

Public Utility Holding Companies On Notice: New Compliance Requirements in January and February of 2009

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Think it is a great time to buy public utility holding companies at bargain prices? Warren Buffett did. Having deep pockets in a crisis gave him a chance to pick up Constellation Energy's assets for such a bargain that shareholders had to reconsider the deal. And thanks to the streamlined utility ownership requirements in the Public Utility Holding Company Act of 2005 ("PUHCA 2005"), it is likely to be even easier to own holding companies without filing a lot of paperwork, right?

Not so fast. Two recent orders concerning PUHCA 2005 require filings by January 9, 2009, and February 23, 2009, respectively, for certain entities, potential holding company purchasers, and currently exempt holding company owners. These orders indicate that filing first may be better than having the Federal Energy Regulatory Commission ("FERC") ask questions later.

The first order cautions that even indirect owners, such as investment account managers, may face possible sanctions if they do not make appropriate filings before they buy because trading in holding company stocks on behalf of investors still requires the adviser to "purchase, acquire or take" utility or holding company securities.

Under FERC's guidance in a second order, owners of holding companies who previously sought exemption from PUHCA 2005 have an ongoing obligation to update their FERC-65A exemption notification when they experience a material change of facts "whether or not" a change has occurred with respect to the basis on which the exemption or waiver was granted."

Both orders, summarized below, are likely to put exempt holding companies, as well as potential buyers, on notice that the new year brings new compliance requirements along with other resolutions.

I. Introduction

On November 20, 2008, FERC issued two orders relevant to the reporting obligations of investment companies, advisers, and other entities that engage in the acquisition of securities in electric utilities and electric holding companies.

The first order, *Horizon Asset Management, Inc.*, 125 FERC ¶ 61,209 (2008) (the "Horizon Order") is significant because it addresses an issue of first impression under the "purchase, acquire or take any security" clause of Federal Power Act ("FPA") Section 203(a)(2), i.e., whether an investment adviser, Horizon Asset Management ("Horizon"), is considered to be an entity that "purchases, acquires or takes" securities in circumstances where the investment adviser is not itself a security account holder, but security account holders delegate the power to vote securities to Horizon and Horizon generally defers to another entity to vote the securities.

FERC determined that Horizon is a public utility holding company and is engaged in activities constituting the purchase, acquisition or taking of the securities within the meaning of FPA Section 203(a)(2). Therefore, it must obtain FERC authorization prior to acquiring public utility securities in excess of \$10 million. Failure to obtain FERC approval before directing the acquisitions of securities of public utility companies or public utility holding companies may result in monetary sanctions of up to \$1 million per day and other sanctions. Furthermore, all affected entities must submit filings by **February 23, 2009**, to avoid potential sanctions.

In the second order, *Material Changes in Facts that Require Notifications Under Commission Regulations Under the Public Utility Holding Company Act of 2005*, 125 FERC ¶ 61,208 (2008) (the "Material Change Notification Order"), FERC approved an order clarifying that holding companies that have obtained exemptions or waivers from certain accounting, reporting and recordkeeping requirements by filing FERC-65A or FERC-65B notification, or by obtaining a declaratory order granting a waiver or exemption, must notify FERC when they obtain the power to vote 10 percent or more of the voting securities of an additional public utility company or holding company of any public utility company. Entities affected by this clarification must submit a PUHCA notification by **January 9, 2009**.

II. Horizon Order

A. Horizon's Filing

On May 19, 2008, as amended on September 25, 2008, Horizon filed an application containing two requests. First, Horizon requested that FERC disclaim jurisdiction over its account management activities that involve the acquisition of holding company or utility securities that otherwise would be subject to FERC approval under FPA Section 203. For the reasons discussed below, FERC rejected Horizon's request. Alternatively, Horizon sought a blanket authorization, under sections 203(a)(1) and 203(a)(2) of the FPA: (1) for Horizon to instruct or advise on the acquisition on behalf of the individuals and

entities who own the accounts managed by Horizon ("Account Holders") of securities of public utilities or public utility holding companies; and (2) for public utilities or public utility holding companies to sell securities to Horizon on behalf of the Account Holders. While FERC dismissed Horizon's request under FPA Section 203(a)(1) as unnecessary, FERC granted Horizon a blanket authorization under FPA Section 203(a)(2), subject to certain conditions.

B. FERC's Decision

In its decision, FERC first concluded that Horizon is a public utility holding company. FERC noted that Horizon has conceded in previous filings that it "is a holding company under PUHCA 2005 because, in its capacity as investment adviser to certain accounts it has power to vote more than ten percent of the outstanding voting securities of Aquila, Inc."

FERC next found that Horizon engaged in activities constituting the purchase, acquisition or taking of securities within the meaning of FPA section 203(a)(2). FERC focused its interpretation of the definition of "purchase, acquire or take" any security in terms of whether a holding company (by definition) "owns, controls, or holds" the securities with the power to vote. FERC broadly interpreted the clauses, indicating that it did not see a way for Horizon to "hold securities with the power to vote them if it did not gain possession or control of them, *i.e.*, if it did not 'acquire' or 'take' them" and found that Horizon violated FPA section 203(a)(2) by purchasing securities without prior approval. However, FERC declined to impose any sanction upon Horizon because FERC had not previously addressed the "purchase, acquire or take" clause under section 203(a)(2).

FERC also denied Horizon's request for a blanket authorization under section 203(a)(1) of the FPA as unnecessary based on the conditions imposed by FERC on Horizon's request for blanket authorization under section 203(a)(2) of the FPA. Specifically, FERC accepted Horizon's proposed conditions on its actions, including an obligation to make certain SEC filings and to restrict the holdings of voting securities of any public utility or public utility holding company in individual accounts, and found that Horizon's proposed transactions would not have an adverse effect on competition. FERC further found that Horizon's proposed transactions would not adversely affect rates or regulation and would not result in cross-subsidization under section 203(a)(2) and granted a blanket authorization for three years, rather than the permanent blanket authorization requested by Horizon.

Finally, FERC denied Horizon's request for retroactive approval of its holdings and stated that the Horizon Order constitutes notice that FERC considers certain types of utility transactions conducted by holding companies to be jurisdictional. FERC did not impose sanctions on Horizon, but cautioned Horizon and any other investment advisers that they may face possible monetary or other sanctions if they do not obtain advance approval under Section 203(a)(2) of similar acquisitions of securities. FERC further noted that investment companies and advisers may seek a jurisdictional determination through a declaratory order or other appropriate procedural mechanism before they acquire the securities of public utility companies or public utility holding companies.

Because some investment companies and advisers may not be aware of FERC's interpretation of its jurisdiction, FERC will allow such entities to file an application by **February 23, 2009**, requesting such authorization. Affected entities may want to make a timely filing to avoid civil penalties or other sanctions.

III. Material Change Notification Order

In the Material Change Notification Order, 125 FERC ¶ 61,208, FERC clarified the notification requirements for a holding company that is receiving either a waiver or exemption from certain PUHCA 2005 regulations. Currently, FERC's PUHCA 2005 regulations require entities that meet the definition of a holding company to notify FERC of their status no later than 30 days after they become a holding company. Under FERC's regulations, a "holding company" is a company that directly or indirectly owns, controls or holds, with power to vote, 10 percent or more of the outstanding voting securities of a public utility company or a holding company of any public utility company.

FERC explained that companies seeking waivers or exemptions from PUHCA 2005 regulations regarding accounting, record-retention and reporting requirements as well as regulations that allow FERC access to their books and records must file an exemption notification with FERC, *i.e.*, FERC-65A. While the PUHCA 2005 regulations require notification to FERC of material changes of fact that affect a company's waiver or exemption, the regulations do not specify when such notification is required. In particular, FERC stated that a holding company that has filed an exemption or waiver notification (*i.e.*, FERC-65A or FERC-65B) or has received an exemption or waiver through a declaratory order should make a filing to notify FERC of that material change of facts "*whether or not* a change has occurred with respect to the basis on which the exemption or waiver was granted." Therefore, FERC issued the Material Change Notification Order to clarify its interpretation and to place all holding companies on notice that they must file with FERC, by **January 9, 2009**, an update of material changes of fact for any investment of 10 percent or more of a public utility company or holding company's voting securities since the time the exemption or waiver was granted. Noncompliance may result in sanctions by FERC.

For Further Information

If you have questions concerning the orders issued by FERC discussed above or would like more information, please contact any member of the Energy, Environment and Resources Practice Group or the attorney in the firm with whom you are regularly in contact.