

116 FERC ¶ 61,268
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Legg Mason, Inc.

Docket No. PH06-48-000

ORDER ON EXEMPTION NOTIFICATION

(Issued September 22, 2006)

1. On May 5, 2006, Legg Mason, Inc. (Legg Mason) filed a notice of exemption from Commission regulations under the Public Utility Holding Company Act of 2005 (PUHCA 2005).¹ For the reasons discussed below, the Commission will grant Legg Mason's requested exemption.

Background

2. On May 5, 2006, pursuant to 18 C.F.R. § 366.4(b)(1), Legg Mason filed a FERC-65A, an exemption notification, seeking exemption from 18 C.F.R. §§ 366.2, 366.21, 366.22, and 366.23 ("books and records" requirements).² Legg Mason acknowledges that, through one or more of its asset management subsidiaries and affiliates, it is a holding company under PUHCA 2005 by virtue of its beneficial ownership of more than ten percent of the outstanding voting securities of the AES Corporation (AES). However,

¹ The Energy Policy Act of 2005, Pub. L. No 109-58, 119 Stat. 594 (2005)(EPA Act 2005), among other things, repealed the Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 *et seq.* (2000) and enacted the Public Utility Holding Company Act of 2005, Pub. L No. 109-58, §§ 1261 *et seq.*, 119 Stat. 594, 972-78 (2005) (to be codified at 42 U.S.C. §§ 16451 *et seq.*).

² These regulations were promulgated in *Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005*, Order No. 667, 70 Fed. Reg. 75,592 (Dec. 20, 2005), FERC Stats. & Regs. ¶ 31,197 (2005), *order on reh'g*, Order No. 667-A, 71 Fed. Reg. 28,446 (May 16, 2006), FERC Stats. & Regs. ¶ 31,213, *order on reh'g*, Order No. 667-B, 71 Fed. Reg. 42,750 (July 28, 2006), FERC Stats. & Regs. ¶ 31,224 (2006).

Legg Mason seeks exemption from PUHCA 2005's requirements pursuant to 18 C.F.R. § 366.3(b)(2)(i), which creates an exemption for holding companies that are merely passive investors. Legg Mason submits that it is a passive investor in AES and thus qualifies for an exemption under this section.

Notice of Filing and Protest

3. Notice of Legg Mason's filing was published in the *Federal Register*, 71 Fed. Reg. 28,317 (2006), with motions to intervene and protests due on or before May 26, 2006. LNG Opposition Team, part of the Greater Dundalk Alliance, filed a protest.³

4. LNG Opposition Team notes that AES is planning to submit an application to the Commission to develop and operate a liquefied natural gas import facility in Sparrows Point, Maryland (LNG project). LNG Opposition Team then contends that the Commission should deny Legg Mason's request for an exemption from the books and records requirements of PUHCA 2005 for three reasons. First, LNG Opposition Team argues that, as of the date of the most recent available figures of the top 200 holders of AES' shares, Legg Mason is the largest single shareholder, accounting for 19.19 percent of the outstanding shares and \$2.3 billion of the \$12.01 billion market capitalization of AES. LNG Opposition Team claims that, as the largest single investor in AES, Legg Mason would have a "powerful voice" at annual shareholder meetings and should not be considered "passive."

5. Second, LNG Opposition Team states that Legg Mason is based in Baltimore, Maryland, which is approximately 20 minutes away from the site of the proposed LNG project. It argues that, since Legg Mason is "an integral part of Baltimore's financial structure," it could provide the Commission with "valuable guidance" on the "financial implications" to the area of the proposed LNG facility.

³ LNG Opposition Team did not seek to intervene, *see* 18 C.F.R. § 385.214 (2006), and hence while it is a protestor under Rule 211 of the Commission's Rules of Practice and Procedure, *see* 18 C.F.R. § 385.211 (2006), it is not a party. *See* 18 C.F.R. § 385.211(a)(2) (2006) (protest does not make a protestor a party; protestor must intervene to be a party); *accord* 18 C.F.R. § 385.102(c) (2006) (parties are applicants, respondents, and intervenors); 18 C.F.R. § 385.214(a)(3) (2006) (person seeking to become a party must file a motion to intervene).

While LNG Opposition Team did include a passing reference to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), LNG Opposition Team did not seek intervention and party status. Rather, in the caption of its pleading and in three places in the body of its pleading, it expressly sought only to protest the filing.

6. Finally, LNG Opposition Team submits that the citizens of Baltimore should be aware of Legg Mason's involvement with AES, as well as Legg Mason's desire to avoid taking a public position on the LNG project, so that they may withdraw their funds from Legg Mason's investment vehicles if they believe that Legg Mason is acting against the public interest.

Commission Data Request and Legg Mason Response

7. On June 30, 2006, Legg Mason was asked to submit additional information to support its application for exemption from the books and records requirements of PUHCA 2005. Legg Mason was asked to provide information on: (1) its ownership interests in AES; (2) its role and its subsidiaries' role in the management and operational decisions of AES, and its participation in, among other things, AES decisions to buy or sell electric energy or natural gas, to buy or sell transmission or distribution, and to operate, buy, or sell facilities for production, transmission, or distribution; (3) whether any of Legg Mason's officers or directors sit on AES' board of directors or are AES officers; and (4) how Legg Mason or its subsidiaries' ownership interests in AES are managed.

8. On July 31, 2006, Legg Mason provided responses to the data request, as well as an answer to LNG Opposition Team's protest (Legg Mason July 31 Filing). While Legg Mason acknowledges beneficial ownership of a substantial number of AES shares, Legg Mason submits that, along with its subsidiaries and affiliates, it does not have a role in the management and operational decisions of AES or in AES transactions to buy or sell electric energy or natural gas, to buy or sell transmission or distribution, or to operate, buy, or sell facilities for production, transmission, or distribution. Legg Mason adds that it is not engaged in the electric or gas utility business or in power or gas marketing or trading, and that it would not have a reason to seek control of or influence the management or operations of AES. Legg Mason states that there are no interlocking officers and directors between the AES companies and the Legg Mason companies, that it does not have a right to receive information that is not also available to other investors, and that AES does not consult with Legg Mason personnel prior to making management or operational decisions.

9. Furthermore, Legg Mason states that its interests in AES are managed for investment purposes only, that Legg Mason does not seek to manage AES as part of an integrated energy business (and that Legg Mason does not own utility assets or trade or market electric energy or natural gas), and thus that there is no competitive impact associated with Legg Mason's interests in AES.

10. Legg Mason further clarifies that all AES shares are, in fact, owned by clients of Legg Mason's subsidiaries and affiliates, which oversee the clients' investments with the

primary focus to optimize the performance of the clients' accounts.⁴ Legg Mason states that it plays no role in the voting of AES shares held for the benefit of clients and contends that the role of its subsidiaries and affiliates with respect to voting depends on the agreement with each client whose account holds shares of AES.⁵

11. In its answer to LNG Opposition Team's protest, Legg Mason emphasizes that it is a passive investor of AES. Legg Mason states that, in its Securities and Exchange Commission (SEC) Schedule 13G, it has certified that AES securities are acquired and held in the ordinary course of business and not for the purpose or effect of changing or influencing the control of the issuer of the securities.⁶ Legg Mason states that if it was found to be exercising operational control over AES, it would likely lose its eligibility to file with the SEC on Schedule 13G with respect to AES. Further, Legg Mason argues that the fact that it is a member of Baltimore's financial community has no relevance in determining whether it exercises operational control over AES. Legg Mason states that, together with its subsidiaries and affiliates, Legg Mason has not exercised and does not wish to exercise any influence over AES with respect to the LNG facility or any other issue.

Discussion

12. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Legg Mason's answer because it has provided information that assisted us in our decision-making process.

13. Pursuant to authority provided by PUHCA 2005, the Commission promulgated the "books and records" requirements, which direct each holding company and each associate company, as well as affiliates and subsidiaries, to maintain and make available to the Commission such books, accounts, memoranda, and other records as the Commission determines are relevant to the costs incurred by a public utility or natural gas

⁴ Legg Mason states that acquiring securities on behalf of clients for investment purposes in the "ordinary course of business" is not for the purpose, or with the effect of, influencing control of the issuer. It also clarifies that its subsidiaries and affiliates do not coordinate their investment activities, but implement independent investment strategies.

⁵ Legg Mason explains that as is customary for investment advisors, its subsidiaries and affiliates vote the securities held by their clients pursuant to a fiduciary duty to vote in their clients' best interests. Further, the subsidiaries and affiliates independently draft their own proxy voting policies and do not pool their respective voting or investment power towards any common purpose.

⁶ Legg Mason July 31 Filing at 2-3 (citing Schedule 13G/A for AES Corp. common stock, SEC File No. 005-41672 (Feb. 14, 2006)); *accord id.* at 5 n. 3.

company (that is an associate company of that holding company) and that are necessary or appropriate for the protection of utility customers with respect to jurisdictional rates.⁷ PUHCA 2005 also directed the Commission to exempt persons and transactions from the “books and records” requirements if it finds that they are not relevant to the jurisdictional rates of a public utility or natural gas company.⁸

14. The Commission established, in the context of PUHCA 2005, several exemptions, including the “passive investor” exemption in 18 C.F.R. § 366.3(b)(2)(i), which exempts passive investors from the “books and records” requirements. The Commission found, in the context of PUHCA 2005, that passive investors would not exercise operational control over jurisdictional companies, and for that reason, the Commission would not need access to their books and records to ensure just and reasonable rates.⁹ Although the Commission declined to adopt a specific definition of “passive investor,” it determined that mutual funds, collective investment vehicles, and persons that directly, or indirectly through their subsidiaries or affiliates, buy and sell the securities of public utilities in the ordinary course of business as a broker/dealer, underwriter, or fiduciary and that do not exercise operational control over the public utility do qualify for this exemption.¹⁰

15. We find that, consistent with the requirements of 18 C.F.R. § 366.3(b)(2)(i), Legg Mason is a passive investor and thus qualifies for exemption from our “books and records” requirements.¹¹ We find the LNG Opposition Team's argument that Legg Mason is not a passive investor unpersuasive. Simply because Legg Mason is AES' single largest shareholder and potentially can influence shareholder meetings does not mean Legg Mason is not passive. The size of the holdings alone is not determinative of whether an investor is a passive investor for purposes of exemption from PUHCA 2005's requirements. While admittedly holding a substantial number of AES shares, Legg Mason states: Legg Mason does not (and plans not to) have a role in AES management or operational decisions or in AES transactions to buy or sell electric energy or natural gas,

⁷ See 42 U.S.C. § 16452; 18 C.F.R. § 366.2.

⁸ See 42 U.S.C. § 16454; 18 C.F.R. §§ 366.3, 366.4.

⁹ Order No. 667, FERC Stats. & Regs. ¶ 31,197 at P 119.

¹⁰ *Id.* at P 119-20.

¹¹ Exemption from the “books and records” requirements does not exempt a holding company from the separate requirements of section 203 of the Federal Power Act (FPA), 16 U.S.C. § 824b, as amended by section 1289 of EPAct 2005, 119 Stat. at 982-83. See generally *Capital Research and Management Company*, 116 FERC ¶ 61,267 (2006) (Docket No. EC06-129-000). We are not called upon to address, and we do not address, whether or to what extent Legg Mason may need to seek Commission authorization(s) pursuant to section 203.

or transmission or distribution, or the operation, buying, or selling of facilities for production, transmission, or distribution;¹² there are no interlocking officers or directors between the AES companies and the Legg Mason companies; that Legg Mason's interests in AES are managed for investment purposes only, and not as part of an integrated energy business;¹³ and the voting decisions of Legg Mason's subsidiaries and affiliates are dependent on individual agreements with individual clients whose accounts hold the shares of AES, with Legg Mason having a fiduciary duty to vote in the respective best interests of each such client.¹⁴ These statements, including Legg Mason's representation to the SEC in its Schedule 13G, justify our finding that Legg Mason is a passive investor in AES.

16. PUHCA 2005 does not give the Commission access to books and records for reasons other than assisting the Commission in ensuring just, reasonable, and not unduly discriminatory or preferential jurisdictional rates.¹⁵ Indeed, the Commission is required under section 1266(b) of PUHCA 2005 to exempt a person or transaction from PUHCA 2005's requirements if the Commission finds that the books and records of such person or transaction are not relevant to the jurisdictional rates of a public utility or natural gas company. This provision is not discretionary, *i.e.*, it provides that the Commission "shall exempt a person or transaction" if the Commission finds that the books and records of such person or transaction are not relevant to the jurisdictional rates of a public utility or natural gas company.¹⁶ LNG Opposition Team's arguments for not exempting Legg Mason from PUHCA 2005's requirements – to raise public awareness of the holding company's involvement with other companies, and to provide a forum for the holding company to provide guidance on the financial implications of the LNG project – have nothing to do with ensuring just, reasonable, and not unduly discriminatory or preferential jurisdictional rates under the FPA or the Natural Gas Act.¹⁷ Therefore, to deny the requested exemption for the reasons proffered by LNG Opposition Team would be inconsistent with the directives of PUHCA section 1266(b).

¹² Legg Mason adds that AES does not consult with Legg Mason personnel prior to making management or operational decisions.

¹³ Legg Mason explains, as well, that it is not engaged in the electric or gas utility business or in power or gas marketing and trading.

¹⁴ Legg Mason states that its subsidiaries and affiliates do not coordinate their investment activities; they implement individual investment strategies.

¹⁵ See 42 U.S.C. § 16452.

¹⁶ 42 U.S.C. § 16454(b).

¹⁷ See 16 U.S.C. §§ 824d, 824e (2000); 15 U.S.C. §§ 717c, 717d (2000).

The Commission orders:

Exemption is hereby granted to Legg Mason pursuant to 18 C.F.R. § 366.3(b)(2)(i), as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.