FERC Clarifies that Certain Investment and Investment Adviser Companies Must Receive Prior Approval to Acquire Utility Company Securities

The Federal Energy Regulatory Commission (FERC) recently issued an order in a case involving Horizon Asset Management, Inc., clarifying its jurisdiction over certain investment adviser activities under section 203(a)(2) of the Federal Power Act (FPA). The FERC order affects many investment advisors that invest in the securities of public utility companies. In the November 20, 2008 order, the Commission analyzed when an investment adviser is classified as a "holding company" under the FPA. If the company falls within the definition of a holding company, the Commission concluded that the holding company is required to seek FERC authorization prior to directing its account holders to purchase, acquire, or take utility or utility holding company securities with a value in excess of $10 million; failure to do so could result in sanctions, including monetary penalties. The Commission also provided, however, the opportunity for a holding company to seek a blanket authorization to purchase utility securities going forward as long as the holding company satisfies certain conditions.

When is an Investment Adviser Classified as a Holding Company under the FPA?

An investment adviser is required to obtain FERC authorization if it falls within the definition of a holding company. The definition of a holding company is found in the Public Utility Holding Company Act of 2005 (PUHCA). Pursuant to PUHCA, any company that directly or indirectly owns, controls, or holds, with voting power, 10 percent or more of the voting securities of a utility or utility holding company is considered a holding company.

Horizon, a registered investment adviser, argued that it should not be treated as a holding company since the account holders and not Horizon held the voting securities of the utility companies in question. Horizon directed certain of its account holders to purchase 10 percent or more of the voting securities of Reliant Energy, Inc., Sierra Pacific Power, and Aquila, Inc. at a time when certain of Horizon's accounts under advisement already held more than 10 percent of the voting securities of Aquila, Inc. These account holders in turn delegated their voting power to Horizon. Although Horizon generally relied on a third party for recommendations on how to exercise the voting power, it had the ability to override the third party recommendations. These facts were adequate for the Commission to conclude that Horizon controlled or held the voting power and thus Horizon itself fell within the definition of a holding company.

When Certain Investment Adviser Activities Constitute Purchasing, Acquiring, or Taking Securities

Under section 203(a)(2), a company that is classified as a holding company must receive approval from FERC prior to purchasing, acquiring, or taking greater than $10 million of voting securities of a utility or utility holding company. Horizon argued that as an investment adviser that directed stock purchases for its discretionary accounts where the account holders and not Horizon held the securities, its activities did not constitute purchasing, acquiring, or taking securities under section 203.

The Commission, in rejecting Horizon's argument, adopted a much broader interpretation. Since Horizon qualified as a holding company and held the voting power of its account holders' securities, Horizon could use its voting power to exercise

control over a public utility company. Thus, the Commission reasoned that Horizon had "acquired" securities for purposes of section 203(a)(2). The Commission ultimately concluded that Horizon and similarly situated companies are required to seek FERC approval prior to directing their account holders to acquire over $10 million of securities in a utility or utility holding company.

Outcome and Further Actions to be Taken

FERC determined that Horizon violated section 203(a)(2) when its managed accounts purchased over 10 percent of the voting shares in certain utility companies. While the Commission refused Horizon's request for retroactive approval of these transactions, it decided not to impose any sanctions since it had yet to clarify its jurisdiction under section 203(a)(2) at the time of Horizon's acquisitions. Going forward, however, an investment or investment adviser company that meets the definition of a holding company and does not obtain FERC approval prior to directing its account holders to purchase utility or utility holding company shares with a value in excess of $10 million could be subject to sanctions including monetary penalties. Companies that previously directed their account holders to purchase utility or utility holding company securities in violation of section 203(a)(2) have until February 23, 2009 (90 days from the date the order was published in the Federal Register) to submit an application requesting FERC authorization for such transactions.

For Horizon's future acquisitions, the Commission granted Horizon a blanket authorization for three years to engage in account management activities involving the acquisition of voting securities in utility or utility holding companies. The authorization is contingent upon the ongoing satisfaction of certain conditions. Each individual Horizon account must hold less than 10 percent of a company's voting securities, while the accounts of Horizon and its affiliates in the aggregate may only hold up to 19.99 percent of a company's voting securities. Where it is required to make either a Schedule 13D or 13G filing with the SEC, Horizon committed to making a Schedule 13G filing and submitting a copy to the Commission. If there are any changes to the information provided in the initial Schedule 13G filing, an annual amended filing must be submitted to the Commission within 45 days of the end of the calendar year. Quarterly reports are required to be submitted within 45 days of the end of each calendar quarter listing the utility and utility holding company shares held, the numbers of shares held, and the percentage of outstanding shares held. If there are any material changes from the facts relied upon by the Commission in granting the blanket authorization, Horizon is required to inform the Commission of these changes within 30 days.

Contact Information

For further information on the implications of this FERC order or to learn more about applying for a blanket authorization to purchase utility company securities, please contact the Ropes & Gray attorney who normally advises you.