

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. EL02-105-002 and  
EC02-91-002

Bank of America, N.A.

Docket Nos. EL02-130-002 and  
EC02-120-002

ORDER GRANTING REHEARING

(Issued October 22, 2003)

1. In an order issued on June 5, 2003 (June 5 Order),<sup>1</sup> the Commission granted in part and denied in part UBS AG's (UBS) and Bank of America, N.A.'s (Bank of America) (collectively, Applicants) request for rehearing of an order issued December 19, 2002 (December 19 Order).<sup>2</sup> The December 19 Order granted Applicants' request for blanket authorization, pursuant to Section 203 of the Federal Power Act (FPA), to acquire public utility securities, subject to certain conditions.<sup>3</sup> In response to Applicants' request for rehearing of the December 19 Order, the June 5 Order modified those conditions.

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<sup>1</sup> UBS AG, 103 FERC ¶ 61,284 (2003).

<sup>2</sup> UBS AG and Bank of America, N.A., 101 FERC ¶ 61,312 (2002). The December 19 Order also denied Applicants' request for a declaratory order confirming that the acquisition of securities clause of Section 203 of the FPA does not apply to the acquisition of public utility securities by Applicants in the course of their banking businesses.

<sup>3</sup> Applicants are public utilities, having previously been granted market-based rate authority. Under Section 203 of the Federal Power Act, Applicants require the Commission's approval before they may acquire securities of another public utility.

2. Applicants have now requested rehearing of the June 5 Order, seeking further modification of the conditions and also offering certain additional commitments.<sup>4</sup> According to Applicants, unless the conditions are modified, they will be prevented from participating directly in electricity trading markets. The Commission will grant Applicants' request for rehearing of the June 5 Order.

### **I. Prior Orders**

3. The December 19 Order granted blanket authorization to Applicants to acquire public utility securities, including debt of such a public utility, up to one percent of any class of equity security, regardless of the form in (or purpose for) which the securities are acquired or held. The December 19 Order required the filing of public reports on Applicants' acquisition of public utility securities within 45 days after the close of each calendar quarter.

4. The June 5 Order granted in part and denied in part Applicants' request for rehearing. We granted Applicants' request that they be allowed to acquire securities of public utilities on a blanket basis, subject to: i) a limitation (on holdings of voting equity securities held as principal) of five percent of each voting class of securities issued by the public utility; and ii) the condition that Applicants' holdings 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 the public utility. The June 5 Order modified the reporting requirement to require Applicants to report their holdings of voting equity securities held as principal and their total holdings of voting equity securities, irrespective of the connection in which such securities are held or acquired. Such reports are subject to a de minimis threshold of one percent.

5. The June 5 Order also granted Applicants' request to exclude from the percentage calculation Applicants' acquisition of public utility securities in connection with their lending activities, i.e., securities held as debt. However, the Commission recognized that as lenders, Applicants could be placed in a position of assuming control over another public utility. In such situations, the Commission required Applicants to obtain its approval under Section 203 before acquiring control.

6. In addition, the June 5 Order excluded from the five percent limitation Applicants' acquisition of public utility securities in connection with their fiduciary activities, with

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<sup>4</sup> Applicants initially filed a Joint Request for rehearing (Joint Request), dated July 7, 2003, and then filed a supplemental request for rehearing (Supplement), dated August 26, 2003.

one exception. The Commission determined, consistent with its interpretation of the Bank Holding Company Act (BHC Act),<sup>5</sup> that holdings or acquisitions of public utility securities in a fiduciary capacity where the Applicant has discretionary voting rights for two years would be considered as securities held in principal and thus subject to the five percent limitation. On rehearing, Applicants take issue with the Commission's interpretation and ruling on acquisitions in a fiduciary capacity.

7. Further, the June 5 Order eliminated from the five percent limitation Applicants' acquisition of public utility securities in connection with their underwriting activities, with one exception. In situations where Applicants are unable to immediately resell voting equities they acquire in an underwriting capacity, such holdings not sold or disposed of within 45 days are to be treated as holdings in principal and subject to the five percent limitation. On rehearing, Applicants propose a modification of this condition.

8. Finally, the June 5 Order allowed no exclusion for acquisition of public utility securities in connection with derivatives/hedging activities. The Commission noted that its ruling is consistent with Bank Regulators' rules that allow banks to acquire equity securities, subject to a limitation of five percent of the stock of any issuer, solely to hedge the bank's exposure arising from customer-driven equity derivative transactions.<sup>6</sup> Applicants take issue with this ruling and propose a condition to mitigate Commission concerns.

## **II. Discussion**

### **A. Acquisition of public utility securities in an underwriting capacity**

9. The June 5 Order puts no limitation on Applicants' acquisition of public utility securities, except that holdings that Applicants are unable to sell or otherwise dispose of within 45 days are to be treated as holdings in principal and thus subject to the five percent limitation. On rehearing, Applicants contend that this is unworkable and creates a risk of noncompliance with Section 203 of the FPA. Applicants state that in an unstable market, a failed underwriting may occur, in which case the underwriter would seek to sell the unsold shares over a period of time following the closing of the initial purchase. Because Applicants at the outset of an underwriting would not know whether they would succeed in selling enough shares so that they would not violate the five

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<sup>5</sup> Bank Holding Company Act, 12 U.S.C. § 1842 (2000).

<sup>6</sup> The Bank Regulators are the Office of the Comptroller of the Currency (OCC), which regulates national banks, and the Federal Reserve Board (Federal Reserve), which regulates bank holding companies.

percent limitation after 45 days, Applicants would have to seek the Commission's approval immediately to retain the shares, with no assurance that such approval would be timely granted, or risk noncompliance. According to Applicants, making a public application to the Commission for this purpose could harm the market and significantly lower the price of the shares, injuring both Applicant and the issuing public utility. They also state that if Commission approval were not granted within 45 days, Applicants might also have to make forced sales of the shares, disadvantaging the issuer, or risk noncompliance.

10. To address the Commission's concern about control, Applicants ask the Commission to provide that the exemption for public utilities acquired in an underwriting capacity will end after 45 days unless the Applicant has within that period filed an application for Section 203 approval to retain the securities and has undertaken during the pendency of such application not to vote the securities. Applicants argue that this condition would prevent them from exercising any voting control over a public utility and at the same time allow them to seek to dispose of such shares in an orderly manner, thus decreasing the likelihood that the filing of disclosure notice of Applicants' holdings would harm the market for the shares.

11. The Commission will accept Applicants' proposed modification of the condition. There can be no certainty that the Commission would act on a Section 203 application within 45 days and Applicants might have to dispose of the shares in a market that is well aware of the need for Applicants to sell them quickly, thus injuring the issuer. Applicants' proposal to not vote the securities held in this capacity is a reasonable solution that ensures that such holdings will not allow Applicants to exercise voting control beyond the five percent limitation on holding equity securities as principal.

#### **B. Acquisition of public utility securities in a fiduciary capacity**

12. The June 5 Order permits public utility securities acquired in a fiduciary capacity to be excluded from the five percent limitation on holdings as principal, except where the Applicant has discretionary voting rights for two years. The Commission held that this was consistent with the BHC Act, based on our interpretation that the Federal Reserve, for purposes of assessing bank holding companies' ownership in non-banking entities, includes securities held in a fiduciary capacity where a bank has discretionary voting rights for two years.

13. Applicants contend that this is a misapplication of banking law. They note that although Section 3 of the BHC Act does contain a temporal limitation on holdings, the section actually addresses ownership in banking entities, rather than non-banking entities. Applicants point out that while Section 4 of the BHC Act generally prohibits acquisition of shares by bank holding companies in non-banking entities, an exemption is provided for shares held in good faith in a fiduciary capacity, without a temporal limitation on

holdings of shares with discretionary voting authority and without a specific percentage limitation on the proportion of shares held by the banking entity.<sup>7</sup>

14. Applicants assert that applying a Section 3 standard to their fiduciary activities would thus create a new standard for fiduciary holdings of public utility securities with voting discretion that has no corollary under banking law. They say that complying with that standard would be a substantial practical and legal burden. They would have to establish new systems across fiduciary business lines to track and aggregate those holdings. Applicants also say that a Section 3 standard could cause them to have to limit the securities their fiduciary customers could place in trust or to decline to exercise discretionary voting rights for such customers; either action might be inconsistent with Applicants' fiduciary obligations. Applicants contend that these concerns, in addition to being placed at a competitive disadvantage compared to other banks not subject to the same restrictions, would effectively preclude them from participating directly in electricity trading. They also reiterate that as fiduciaries, banks are obligated to manage their fiduciary accounts in the best interests of the beneficiaries and not in their own interest, and that the adequacy of their procedures and controls applicable to fiduciary activities is scrutinized by bank regulators.

15. In addition, Applicants have committed that their acquisition of public utility securities, regardless of the capacity in which they are acquired, will not confer upon them the right to control the management or operation of a public utility. Thus, Applicants state, fiduciary holdings will be taken into account for purposes of determining compliance with this commitment. Further, their fiduciary holdings will remain fully subject to the reporting requirements. They state that the Commission may inquire further as to any particular holding on the basis of the quarterly reports.

16. The Commission will grant rehearing and eliminate the requirement that fiduciary holdings be treated as holdings in principal, subject to a five percent limitation, where the Applicant has discretionary voting rights for two years. Applicants have correctly pointed out that we erred in interpreting provisions of the BHC Act as they apply to ownership by banks in non-banks. On further review, the Commission is satisfied that the relaxation of this restriction with respect to acquisition of public utility securities will not allow Applicants to use their ownership positions to influence the market behavior of their competitors in power markets. As we noted in the June 5 Order, backstop protection is provided by the procedures, controls and monitoring programs banking institutions are required to have in place in order to conduct fiduciary activities and the

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<sup>7</sup> Bank Holding Company Act, 12 U.S.C. § 1843 (2002). Applicants assert that the legislative history suggests that this exemption was intended to prevent the Section 4 restriction from interfering with traditional functions of bank holding companies.

comprehensive nature of supervision and regulation by Bank Regulators of banks' fiduciary. We are satisfied that Applicants will be precluded from using their fiduciary holdings to serve their own interests, rather than the interests of their fiduciary clients.

**C. Acquisition of public utility securities as a hedge to derivative transactions**

17. The June 5 Order held that acquisitions of public utility securities in connection with Applicants' derivative/hedging activities would not be excluded from the five percent limitation. The Commission stated that this is consistent with Bank Regulators' rules that 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.

18. On rehearing, Applicants argue that the Commission has not correctly characterized bank regulatory authority with respect to hedging derivative transactions. They request that they be permitted to exceed the five percent limitation with respect to securities held to hedge derivative transactions to the extent that such holdings are consistent with bank regulatory requirements. If the ruling is so modified, Applicants state that they will undertake not to vote more than five percent of the voting securities of such public utilities where such securities are held as principal for derivative hedging purposes.

19. Applicants note that acquisitions of securities for hedging purposes are intended to promote bank safety and soundness by reducing the risk from a bank's derivative business. Because of this link, Applicants state that there is no general bank regulatory ceiling of five percent on equity securities held for hedging purposes. They describe situations where departures from the five percent limitation may occur. According to Applicants, the five percent limitation for hedging purposes referred to by the Commission is a supervisory standard, not a legal requirement, of the OCC applicable to national banks.<sup>8</sup> Applicants claim that this standard may be exceeded in certain circumstances with OCC concurrence.<sup>9</sup> For instance, Applicants state, the OCC might authorize an equity derivative hedge of more than five percent of stock price movements indicate that, to protect the bank's safety and soundness, the bank should hedge its exposure on underlying derivative transactions by purchasing additional shares. Alternatively, if an issuer took action to reduce its outstanding equity securities, resulting in a bank's pre-existing hedge exceeding five percent, the OCC might agree that the hedge nonetheless is consistent with bank risk management. Applicants also assert that there is no basis to suggest that Bank Regulators would permit a bank to depart from the

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<sup>8</sup> Included here are Bank of America and UBS' U.S. branches.

<sup>9</sup> Bank of America received authorization from the OCC in Letter No. 892 to acquire equity securities to hedge its exposures on equity derivative transactions.

five percent standard if the purpose would be to permit the bank to acquire or exercise control over a public utility issuer.

20. Applicants point out that in the three-year period since Bank of America received OCC authorization to engage in purchase of securities to hedge derivative transactions, Bank of America has not applied for OCC approval to exceed five percent of a class of stock of any issuer, including a public utility. Applicants further state that neither currently has any voting equity position in a public utility as a hedge against its derivative transactions that exceeds the OCC supervisory standard of five percent, and neither expects that it would exceed the five percent limitation on a regular or frequent basis as a result of requesting exemption from the OCC supervisory standard.

21. Applicants therefore request that they be permitted to exceed the five percent limitation previously imposed by the Commission with respect to securities held to hedge derivative transactions to the extent that such holdings are consistent with bank regulatory requirements. To eliminate concerns about exercise of control, each Applicant agrees to not vote more than five percent of the voting securities of a public utility where the Applicant holds such securities as principal for derivative hedging purposes. Finally, Applicants note that as with their fiduciary holdings, they commit that their security acquisitions for hedging will not confer upon them the right to control the management or operation of any public utility. Applicants further note that the reporting requirement for total holdings encompasses securities acquired for hedging purposes and includes an obligation to make underlying information available to the Commission, as requested.

22. The Commission will grant rehearing with respect to holdings of public utility securities for hedging purposes and accept Applicants' proposed condition for implications concerning control. Their agreement not to vote such shares alleviates our concern that they could use their positions to influence market behavior of competitors.

The Commission orders:

Applicants' requests for rehearing are hereby granted, 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.