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Merger of the Titans

The big news on the Georgia energy scene is the announced purchase by Southern Company of AGL Resources (AGLR). Both these holding companies have regulated units operating in several states as well as unregulated subsidiaries that provide services to the regulated lines of business.

Southern Company, with disastrous costly overruns on projects in Mississippi and Georgia, will need more capital in the form of equity to meet its cash outlay needs. AGLR, owner of Atlanta Gas Light (AGL), Nicor and other gas utilities, has had its bond rating lowered due to overweighting in debt. So the merger will increase the need for additional high-cost equity for Southern Company.

Southern's comments on the deal emphasize that Southern generates about half its power with natural gas and AGLR will "provide a broader, more robust platform for long term success." If that were the true goal of the acquisition, then Southern Company should have bought the Southern Natural Gas pipeline that serves its gas-fired plants across the southeast. With the failure of its nuclear and clean-coal projects, Southern does indeed need to beef up its future supply arrangements for natural gas supply and delivery in its operating territories. However, AGLR is a scattered collection of primarily distribution companies serving mainly residential gas users. Like Southern, AGLR companies ship gas on interstate gas pipelines owned by others.

Both holding companies are past masters of affiliate abuse. Affiliate abuse is when the holding company of both regulated units and unregulated units shifts cost that rightfully should be borne by the unregulated company to the virtually guaranteed recovery of the regulated company. Also the regulated units make sweetheart deals with the unregulated company to shift profits to that unit.

For AGLR the primary tool for affiliate abuse is Sequent Energy which provides gas procurement and pipeline shipping arrangements to the various sister gas distribution companies. The Georgia PSC Staff has pointed out Sequent's alleged costs that are passed on to AGL cannot be properly audited. This criticism is echoed by the regulatory staffs in other states and the SEC. The services of Sequent used to be bid out with other independent companies offering to provide the same services. However, the bid evaluation favoritism was so blatant that others quit bidding. AGL then encouraged other companies to make fake bids to create the appearance of competition. When the truth came out, Sequent solved the problem by splitting its ill-gotten gains 50/50 with the Public Service Commission's slush fund for vote buying.

Georgia Power uses unregulated affiliate Southern Power as its instrument for shifting costs and profits back and forth between regulated and unregulated entities. Southern Power builds low-risk gas-fired power plants to sell the output to Georgia Power or to be a part of complex *quid pro quo* deals with other utilities.

Joint gas-electric utilities have different approaches to serving customers. The electric-only utilities use various incentives to compete with gas appliances. For example under Georgia Power's Demand-Side Management program of incentives, the rebate for no-competition air conditioning is $20 per ton. The rebate is $40 per ton for heat pumps where gas is a competitor for the heating component. In AGL's last rate case they proposed incentives for gas appliances arguing that was needed to offset Georgia Power's incentives.

Joint gas-electric utilities usually tell customers the best way to use energy is to have gas for space heating and water heating. AGL has noted the "direct use" of gas is more efficient than burning the gas in a power plant then converting the electricity back to heat in the home.

This merger could lead to some changes in Southern Company strategies. CEO Tom Fanning has said the Company's efficiency programs are not about selling less electricity but are aimed at replacing other forms of energy, namely natural gas. Will this change, with a vested interest in selling gas?

And what about the electric utility-green strategic alliance to replace other energies with renewable electricity? This is just a green fantasy, of course; but what side of the issue will Southern take?

One strength AGL brings to the deal is their famous acronym making ability to describe their programs and policies. We will see if Georgia Power picks up on this unusual regulatory tactic.

Both utilities are very good at getting what they want from the Georgia PSC. In PSC proceedings AGL is the meaner player, ruthlessly crushing any opposition, stubbornly sticking to their initial litigation position even after it has been undermined and bad-mouthing the PSC Staff. Georgia Power is the kinder gentler strategist that pretends to listen to its opposition, occasionally compromises and cuts deals.

In the past when we made our first take on the proposed schemes of the utilities, we have found ourselves insufficiently cynical. The proposals turned out worse for customers than we contemplated. That's probably the case here, too; we just don't have enough information at this stage.

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