Will Warren Buffett Be The New Samuel Insull?

by Paul Gallagher

When George W. Bush signed the new energy bill in an Albuquerque ceremony on Aug. 8, Omaha-based mega-billionaire Warren Buffett could take the most direct credit for the legislation's worst mistake: repeal of the 1935 Public Utilities Holding Company Act (PUHCA). Buffett, advisor and political controller of Gov. Arnold Schwarzenegger, and a mover of the disastrous California "electricity deregulation" fiasco of 2000-01, had repeatedly told Congressional committees since then, that he had $10 billion he would invest in electric utility infrastructure as soon as Congress repealed PUHCA. The so-called super-investor and "sage of Omaha" personally lobbied all the western states' governors on that idea, and his flunky George Sokol, CEO of the MidAmerican Energy Holdings subsidiary of Buffett's Berkshire Hathaway Corp., lobbied former Congressman Billy Tauzin of Louisiana to first put PUHCA repeal in the House version of what's now the new energy act.

With Franklin Roosevelt's landmark PUHCA out of the way, Buffett thinks it will now be a simple matter for his MidAmerican to buy the major Oregon-based electric utility, PacifiCorp, triggering a wave of takeovers of utilities by financial companies, conglomerates, and larger utilities. Texas Pacific Group, backed by Berkshire Hathaway shareholder Bill Gates and Buffett, will buy Portland General Electric, a sale that was previously blocked. The big energy-marketing conglomerates Cinergy and Exelon, which have bought up half the nation's nuclear power plants between them, will merge, respectively, with Duke Energy and Public Service Enterprise Group. The 2000 purchase by American Electric Power of Central and Southwest Corp. created the country's biggest mega-utility, and was waved through by the passive Federal Energy Regulatory Commission (FERC)—but then *declared in violation of PUHCA* by the Securities and Exchange Commission this year. With PUHCA repealed and SEC chairman William Donaldson booted out by the White House, it will now be home free. The United States' 220 investor-owned public utilities will be up for sale, and "within the next five to ten years, could shrink to just 10," as one leading energy lawyer forecast.

With MidAmerican, Buffett's Berkshire Hathaway has formed a classic, nationwide, speculative public utility holding company of the 1920s type to which Roosevelt's PUHCA gave the death sentence. It owns utilities and/or power plants in Nebraska, Iowa, California, and in England; is near adding one or more utilities in the Northwest; and has gotten control of North America's biggest gas pipeline networks (**Figure 1**) for sales to utilities in a period in which both electric usage and prices of natural gas have been, and are still, rising sharply. Using Berkshire Hathaway loans to distressed energy companies at rates of interest ranging up to 30%, Buffett assembled the gas pipeline complex, at bargain-basement prices, out of the self-destruction of Enron, Williams, Dynegy, and other "energy pirates" who roamed the high seas of deregulation. MidAmerican is also the second-largest residential real estate brokerage in the United States, through its HomeServices of America subsidiary, much of which is based in California.

Allow History To Repeat?

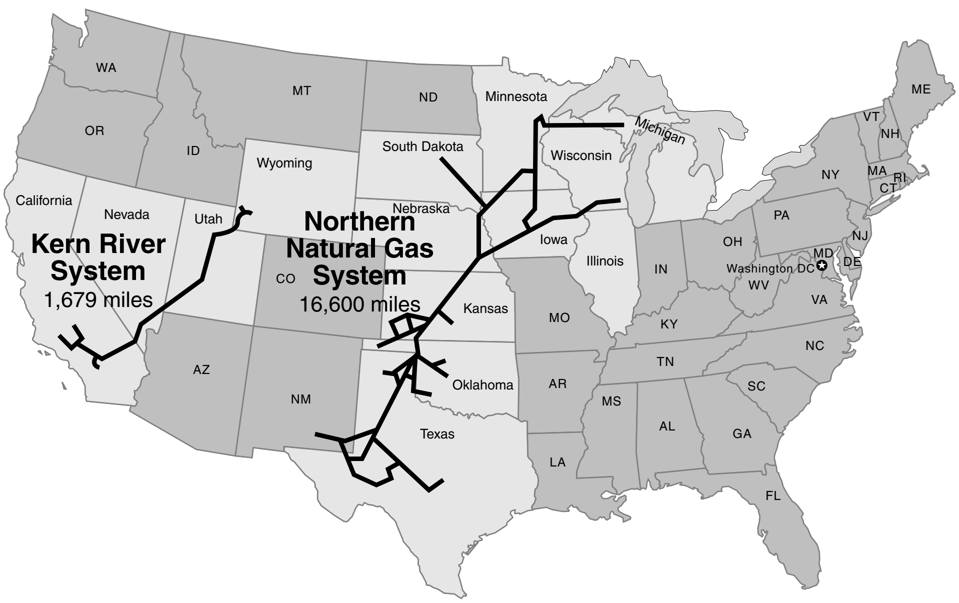
Before PUHCA, in the 1920s, the barons of the speculative public utility holding companies were Samuel Insull's Commonwealth Edison and J.P. Morgan's General Electric. Insull was an engineer who had worked with Thomas Edison, but by the "Roaring Twenties" became an ally of the Morgan financiers who had taken what was originally Edison General Electric, away from the great inventor and builder.

As *EIR*'s Richard Freeman described in a 2000 report, "Between 1922 and 1927, the utility holding companies swallowed more than 300 small to medium-sized private companies *per year.* The holding companies financed the takeover of the smaller companies by issuing either new debt or new stock. . . . During the 1920s, one-third of all corporate financing in America was issued by private power companies. . . . The private electric holding company was leading the speculative stock market boom." Why? The utilities they were buying up were ideal cash-revenue sources for diversion to other speculation. "In 1930, the Senate Interstate Commerce Committee held hearings in which it found that utility holding companies' servicing fees imposed upon subsidiary companies often 'milk[ed] the subsidiaries [so that] in many instances they yielded profits ranging from 51% to 321% of the cost of the services performed.' " Electricity rates, of course, rose considerably, while the spread of electrification out of the cities into rural areas, was blocked.

Samuel Insull's holding company empire controlled 10% of all electricity generation in America by 1929, with 18 major holding companies owning more than 175 operating companies. (Morgan's United Corp. supergroup of holding companies had far more control, 27% of all electricity-generating capacity in the United States; with General Electric as well, Morgan's control was near 40%.)

"Between January and August 1929, a share of stock of Insull's Commonwealth Edison more than doubled in price, from $202 to $450, while a share of stock of Insull's Middle West Utilities more than tripled in price, from $169 to $529." But in April 1932, denied loans by Morgan and the other New

FIGURE 1
Warren Buffett's Natural Gas Pipeline Empire



York banks, Insull's companies defaulted on $200 million in obligations, hitting their investors with stock losses which may have reached $2 billion. Insull fled the country.

Already in the first week of August 2005, a boom in utility stocks took off, in anticipation of the buyouts and mergers the new energy act will allow. Standard and Poor's research division forecast in a July report that stocks of the merged utiities would be "levered up to use the cash to invest in higher-risk, unrelated ventures" (the 1920s term was "watered" stock).

The 2005 Energy Act repeals PUHCA, modifies the New Deal-enacted Natural Gas Act, and weakens the 1935 Federal Power Act, which was passed to give the Federal government the power to ensure "reasonable pricing" in wholesale (interstate and inter-region) sales of electricity. That Act had already been deliberately unenforced since 2000, against the dereg looters like Enron, Reliant, etc., by the FERC which is supposed to enforce it.

The *Christian Science Monitor* noted on Aug. 1 that FERC "hasn't rejected a utility merger since 1994. When states' attorneys general recently requested a hearing by FERC on whether consumers might be harmed by the nation's largest proposed utility merger of Newark-based Public Service Enterprise Group and Chicago-based Exelon Corporation, FERC declined. It approved the merger in July without a hearing."

The legislation also stops the states from enforcing regulations which the Bush Administration has let lie fallow, and allows Washington, for example, to overrule the states' blocking of dangerous liquefied natural gas (LNG) ports and storage terminals, which will further drive up the price of natural gas if they're widely built on the coasts. The feckless FERC will be able to bypass state licensing proceedings and streamline environmental review by other Federal agencies. Immediately, California's court challenge to a Buffett/CalEnergy LNG terminal proposed in Long Beach Harbor, will be trumped, as the Federal government will now control LNG siting.

The bill removes the major impediment to investment in the electricity and natural gas industries by non-utility businesses, from private equity funds, to large manufacturing companies, to investment banks. In addition, it removes geographic limits to the size of electric and gas utilities.

Buffett and Wal-Mart

Fifty percent of the revenues and net profits of Buffett's Berkshire Hathaway empire come from ownership of insurance companies, and another full one-third comes from owning McLane Corp., the distribution company for all Wal-Mart goods. The third and fourth major areas, are residential real estate and natural gas fields and pipelines. Insurance company holdings are risky; the sector is currently using high premiums of all kinds to make up for Greenspan's low-interest-rate regime and for unpredictably surging disaster claims. Let the U.S. real estate bubble deflate—along with the consumer spending dependent on it—and Buffett would be facing low-to-negative returns in much of his empire.

Berkshire Hathaway has essentially been a high-interest bank to MidAmerican Energy Holdings, charging the latter 11.5% on nearly $2 billion in loans since its acquisition by Buffett in 2001. Berkshire Hathaway charged Williams Corp. 30% for the loan by which Buffett eventually grabbed his biggest pipeline network; and he is trying to do the same to Nebraska Public Power, from whose Cooper nuclear unit MidAmerican buys power. For PacifiCorp, all his talk is of windpower, biopower, and investment in transmission systems. But *The Oregonian* on July 18 warned that Buffett wants a captive PacifiCorp primarily to lend to it—up to $4.5 billion—at high interest rates (thus driving up its electricity rates), to develop it as a cash source for his other investments.

The utilities Buffett's buying up could become his cash cows—until they end up like Sam Insull's.