer Benefits" addressed a utility merger's birth: how buyer and seller choose each other and decide the transaction price, in a monopoly market context undisciplined by competition. Repeated dozens of times over thirty years, that birthing process concentrates franchise ownership and complicates business structure, in ways no one intended.

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Madison Gas & Electric serves the Madison, Wisconsin area. It is the sole utility subsidiary of a publicly-traded holding company, MGE Energy. The utility owns 92 percent of its holding company's assets, producing nearly all of the holding company's revenues and earnings. Seven small subsidiaries exist for only one reason: to support the local utility, which provides only local service.

Baltimore Gas & Electric (BG&E) serves the Baltimore, Maryland area. Its holding company parent, Exelon, owns five other utility subsidiaries, plus around 300 other companies. Those companies invest in fossil, nuclear, solar and wind generation, making wholesale and retail sales in over thirty states. BG&E represents about 8 percent of Exelon's assets and 9 percent of its revenues.

Before the 1980s, BG&E looked like MG&E. So did most electric utilities—each one a stand-alone company serving a single local territory, with a few minor affiliates created mostly to support its primary operations. Today, most electric utilities look like BG&E—one subsidiary among many, a minor part of a multi-state, multi-billion dollar, multi-product, multi-market holding company system.

Over three decades, nearly 80 electricity mergers have concentrated control of the BG&Es—their monopoly franchises; their generation, transmission and distribution assets; and their sources of financing. Accompanying this concentration has been complication—complication of business activity, corporate structure and financial structure. Yet during these same three decades, legislators and regulators have worked to inject competition into historically monopolistic utility markets. This coinciding is no coincidence. Whether the competition is for wholesale generation, retail sales, transmission construction or distributed energy, incumbents' natural reaction is to merge.

Concentration: Chronological and geographical

Concentration refers to a reduction in the number of independent corporations controlling monopoly retail electric franchises. One can view electricity's concentration trend chronologically and geographically.

Chronologically: From the 1986 merger of Cleveland Electric Illuminating and Toledo Edison to the 2018 acquisition of South Carolina Electric & Gas by Dominion Energy, mergers have been continuous. The ten most active acquirers now own what used to be sixty-four independent utilities—over half the U.S. total. Eighty-three formerly independent utilities are now owned by thirteen holding companies. Of several hundred independent investor-owned utilities from the early 1980s, only 14 remain uncoupled with some other franchised utility.[1]

Geographically: The early mergers were intra-regional. They involved either adjacent utilities, or non-adjacent utilities sufficiently proximate to allow generation-and-transmission sharing. Their limited geographic scope stemmed from the Public Utility Holding Company Act's central statutory principle: utility couplings had to "serve the public interest by tending toward the economical and efficient development of an integrated public-utility system."[2] During the 1990s, the SEC applied this integration requirement less literally than did its predecessors, allowing transactions that covered long distances with less integration. With the Act's 2005 repeal, remote utilities have merged with no pretense of integration.

Complication: Business activities, corporate structure, financial structure

The typical 1980s electric utility was a single corporation. It owned generation, transmission, distribution—and little else. It earned most of its revenues providing retail service under a single monopoly franchise subject to a single state's jurisdiction. Minor additional revenues came from wholesale sales and small side businesses.

Mergers have made this simple model complicated, in three main ways.

Business complication means surrounding the original utility with non-utility businesses. Using the utility's ratepayer-funded resources—executives, office buildings, service territory knowledge, name recognition, business connections, legal and accounting help—these non-utility affiliates sell energy-related services, like merchant generation, fuel supply and energy efficiency improvements; as well as non-energy services like home alarm systems and real estate services.

Corporate complication refers to the ownership arrangements that subordinate the utility to its holding company owner. It involves these questions: How many subsidiaries does the top holding company have? Which subsidiaries own which assets? Which subsidiaries conduct which businesses with whom? Who controls what decisions?

Financial complication refers to the types, sources and uses of a holding company system's financing. What is the debt-equity ratio, for the consolidated holding company, the

utilities and each affiliate? Which affiliates pay dividends to which companies, at whose direction? Which companies issue debt or equity to which companies, under what terms and at whose direction? Which affiliates are legally responsible for the debts of other affiliates? Has the merger made the merged utilities more debt-heavy?

Financial complication raises two distinct concerns, one for each direction of fund-flow. First, funds need to flow into the utility. A pure-play utility, owned by the ultimate shareholders, accesses equity markets directly. But when acquired by a holding company, the utility depends for equity on holding company entirely. So its access to equity depends on its place among the holding company's many other investment priorities. Second, funds flow out of the utility to its holding company owner. Because the utility's income stream is predictable, the holding company has incentive—and because of its 100 percent control, opportunity—to extract from the utility the dividends it wants, or to pledge the utility's assets or stock as collateral to support the holding company's other businesses.

Complication's implications: An independent, pure-play utility will attract (and historically did attract) conservative investors—investors seeking to buy and hold shares for stable dividends and slow-but-steady value growth. In contrast, a publicly-traded holding company, one bent on making multiple, debt-financed acquisitions of entities unconnected to core utility service, could attract a different set of investors—those willing to take higher risks, for higher returns and faster value growth. Those differences in shareholder goals can produce differences in corporate leadership. That leadership makes decisions that affect utility customers; decisions such as whether to (a) have the utility control generation, rather than diversify ownership by buying output from others; (b) create trade barriers to maintain dominance, rather than expand trading boundaries and find new trading partners; (c) make acquisitions, be acquired, or remain pure-play; and (d) pay out dividends to shareholders, or instead save cash for future acquisitions.

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Concentration and complication affect an industry's performance. Surrounding a utility with non-utility businesses, handing control over utility finance decisions to executives with conflicting priorities, expecting that the utilities will provide predictable cash to fund other activities—all these factors combine to create risks of economic waste, disproportionate allocation of gains, weakened competition and direct customer harm. The next four monthly essays (May through August) will address those concerns.

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[1] For lists of these companies, see my article "Inconsistent with the Public Interest: FERC's Three Decades of Deference to Electricity Consolidation," Energy Law Journal (Fall 2018), available at [https://www.eba-net.org/assets/1/6/15-233-312-Hempling_[FINAL]1.pdf](https://www.eba-net.org/assets/1/6/15-233-312-Hempling_[FINAL]1.pdf).

[2] Section 10(c)(2) of the Public Utility Holding Company Act of 1935 (repealed).