A profile of Ohio-based FirstEnergy

Enron was no aberration

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In the wake of last week's blackout, a great deal of attention has focused on FirstEnergy Corp., an Ohio-based utility holding company. FirstEnergy is the owner of four of the first five transmission lines that failed on August 14. It also owns a power plant that shut down a few hours before the blackout struck. An hour after FirstEnergy's lines failed, the power outage spread into Michigan, and then across Canada and into New York.

The company is very much a product of the deregulation of the utility market over the past several years. In 1999, Ohio passed legislation forcing FirstEnergy and other Ohio utilities to open their transmission networks to independent power producers. Before then, the company—previously known as Ohio Edison—had a monopoly over energy production and distribution in parts of the state.

While it had opposed the breakup of its monopoly, FirstEnergy had already begun to expand beyond its local boundaries. In 1997, the company began to buy up a number of smaller utilities and power companies, including Centerior Energy Corp, another Ohio-based utility. With the deregulation of the Ohio utility market in 1999, this process picked up steam. One of the company's biggest acquisitions was GPU Inc., a New Jersey-based utility that also had operations in Pennsylvania. The deal was valued at $4.4 billion. GPU owned the Three Mile Island nuclear facility, the site of the greatest nuclear disaster in American history.

FirstEnergy is now the fourth largest utility holding company in the country. It owns seven utilities spanning the states of Ohio, New Jersey and Pennsylvania. It serves 4.3 million customers, operates plants producing 13,000 megawatts of electricity and owns nearly 15,000 miles of high-voltage transmission lines.

It has used its political leverage to help it achieve its present position. In addition to being one of the most influential corporations in Ohio politics, FirstEnergy enjoys very close ties to the Bush administration and the Republican Party. This past June, the company's CEO, H. Peter Burg, hosted a $600,000 fundraiser with Vice President Dick Cheney for the Bush reelection campaign. The president of the company, Anthony Alexander, has been a major contributor to Bush in the past and served on the Republican National Committee's Team 100, which raised money for the party during the 2000 elections. He was rewarded with a seat on Bush's energy transition team, where he was in a prime position to affect energy policy.

During the past two election cycles, executives and a political action committee set up by the company have contributed nearly $2 million to candidates and parties, most of which has gone to Republicans. The company is also a heavy contributor to lobbyists for energy-related issues, with $2.25 million spent to this end in 2002 alone.

Since 1997, FirstEnergy has exhibited features common to many of the companies—including Enron, WorldCom and Tyco—that have collapsed in recent years in the midst of financial and accounting scandals. The speculative environment of the late 90s and the obsession of big investors with share values created conditions in which the company made decisions inimical to its own long-term financial health and the stability of its operations.

The purchase of GPU was a classic example. FirstEnergy paid half of the purchase price in cash, financed by borrowing, so that it could avoid issuing new stock. Had the company issued stock instead of paying with cash, the market, in the form of influential analysts and pundits and the financial institutions that dominate Wall Street, would have punished it by driving down its stock price. The personal interests of executives also played a role. Bonuses of the top executives at FirstEnergy were dependent on earnings-per-share levels, and many owned large amounts of company stock themselves.

The most immediate consequence of FirstEnergy's spurt of acquisitions during this period was an enormous growth in debt. In addition to the over $2 billion in debt used to buy GPU, FirstEnergy also took on over $7 billion of GPU's own debt as part of the deal. The company currently has $13.2 billion in long-term debt and preferred stock. Preferred stock is often considered in the same category as debt because its holders are promised regular dividend payments that are not tied to company earnings.

Like Enron and so many other companies, FirstEnergy sought to inflate its earnings and cover up the difficulties associated with its debt load. It appears to have indulged in accounting fraud during its acquisition binge, and was forced by its auditors to restate earnings for the past three years. At issue was the company's manner of accounting for its acquired assets. Earlier this month the company announced that it would lower its reported earnings for 2002 by $67 million, and would also lower earnings for 2001 and 2000.

The focus on stock price, and the necessity to pay back its debt, contributed to the company's neglect of safety and maintenance at its power plants and transmission lines. In 2002, FirstEnergy's spending on maintaining its Ohio transmission lines was the lowest since 1999.

Last week's blackout is not the company's first problem in recent years. FirstEnergy is the owner of the Davis-Besse nuclear power plant in Ohio, which was shut down in February 2002 when massive corrosion was discovered on a nozzle of the reactor head. A nuclear disaster was only narrowly averted. Several FirstEnergy employees have complained to the federal Department of Labor that they were fired after raising safety concerns at the plant. The Nuclear Regulatory Commission ruled recently that the plant's emergency system was badly flawed and gave the plant its second-worst safety rating.

In December of 2002, two FirstEnergy workers in Chicago were killed by electrocution, and a federal grand jury indicted the company for willful neglect of workplace safety regulations.

Earlier this year, blackouts on FirstEnergy lines in New Jersey prompted state regulators to cut the company's electricity rates. Blackouts on FirstEnergy lines have become more frequent this year in Ohio as well.

The firm has been cited for violations of the Clean Air Act. A federal judge in Ohio ruled that it failed to install modern pollution control equipment when it renovated one of its old coal-fired power plants, as required by the act. Like many companies, FirstEnergy claimed it was only performing routine maintenance, so as to avoid making the necessary investments. The Bush administration has sought to undermine this provision of the Clean Air Act and is set to issue an order that would do just that. FirstEnergy executives personally lobbied Vice President Dick Cheney to include such provisions in the administration's energy plan.

In its defense, FirstEnergy has claimed that its record is not much different from that of other large utilities. This is quite true. Poor maintenance, a lack of concern for environmental effects and poor treatment of workers are characteristic of the industry as a whole.

Since the collapse of Enron and the bursting of the Wall Street stock bubble, FirstEnergy has run into serious financial difficulties. Four investor lawsuits have been filed against the company in response to the restatements of its earnings. The company has been forced to downgrade expected earnings for the remainder of this year, as well as for 2004 and 2005.

"Having come less than an inch from potential radiation leakage from Davis-Besse," noted financial analysts Dorothea Matthews, Glenn Reynolds and Andy Devries of CreditSights, "they've now succeeded in blacking out eastern North America, a much more impressive feat." FirstEnergy is now in danger of having its bond rating reduced to junk status.

FirstEnergy is not alone in its financial difficulties. Many of the major players in the deregulated energy market are suffering a similar fate. Enron was the king of the wholesale electricity market created in the late 1990s, and it declared bankruptcy amidst a massive accounting scandal in December 2001. A number of utilities, including Merchant Corp of Georgia, PG&E of California and Xcel Energy of Minnesota, have filed for bankruptcy court protection. Many other firms have been forced to restate earnings and carry out financial restructuring.

Like many companies, FirstEnergy's financial woes have not prevented its top executives from granting themselves very generous compensation packages. The chairman and CEO of the company, H. Peter Burg, saw his compensation rise 20 percent last year, when he received nearly $1.4 million in salary and bonuses. Even though FirstEnergy has been forced to restate its earnings downward, the company has announced that it will not attempt to take back any of Burg's pay.