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(Long Version)

When will the 1200 lbs Gorillas Arrive?

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The History

It's Nov, 1932. A wheel chair bound paraplegic Democrat sweeps into the White House, thoroughly trouncing the Republican incumbent (Herbert Hoover). In his inauguration, Americas 32nd President, Franklin Delano Roosevelt, declares war on the economic hangover resulting from the excesses of the "roaring twenties", otherwise known as the great depression, invents the "New Deal" and sets out to right the wrongs of the capitalist system. The sense of urgency driving the agenda for the first of FDR's four terms in office was undoubtedly the unsettling fact that this was a global problem. The forces of darkness were in the ascendancy and on the rampage in Germany, Japan, Italy, Russia, Spain, etc. and time was running out. Ideologues of the far left and far right were offering all sorts of quick-fix solutions designed to destroy capitalism, free markets and the rights of individuals, on a global scale. It was a grim time.

One of FDR's key actions was the formation of his "Brain-Trust" (sometimes referred to as FDR's "Whiz Kids"), sprinkled throughout the Executive Branch and inside the then embryonic White House staff. The "Imperial" presidency with its swollen ranks of camp-following cadres didn't really develop into its present form until after WWII. FDR's Brain Trust included such, legendary names like Harry Hopkins, Cordell Hull, Henry Morgenthau, Rexford Tugwell, Harold Ickes and the key guy in this little story, Thomas G. Corcoran, other wise known as "Tommy the Cork". His legacy? – It's "PUHCA", also known as the "Public Utility Holding Corporation Act of 1935".

By 1930, 90% of all operating utilities in America were controlled by only 19 holding companies. The "top three controlled over 45% of America's entire installed electric power capacity, many holding companies had multi-lateral relationships with owners and directors guilty of massive conflicts of interest. Top management often redirected money from

subsidiaries with no liability for incurred debts due to these operating power subsidiaries being legally separate companies. Against the back-drop of disastrous business conditions, multiple bank foreclosures, these machinations led to highly unstable financial structures and the collapse of many power utilities along with their holding companies.

The passage of PUHCA put a stop to most of this hanky-panky. “Tommy the Cork” was the key architect in the drafting of the act as well as the point-person leading the fight for congressional passage. It was a two year battle, becoming law in the Summer of 1935. Most of this omnibus act covered everything from transmission issues to stopping vertical ownerships now allowed again but subject to far stronger anti-trust / monopoly statutes that existed in the 30’s. The really important issue was the placement of federal hand-cuffs on the utilities which precluded horizontal (across state borders) expansion. In August of 2005, the 70 year old “PUHCA” was repealed as part of the new “Energy Policy Act of 2005”, removing restrictions on investor owned utilities, allowing for what was predicted to become a massive consolidation field day. The question is consolidation of what? The vast majority of utilities in the USA are municipally owned and operated. Investor owned utilities number a bit less than 200 but are responsible for approximately 70% of the installed capacity of 860,000 MW in the U.S. a smaller group of IPP’s, members of “EPSA”, include many of the developers that formed the first “Gold-Rush” of overseas investments in Asia in the eighties and nineties.

The Fantasy

With investor owned utilities now free to grow, buy and merge, a huge feeding frenzy of buy-outs was anticipated. The lawyers could hardly wait. Well, a funny thing happened on the way to the plants across the border in the next state. As soon as the federal hand-cuffs came off, state regulators stepped in and slapped the chains on again, not in all states but in certain key areas, aborting much of the expected high voltage merger frenzy. New Jersey made life so difficult for corporate courtships involving Exelon & PSEG and FPL & Constellation, that all parties simply gave up. However, KKR’s recently announced move to acquire TXU which will be the largest leveraged power buy-out ever, could kick-start the long expected M & A merry-go-round. Optimists like to think that a period of substantial “Horizontal” stateside expansion will result in the 200 investor owned power companies becoming consolidated down to as few as 40 to 50 with about a dozen emerging as economic giants. The optimists fantasy continues with a return to Asia by huge investor driven IPP’s, big enough to match or even exceed the resources of the pipe-liners. The pessimists say it could

take another generation before these projected 1200 lbs gorillas come lumbering out of the mist to mix and mate with Asia's power markets Because (see below).

The Cassandras

With or without all of the above, there is still the problem of the “analysts”. Since 2002, the very idea of investing overseas in power became anathema to the financial analyst community.. If a CEO dared whisper over a golf foursome that his / her board was considering a return to Asia or any place else outside of North America, their stock would tank, their bonds would become “junque” their kids became unpopular at school, etc. According to top state-side industry leaders even at this writing this is still the case.

Why Bother?

Another factor is that there is still a lot of low-hanging fruit stateside. “Too many opportunities in North America” according to Bill Ruccius, former head of AES in China,. Ruccius is a respected industry leader and veteran of power development in South Asia and the PRC. He feels that very few stateside or European power decision-makers really understand how to do business in Asia. And, “even if they have the knowledge and desire, why bother when their domestic markets have such expanding needs and opportunities.

Because “it’s there.”

Despite all of the above, there is great optimism here, mainly in “metropolitan Asia” and there are a few success stories. One of the best examples, is the growth of Meiya Power under the stewardship of its Chairman / CEO, Colin Tam. A couple of years back on the heels of the InterGen debacle in Mei Zhou Wan and the retreat from China by the remnants of the first Gold Rush in China, we asked Colin...why? With all the changing goal posts, why did all these companies come out, endured a decade or more of pain and could even return sometime in the future? “Because it’s there” Colin replied, “like Mount Everest”. China simply cannot be ignored. There is a recurring night-mare disturbing the slumber of countless CEOs of major multi-nationals. It is a conventional wisdom cliché that goes something like this....” If you are a global player now and do not have a substantial presence in the China market by 2020 (updated versions of this require the adding of India), you won’t be a relevant global player anymore – this applies to everything from cars, telecom, retail, etc. and of coursepower and energy.

The Potential

Corporations must grow or die. Eventually, the low-hanging fruit in North America and Europe will disappear. Shareholder and key investors will insist on growth, American and European investors will return but with a difference. The M & A action is alive and well in Europe also. All it takes is for a dozen or more companies to create the next big gold rush. These power entities will have been transformed and the Asian markets will have also undergone a transformation, lubricated by local and regional finance, impacted by rapidly evolving technologies and enhanced by a more enlightened array of national regulators and governments that appreciate the value and importance of transparency, level playing fields and the rule of law, essential ingredients for the appropriate investment climate to attract those 1200 lbs gorillas.

The Reality

The Asian Development Bank (ADB) was launched over four decades ago with their core mandate being “the eradication of poverty”. Positioned in Manila in 1966 which at that time (hard to believe?) was the capital of Asia’s most vibrant economy outside of Japan. The ADB, along with other multi-laterals now need to come to grips with the exponentially growing Asian economies existing next door to deprivation and a sprinkling of failed states. Sophisticated Asian based power developers have long since shown that they are ready and able to step into the vacuum left by retreating multi-nationals. However, these are sensible companies with competent management. They have an obligation to their shareholders not to go in where “angels fear to tread”. The ideal therefore will be for the leading acronyms (ADB, World Bank, IFC, etc.) to expand their baskets of risk and credit guarantees which will be a further inducement for eventual return to Asia by developers bringing essential technologies and investment into areas where such efforts are most needed.

IPPF Profile

The IPPF is a non-profit industry support organization mandated by its members to work toward best practices in the Power Generation industry. Our geographic focus includes all developing nations across the Asia / Pacific region. Website: www.ipfpowerasia.com

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