

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

UBS AG

Docket Nos. EL02-105-001 and
EC02-91-001

Bank of America, N.A.

Docket Nos. EL02-130-001 and
EC02-120-001

ORDER ON REHEARING

(Issued June 5, 2003)

1. In an order issued on December 19, 2002,¹ the Commission denied UBS AG's (UBS) and Bank of America, N.A.'s (Bank of America) (collectively, Petitioners) request for a declaratory order confirming that the acquisition of securities clause of Section 203(a) of the Federal Power Act (FPA)² does not apply to the acquisition of public utility securities by Petitioners in the course of their banking businesses. However, the December 19 Order granted Petitioners' requests for blanket authorization to acquire public utility securities, subject to conditions. UBS and Bank of America seek rehearing of the December 19 Order. For the reasons discussed below, the Commission will grant, in part, and deny, in part, Petitioners' requests for rehearing in certain respects, subject to certain conditions and reporting requirements. This order furthers the Commission's goal of encouraging a greater number and cross-section of sellers in the electricity marketplace.

Background

¹UBS AG and Bank of America, N.A., 101 FERC ¶ 61,312 (2002) (December 19 Order).

²16 U.S.C. § 824b(a) (2000).

2. In March and October of 2002 respectively, the Commission authorized UBS and Bank of America to make jurisdictional sales of electricity at market-based rates, subject to the standard waivers and conditions for power marketers.³ Later, on July 1, 2002 and September 3, 2002 respectively, Petitioners sought declaratory orders confirming that the acquisition of securities clause of Section 203(a) does not apply to the acquisition of public utility securities by UBS and Bank of America in the course of their banking business. In the alternative, Petitioners requested blanket authorization to acquire public utility securities, subject to certain conditions.

3. The Commission, in the December 19 Order, denied Petitioners' requests for declaratory orders but granted their requests for authorization to acquire public utility securities, subject to certain conditions. In particular, to ensure that Petitioners do not obtain control over another public utility, the December 19 Order granted blanket authorization but would not allow Petitioners to acquire more than one percent of any class of equity security or debt of such a public utility. The December 19 Order also rejected Petitioners' proposal to file confidential reports 45 days after the close of each calendar quarter showing voting equity securities of public utilities (excluding non-voting securities and securities in the form of debt instruments of public utilities) held at the close of such quarter and the voting percentage that such holdings represent, if such holdings exceed one percent of each voting class of equity securities. Instead, the December 19 Order required the filing of public reports (with a 45-day lag), with no exclusion for any form of the securities.

4. In their rehearing requests, Petitioners contend that the Commission erred in asserting jurisdiction over Petitioners' acquisition of securities of public utilities. They also argue that even if the Commission does have such jurisdiction, we should grant a blanket authorization with a different percentage limit and should not include their acquisition of certain public utility securities in the calculation of that percentage. Petitioners point out that they sought Commission authorization to facilitate their participation in the power trading business. Petitioners contend that in order to achieve the objective of Section 203, it is not necessary for the Commission to impose a one percent limit on all holdings of Petitioners and their affiliates, whether as principal⁴ or otherwise, in any class of equity securities (including non-voting equity securities) and debt of other public utilities, regardless of the capacity in which such securities are held. Petitioners explain that such a limitation would make it virtually impossible for them to enter the

³UBS AG, 98 FERC ¶ 61,255 (March 7, 2002); Bank of America, 101 FERC ¶ 61,098 (October 30, 2002).

⁴The term "principal" is used to distinguish between the Bank's fiduciary role as a trustee as opposed to investing as a principal for its own account.

market as effective, well-capitalized and competitive power marketers, and would also deter other financial institutions.

5. Petitioners reiterate that, in the course of their banking business, they may acquire securities of public utilities by: (1) extending loans in the form of lines of credit to public utilities and, in turn, receiving notes from the borrower as evidence of the borrower's drawing against the line of credit; (2) acting as fiduciaries on behalf of their customers (including acting as trustee, asset manager, investment advisor, agent, administrator and executor); (3) through routine dealing, engaging in trading and merchant banking activities for their own accounts; and (4) entering into derivative transactions and hedging transactions in the ordinary course of their commercial banking, investment banking, merchant banking, or asset management business. Petitioners emphasize that their activities are subject to supervision and regulation by the Office of the Comptroller of Currency (OCC) and supervisory oversight by the Board of Governors of the Federal Reserve System (Federal Reserve) (collectively, Bank Regulators) and are subject to restrictions on nonbanking activities pursuant to the Bank Holding Company Act of 1956 (the BHC Act). Petitioners argue that, except for limitations applicable under U.S. banking law and regulation by the Bank Regulators, no restriction should be applied to their holdings of debt, non-voting equity securities, and securities held in a fiduciary capacity or in connection with underwriting, trading, dealing and derivatives activities; i.e., securities in these categories should not be counted as public utility securities.

6. Petitioners also propose a limit of five percent, rather than one percent, with respect to voting securities held as principal. Petitioners contend that other federal agencies and Congress recognize that having a one percent holding in another company does not confer control.⁵ Petitioners further contend that a five percent level would not only not result in control, but that banks, as highly regulated institutions, also are subject to added protections against the exercise of control. Petitioners also propose that the quarterly

⁵Petitioners cite to the OCC and the Federal Reserve, as well as the Public Utility Holding Company Act (PUHCA) (15 U.S.C. § 79b(a)(11)), where five percent of common ownership is required for a relationship to be considered an "affiliation." Petitioners also argue that the Commission, in Order No. 2000, adopted a five percent ownership level as not conferring control. See Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 809 (January 6, 2000), FERC Statutes and Regulations, Regulations Preambles July 1996-December 2000 ¶ 31,089 at 31,069-70 (1999) (Order No. 2000), order on reh'g, Order No. 2000-A, 65 Fed. Reg. 12,088 (March 8, 2000), FERC Statutes and Regulations, Regulations Preambles July 1996-December 2000 ¶ 31,092 (2000) (Order No. 2000-A), aff'd sub nom. Public Utility District No. 1 of Snohomish County, Washington v. FERC, Nos. 00-1174, et al. (D.C. Cir. 2001).

reports be limited to their holdings of voting equity securities held as principal and include only those public utilities where such holdings exceed one percent.

Discussion

7. The Commission will grant, in part, and deny, in part, Petitioners' request for rehearing, subject to conditions and reporting requirements as discussed below. We will deny rehearing on our finding that Section 203(a) applies to Petitioners' acquisition of securities of public utilities. However, we will authorize Petitioners to acquire securities of public utilities on a blanket basis, provided that (1) their holdings of voting equity securities held as principal will be subject to a limitation of five percent of each voting class of securities issued by the public utility, and (2) their acquisition of public utility securities, regardless of form, confers upon them no right to control (positively or negatively through debt covenants or any other means) the management or operation of such public utility.⁶ We will also require that Petitioners report, by public utility, (1) their holdings of voting equity securities held as principal and (2) their total holdings of voting equity securities, irrespective of the connection in which such securities are held or acquired, within 45 days of the close of each quarter. The reports shall be subject to a de minimis threshold of one percent, and such reports will be made public.

8. Our holdings in this Order are based on the particular facts of this case. The limitations and reporting requirements imposed herein, in combination with banking law and regulation by the Bank Regulators with regard to Petitioners' holdings of securities, including debt, of non-banking entities, are sufficient to alleviate concerns that Petitioners' acquisition of public utility securities will enable them to gain control over other public utilities.

1. Public Utility Securities Excluded From a Limitation on Holdings

9. The Commission will exclude from the percentage calculation Petitioners' acquisition of public utility securities in connection with their lending activities, with fiduciary and underwriting activities and with dealing, trading and derivatives activities from any limitations on holdings, with certain qualifications described below. In general, debt is not likely to be susceptible to use by Petitioners to influence behavior of borrowers that also may be their competitors in power markets. However, in the event that such debt includes covenants according the lender either positive or negative control over action of

⁶In keeping with the Commission's decision in Baltimore Refuse Energy Systems Company, 40 FERC ¶ 61,366 at 62,118, n. 11 (1987) (Bresco), if a bankruptcy or foreclosure proceeding could cause Petitioners to acquire control, such acquisition requires prior Commission authorization under section 203.

the public utility borrower, such debt securities should be included within the five percent threshold. The anti-tying provisions of the BHC Act prohibit banks from requiring borrowers, as a condition of obtaining credit or loans, to provide non-credit related services to the bank or its bank holding company parent, affiliates or subsidiaries. Also, as Petitioners stated, the anti-tying provisions can be enforced without a showing that the lender has market power in the tying product (lending services) or that an anticompetitive effect occurs in the tied product, in this instance, power markets. Further, the Bank Regulators recently affirmed to Congress that they "take seriously the obligation of banks to comply with the [Anti-Tying Statute]" and that "customers or competitors who believe that they have suffered injury to their business or property due to violations of the [Anti-Tying Statute] may pursue treble damages in a civil suit."⁷ The Commission is persuaded that as Petitioners pursue lending activities in the normal course of their business, such activities will not be used to discourage competitive behavior from borrowers that compete in the same power markets as Petitioners.

10. However, the Commission recognizes that as lenders, Petitioners could be placed in a position to assume control over another public utility that is forced to seek bankruptcy. If this situation occurs, Petitioners are required to obtain our prior approval before acquiring control.

11. The Commission will also exclude Petitioners' acquisition of public utility securities acquired in connection with Petitioners' fiduciary activities from any limitation, with the exception noted below. As a practical matter, a fiduciary is obligated, based on numerous laws and regulation, to manage fiduciary accounts solely in the best interests of the beneficiaries, as opposed to acting in its own interest. The Bank Regulators also assess the efficacy of the procedures and controls that ensure adherence to a bank's fiduciary role. Particularly in the case of large institutions like Bank of America, Bank Regulators' personnel work on-site in bank offices, devoting much of their time to supervising fiduciary activities. The Bank Regulators require Petitioners to have compliance programs that include the monitoring of the various laws and regulations that may affect their fiduciary activities. Such comprehensive regulation provides added assurance that Petitioners would not be able to use their fiduciary holdings to control their public utility competitors to serve Petitioners' interest, as opposed to their fiduciary clients' interests.

12. However, we note that for purposes of assessing bank holding companies' ownership in non-banking entities, the Federal Reserve includes securities held in a fiduciary capacity

⁷Letter from the Office of Comptroller of the Currency and the Federal Reserve Board to Representative Dingell of the House of Representatives Committee on Energy and Commerce, August 13, 2002.

where a bank has discretionary voting rights for two years.⁸ Under this circumstance, the Commission will require that Petitioners' holding of such securities be included as securities held in principal, and thus subject to the limitation of five percent.

13. In addition, the Commission will not place any limitation on Petitioners' acquisition of public utility securities in connection with their underwriting activities, with the exception noted below. Such acquisitions would not ordinarily allow Petitioners to control other public utilities. Shares acquired in an underwriting capacity are ordinarily resold immediately and not retained by the underwriter. The Federal Reserve has found that underwriting activities by banks are consistent with provisions of the BHC Act relevant to ownership or control of non-banking entities. Likewise, Congress has deemed it unnecessary to subject underwriting activities to pre-approval by antitrust authorities under the Hart-Scott-Rodino Act (H-S-R).⁹ However, to address the possibility that Petitioners are not able to immediately resell the voting equities they acquire in an underwriting capacity, voting equities acquired in an underwriting capacity are to be treated as holdings in principal if the equities have not been sold or disposed of after 45 days and included in the category of holdings subject to the five percent limitation discussed below.

14. The Commission will not exclude Applicants' acquisition of public utility securities in connection with their customer-driven transactions involving derivatives/hedging activities from the voting securities, subject to the five percent limitation. We note that the Bank Regulators allow banks to acquire equity securities, subject to a limitation of five percent of the stock of any issuer, solely for the purpose of hedging the bank's exposure arising from customer-driven equity derivative transactions. Our ruling today is consistent with the Bank Regulators' rules.

2. Ceiling of Five Percent on Voting Securities Held as Principal

15. The Commission will grant Petitioners' request to increase the ceiling on their acquisition of voting securities held as principal from one percent to five percent. We note first that there is no completely objective basis for either a one percent or five percent limitation; the choice of a specific limit is a matter of judgement rather than precise calculation. The prior orders that authorized acquisitions of up to one percent occurred

⁸Bank Holding Company Act, 12 U.S.C. § 1842 (2000).

⁹The Hart-Scott-Rodino Act Antitrust Improvements Act of 1976 requires parties to acquisitions over a certain size of assets or voting securities to give advance notice to the Federal Trade Commission. See Hart-Scott-Rodino Antitrust Improvement Act of 1976, 15 U.S.C. § 18a (2000).

over 15 years ago.¹⁰ In the period since, regulatory changes have occurred in an effort to promote competition in electric power markets. In this regard, one of the most significant changes instituted by this Commission to sustain the transition to a more competitive market has been the implementation of Order No. 2000. We note that in Order No. 2000, the Commission authorized a market participant to hold as much as a five percent active ownership in an RTO for a transition period of five years, with the right to request to extend that period. The Commission has also adopted the Securities and Exchange Commission's (SEC) definition of "affiliate," which requires ownership of five percent voting interest for purposes of determining whether a utility is an affiliate of an exempt wholesale generators (EWG).¹¹ In light of our own prior holdings and of regulation by the Bank Regulators that circumscribes Petitioners' ownership in principal in non-banking entities, we find that a limitation of five percent will ensure that Petitioners will not gain control of other public utilities.

3. Quarterly Reports

16. Petitioners will be required to report their holdings of voting securities held as principal, by public utility, subject to a de minimis threshold of one percent of outstanding voting securities. In addition, in light of adopting a less stringent limitation on acquisition of securities than previously employed, the Commission believes it necessary to require Petitioners to report their total holdings of voting securities by public utility. However, they are not required to report the capacity in which they hold such securities. Given that the reports would not be disclosed until 45 days after the fact, Petitioners' concerns that disclosure would be of immediate use to competitors should be minimized.

4. Accounting

¹⁰See Portland General Electric Co., 32 FERC ¶ 61,159 (1985); see also Ford Motor Co., et al., 52 FERC ¶ 61,025 (1990).

¹¹As defined by the SEC, an "affiliate" is (a) a person holding 5 percent of outstanding voting securities; (b) a company, 5 percent of whose voting securities are held by the specified company; (c) an official or director of the specified company, or of a company under (a); and (d) any person found by the Commission "to stand in such relation to such specified company that there is liable to be such an absence of arm's-length bargaining in transactions between them" as to require his being called an "affiliate" for the purposes of the Act. See Glass-Steagall Act, 12 U.S.C. § 24 (1982 ed. and Supp. III); 12 U.S.C. § 78 (2000).

17. In the orders authorizing Petitioners to charge market-based rates, the Commission granted Petitioners a waiver of the Commission's Uniform System of Account requirements as contained in Part 101 of the Commission's Regulations under the Federal Power Act.¹² The inclusion of paragraph D in the December 19 Order was an inadvertent error. The Commission clarifies that Petitioners will not be required to record purchases and sales of securities of a public utility in accordance with the Commission's Uniform System of Accounts.

The Commission orders:

Petitioners' requests for rehearing are hereby granted in part and denied in part, subject to conditions and reporting requirements, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

¹²Bank of America, N.A., 101 FERC ¶ 61,098 at 61,361 (2002) and UBS AG, 88 FERC ¶ 61,255 at 62,022 (2002).