

## COMMENT LETTER

October 21, 2005

# ICI Comment Letter on Public Utility Legislation Requirements, October 2005

October 14, 2005

Federal Energy Regulatory Commission  
Office of the Secretary  
888 First Street, N.E.  
Washington, DC 20426

Re: Docket No. RM05-32-000

Dear Sir or Madam:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the Federal Energy Regulatory Commission's proposed rules under the Energy Policy Act of 2005 to implement the repeal of the Public Utility Holding Company Act of 1935 ("1935 Act") and the enactment of the Public Utility Holding Company Act of 2005 ("2005 Act"). Our letter addresses the Commission's request for comment on whether it should exempt classes of transactions involving mutual fund passive investors or other passive investors from the new federal books and records access requirements. As discussed below, the Institute recommends that the Commission exempt from these requirements Securities and Exchange Commission-registered investment companies ("funds") and investment advisers ("advisers") that make passive investments in public utility companies or public utility holding companies (collectively referred to as "utility companies").

A fund or adviser could be deemed to be a "holding company" under the 2005 Act and the proposed rules, and therefore subject to the federal books and records access requirements, if it were to hold 10 percent or more of the voting stock of a utility company.<sup>2</sup> Subjecting funds and advisers to the books and records access requirements does not appear to serve any valid public policy purpose. It is highly unlikely that the share holdings of passive institutional investors, such as funds or advisers, would have any effect on utility rates. As such, exempting them from these requirements is consistent with the purposes of the 2005 Act: to eliminate unnecessary regulation while continuing to protect electric and gas utility customers with respect to utility rates by providing regulators with access to the relevant books and records of companies in a public utility holding company system. It also will avoid the possibility that these provisions may act as an impediment to the flow of capital into the utility industry by discouraging funds and advisers from investing in close to or more than 10 percent of a utility company's outstanding shares.

For similar reasons, the Institute in the past has suggested that funds and advisers should be exempted from regulation under the 1935 Act.<sup>3</sup> Funds and advisers do not raise the policy concerns the 1935 Act was designed to address, i.e., concerns about control of or influence over a utility company. Neither funds nor advisers generally invest for the purpose of exercising control. Many funds state in their investment policies that they do not purchase securities for the purpose of influencing or exercising control. Similarly, an adviser acting in a fiduciary capacity when purchasing securities for the accounts of clients typically does not invest with the intent to control the issuer. In addition, funds and advisers are subject to comprehensive regulation under the federal securities laws.

In a 1995 report on public utility holding company regulation, the SEC's Division of Investment Management discussed comments submitted by the Institute and others in support of an exemption for funds and advisers from regulation under the 1935 Act.<sup>4</sup> The Division expressed the view that "there is merit to exempting investment companies and advisers from application of the 1935 Act," and recommended that the SEC consider a rule on this matter. The policy justifications for an exemptive rule under the 1935 Act remain valid today and support an exemption from the federal books and records access requirements under the 2005 Act.

An exemption for funds and advisers would be consistent with the treatment of banks, savings associations, and trust companies in the 1935 Act, 2005 Act and proposed rules. The definition of "holding company" excludes these financial institutions, to the extent they hold utility company securities in the ordinary course of business as fiduciaries.<sup>5</sup> Exempting funds and advisers would be an appropriate way to recognize significant changes in the investing world since 1935 – in particular, the increasingly important role of funds and advisers as financial intermediaries.

Our recommendation also is consistent with provisions of the 2005 Act and proposed rules that require the Commission to exempt a person or transaction from the federal books and records access requirements if, upon application or upon motion of the Commission: (1) the Commission finds that the books, accounts, memoranda, and other records of any person are not relevant to the jurisdictional rates of a public utility or natural gas company; or (2) the Commission finds that any class of transactions is not relevant to the jurisdictional rates of a public utility or natural gas company. Given the lack of relevance of fund and adviser books, records and transactions to public utility jurisdictional rates, providing a class exemption by rule rather than relying on case-by-case applications should not raise any consumer protection concerns.

A class exemption also is likely to conserve the Commission's regulatory resources and allow them to be put to better use. In the absence of an exemption, the Commission might receive and be required to process individually multiple applications presenting substantially identical fact patterns. A class exemption is more efficient in these circumstances.

To limit the exemption to funds and advisers making passive investments in utility companies, we suggest that the Commission model it on Rule 13d-1 under the Securities Exchange Act of 1934 ("Exchange Act"). Rule 13d-1(b)(1) permits certain institutions and persons (including funds and advisers) to file reports of beneficial ownership of securities with the SEC on a short-form statement, Schedule 13G, rather than the long-form Schedule 13D because their acquisitions do not affect the control of issuers. We believe Rule 13d-1(b)(1) provides an appropriate model because it is based on the same premise that justifies an exemption from the books and records access requirements, i.e., that the share

holdings of certain passive institutional investors (specifically including funds and advisers) do not raise the concerns that those requirements are designed to address because they do not involve changing or influencing control of the issuer.<sup>6</sup>

To implement this approach, the Commission's rules should exempt from the federal books and records access requirements any investment company registered under Section 8 of the Investment Company Act of 1940 and any investment adviser registered under Section 203 of the Investment Advisers Act of 1940 that owns, controls, or holds, with the power to vote, securities of a public utility company or holding company of a public utility company, so long as the investment company or investment adviser has acquired the securities in the ordinary course of business and without the purpose or effect of changing or influencing control of such public utility or holding company.

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We appreciate the opportunity to express our views on the Commission's proposed rules. If you have any questions about our comments, please contact the undersigned at 202/326-5822.

Sincerely,

Frances M. Stadler  
Deputy Senior Counsel

cc: David B. Smith, Jr.  
Associate Director  
Division of Investment Management  
Securities and Exchange Commission

#### **ENDNOTES**

<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. The Investment Company Institute's membership includes 8,509 open-end investment companies (mutual funds), 659 closed-end investment companies, 147 exchange-traded funds, and five sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$8.428 trillion (representing more than 95 percent of all assets of US mutual funds); these funds serve approximately 87.7 million shareholders in more than 51.2 million households.

<sup>2</sup> Like the 1935 Act, the 2005 Act and the proposed rules define a "holding company" to include "any 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 of a holding company of any public-utility company."

<sup>3</sup> See, e.g., Letter from Frances M. Stadler, Associate Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated February 6, 1995.

<sup>4</sup> The Regulation of Public-Utility Holding Companies, Division of Investment Management, United States Securities and Exchange Commission (June 1995), at 126.

<sup>5</sup> Similarly, the definition excludes a broker or dealer that owns, controls, or holds with the power to vote public utility or public utility holding company securities, so long as the

securities are not beneficially owned by the broker or dealer and are subject to any voting instructions which may be given by customers or their assigns.

[6](#) We previously recommended that the SEC model an exemption for funds and advisers on Rule 16a-1(a)(1) under the Exchange Act, which defines the term “beneficial owner” for purposes of determining whether an entity is a “ten percent holder” that may be subject to reporting requirements and short-swing profit restrictions under Section 16 of the Exchange Act. Under this rule, specified institutions and persons (including funds and advisers) are not considered to be the beneficial owners of securities “held for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business . . . as long as such shares are acquired by such institutions or persons without the purpose or effect of changing or influencing control of the issuer . . . .” We now believe that Rule 13d-1 may serve as a better model because, as a technical matter, funds own securities for their own account, not for the benefit of third parties or customers.

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