Utility Mergers: Who Has a Vision?

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Madison Gas & Electric serves the Madison, Wisconsin area. It is the sole utility subsidiary of the publicly traded holding company MGE Energy. MGE's regulated utility business represents nearly 99% of the holding company's business: whether measured in assets, liabilities, revenues, expenses or operations. And the 1% in unregulated business is all performed for energy customers in and around Madison.

Baltimore Gas & Electric serves the Baltimore, Maryland area. It is one of over 20 subsidiaries owned by the publicly traded holding company Exelon Corporation, which merged in 2012 with BGE's holding company, Constellation Energy Group (CEG). Two of those 20 subsidiaries are utilities serving in Illinois and Pennsylvania. Exelon's other affiliates do one or more of the following: invest in fossil, nuclear, solar, and wind generation; sell in wholesale and retail competitive markets in some or all of the Mid-Atlantic, Midwest, and South and West (14 states total); and/or conduct energy trading. (Obligations incurred by the energy trading business—a CEG operation—led to what the Maryland Commission called "CEG's real-life, near-death experience in September 2008[,] demonstrat[ing] all too vividly how vulnerable BGE is if, and when, things go badly for CEG." Order 82986 (Oct. 30, 2009) (approving, with conditions, Electricite de France's (EDF) partial acquisition of CEG nuclear's subsidiary).)

BGE's place in the holding company hierarchy is several corporate layers down from the holding company; in other words, it is owned by a company that is owned by a company that is owned by Exelon Corporation (which in turn is owned by the ultimate shareholders). Whereas MGE contributes nearly 99% of its holding company's revenues, BGE contributes only about 12% of Exelon's revenues.

BGE once looked like MGE: an electric utility corporation whose sole reason for being was to use its generation, transmission, and distribution assets to serve a single local service territory. BGE looks different today because of two factors: its business choices and its regulators' responses. The intent here is not to recommend one outcome over the other, but to show how profoundly 20 years of incremental decisions can change a company. Most utilities today reside within a larger corporate family, due to two decades of near-continuous decisions to reorganize and combine. Given this behavior, a common question confronts every commission: When an MGE seeks to become a BGE, dropping from a 99% role to a 12% role, from the second tier to the fourth tier, one out of 20 affiliates, what should regulators do?

The objective answer is this: No one knows, and few think about it. ***Over a century, we have tried everything, from permissiveness to prohibition and back again.*** In electricity and gas, we have traveled from (a) the free-wheeling acquisitions of scattered systems in the 1920s to (b) the Public Utility Holding Company Act of 1935's limit of every holding company to a "single integrated public-utility system," to (c) PUHCA's repeal in 2005. In telephone, we have zig-zagged from (a) the national Bell System's 60-year near-monopoly over phones and phone-

calling, to (b) the 1984 breakup of the Bell System, to (c) today's horizontal and vertical re-combinations of Bell's former building blocks allowed by the Telecommunications Act of 1996.

There is today no coherent national policy on utility mergers. Among regulators, there is no common vision for how a community's dependence on the local utility monopoly should square with its executives' plans to leverage that monopoly. ***Congress's actions have removed any legal limit on proposals to acquire and mix utility and non-utility businesses in the electricity, gas and telecommunications industries.*** Anyone can acquire anything anywhere, subject to regulatory reviews but not subject to any clear regulatory policy. Regulatory policy on corporate combination is a case-by-case affair. Agencies issue approvals in reaction to utility requests, the holding company painting its self-portrait on the commission's canvas, shading at the edges to close the sale. Only the rare decision reflects regulatory vision of how corporate structure serves, or disserves, the public interest. The California Commission in 1991 rejected the Southern California Edison–San Diego Gas & Electric merger, and the Montana Commission in 2007 disapproved the NorthWestern Utilities–Babcock & Brown coupling: two decisions that boiled down to this question: "Who needs it?"

Readers of a certain age will remember humorist Art Buchwald's 1966 column, predicting America's corporate landscape: "[E]very company west of the Mississippi will have merged into one giant corporation known as Samson Securities. Every company east of the Mississippi will have merged under an umbrella corporation known as the Delilah Company. It is inevitable that one day the chairman of the board of Samson and the president of Delilah would meet and discuss merger. 'If we could get together,' the president of Delilah said, 'we would be able to finance your projects and you would be able to finance ours.' 'Exactly,' the chairman of Samson said. 'That's a great idea and it certainly would make everyone's life less complicated.'" See the full column here.

A century of experience tells us that corporate structure affects utility performance. (See the CEG–EDF story above.) Will the non-utility business risks raise the utility's cost of capital? Will the holding company distort competition by using utility customer-financed assets to launch non-utility businesses? Will those non-utility businesses distract utility management from its obligation to innovate, to solve problems like climate change and terrorism risk? Will the utility be the loser in family conflicts over scarce capital?

Big doesn't mean bad. Some combinations can be positive. But commissions need criteria that distinguish mergers that promote the public interest from those that undermine it. Is the merger motivated by efficiency, innovation, and accountability? Or market share, insulation from competition and control of strategic technology? ***Rather than react to merger promoters, policymakers should position themselves.*** Only by articulating their own vision—of performance excellence, of the corporate and market structures most likely to produce that excellence, of the merger policies most likely to produce those structures—can regulators ensure that when MGEs become BGEs, they do so for the right reasons.

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This essay is the first in a series on mergers in the utility industries. I welcome readers' reactions and ideas.