UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Federal Power Act Section 203 Blanket Authorizations for Investment Companies — Docket No. AD24–6

Reply Comments of Public Citizen, Inc.

The Commission "seeks comment on what constitutes control of a public utility in evaluating holding companies", and whether it "should revise its policy on providing blanket authorizations for investment companies".[1]

Recent efforts by activist investors, private equity funds and bank holding companies to control public utilities have exposed major gaps in the Commission's affiliation and change in control regulations. To uphold Federal Power Act statutory protections for public utilities, the Commission should:

A. Hold Activist Investors Accountable To The Federal Power Act

- Eliminate the "rebuttable presumption of lack of control" for investors owning, holding or controlling less than 10% of a utility's voting shares, per 18 CFR § 35.36(a)(9)(v).
- Clarify that investors securing legal cooperation agreements that entitle them to rights and privileges to access material, non-public information about a public utility constitutes affiliation and control.
- Compel affiliation for investors that secure control over seats on the board of a directors of a public utility, regardless of whether or not the seat is filled by an employee of the investor.
- Acknowledge that activist investors utilize financial engineering strategies outside of owning, holding or controlling voting shares, such as the use of cash-settled derivatives, that convey economic control over a public utility. The Commission must equate control of voting securities with such efforts to obtain indirect economic control through the use of derivatives and other schemes.

B. Preserve Market Integrity By Strengthening Regulations Over Private Equity

- Require disclosure of limited partners and disallow interlocking directors.
- Compel public disclosure of investment advisory agreements and certain limited liability agreements.

[1] www.govinfo.gov/content/pkg/FR-2023-12-27/pdf/2023-28665.pdf

C. Condition Blanket Authorization for Passive Investors

- Disallow blanket authorizations when an investment manager also directs an investment fund that acquires and manages Commission-jurisdictional facilities.
- Schedule a technical conference to explore the effectiveness of the Commission's blanket authorization policy.

Eighty-nine years ago, Congress demanded that public utilities and their customers be subjected to enhanced regulatory treatment from most other companies in the economy, enshrining in Section 201 of the Federal Power Act "that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest".[2] The Federal Power Act requires all rates and charges of public utilities to be "just and reasonable".[3] And because public utilities are "affected with a public interest", Congress erected unique protections to ensure that any entity seeking to acquire or control a public utility must first obtain permission from the Commission: "[n]o public utility shall, without first having secured an order of the Commission authorizing it to do so" allow a "change in control" until "it finds that the proposed transaction will be consistent with the public interest".[4]

Determining control and affiliation of and among public utilities is necessary to protect consumers and the public interest for three key reasons:

- Ensuring electricity market integrity by accurately mapping financially-affiliated public utility power assets to identify and prevent anti-competitive practices.
- Protecting captive customers by preventing affiliate abuses by investors in franchised public utilities.
- Inhibiting activist investors from exploiting public utilities as speculative commodities.

The Commission has historically relied on a rather simplistic approach—control of voting shares—to determine affiliation, defining *affiliate* as "[a]ny person that directly or indirectly owns, controls, or holds with power to vote, 10 percent or more of the outstanding voting securities of the specified company" [emphasis added].[5] While these regulations include a broad array of actions, as indicated by the explicit inclusion of both

[2] 16 USC § 824.
[3] 16 U.S. Code § 824d(a).
[4] 16 U.S. Code § 824b(a).
[5] 18 CFR § 35.36(a)(9)(i).

indirect and *direct* and the use of three separate words which point to distinct activities (*owns*, *controls* or *holds)*, it is constrained by the arbitrary 10% percentage standard.

The Commission's regulations include a *catch-all* provision designating "[a]ny person or class of persons that the Commission determines, after appropriate notice and opportunity for hearing, to stand in such relation to the specified company that there is liable to be an absence of arm's-length bargaining in transactions between them as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that the person be treated as an affiliate".[6]

Public Citizen cited this catch-all provision to compel two new affiliation precedents at the Commission. First, that an investor owning less than 10% of a utility's voting shares is deemed an affiliate when its employee has a seat on the board of directors.[7] Second, that JP Morgan Chase & Co, serving as an investment advisor to a private equity entity, was deemed to be an affiliate due to the contractual relationship between the two entities.[8] It is preferable for the Commission to amend and clarify its rules on affiliation and change in control rather than continue to rely on the catch-all provisions of 18 CFR § 35.36(a)(9)(iii).

Legal Cooperation Agreements Between Investors And Utilities Convey Control And Harm Competition

In numerous recent cases involving entities such as Elliott Management and Carl Icahn, activist investors targeting public utilities exploit the implied threat of hostile shareholder actions to negotiate legal agreements with utilities that entitle the investor to access to material, non-public information and sometimes rights to control seats on the board of directors.[9] These *legal cooperation agreements* empower the activist investor to directly impact competitive decision-making, capital management and other fundamental business decisions of the public utility. Competition is threatened should the investor have simultaneous agreements with access to material, non-public information across multiple public utilities. The Commission should therefore require

[6] 18 CFR § 35.36(a)(9)(iii).
[7] www.citizen.org/news/ferc-vote-a-victory-against-corporate-energy-raiders/
[8] www.citizen.org/article/september-2023-pc-letter-to-the-federal-reserve-on-jp-morgan/
[9] See, for example, www.citizen.org/article/icahn-aep-american-electric-power/ and www.citizen.org/article/elliott-management-nrg-energy-derivatives/

any investor seeking to secure a binding, legal cooperation agreement with a public utility to first seek approval under Section 203 of the Federal Power Act.

Investors Controlling Board Seats of Utilities Must Be Deemed Affiliates

In *Public Citizen vs. Centerpoint*,[10] and again affirmed in *Evergy*,[11] the Commission determined that investors owning less than 10% of voting shares that have control over seats on the board of directors of a public utility but place individuals that are not directly financially compensated by the investor on the board are not affiliated. The Commission must reevaluate this mistaken precedent, as activist investors frequently utilize the same "independent" directors for different corporate target campaigns, developing de facto close relationships. And, as the Commission points out in Evergy, "[b]oard membership confers rights, privileges, and access to non-public information, including information on commercial strategy and operations."[12] When that "independent" director is ultimately beholden to the investor—regardless of whether the investor directly financially compensates them or not—it should be assumed that the director is sharing the non-public information with the investor. As such, any agreement that legally conveys control over a seat on the board of a public utility to an investor should deem that investor to be affiliated.

Use of Cash-Settled Derivatives Mimics Control Over Voting Shares

We recently noted that Elliott Management's use of cash-settled swaps to control more than 10% of the economic interest of a public utility should have deemed the activist fund to be affiliated with the utility.[13] A recent investigation and proposed rule by the U.S. Securities and Exchange Commission details how such cash-settled swaps convey influence and control on the part of investors utilizing them:

> *Holders of cash-settled derivatives also may have incentives to influence or control outcomes at the issuer of the reference security <u>just as they would if they directly owned the reference security outright</u>. Although holders of derivatives settled exclusively in cash ordinarily would lack the express legal power under the terms of such instruments to direct the voting or disposition of a covered class, such holders may possess*

[10] 174 FERC ¶ 61,101
[11] www.citizen.org/news/ferc-vote-a-victory-against-corporate-energy-raiders/
[12] 181 FERC ¶ 61,044, at 45.
[13] www.citizen.org/wp-content/uploads/Elliott-Answer.pdf

> *economic power that can be used to produce desired outcomes through engagement with a counterparty or the issuer of the reference security . . . Cash-settled derivatives imitate the economic performance of a direct investment in an issuer's equity securities and, in turn, may economically empower the holders of such derivatives to influence the issuer or the price of its securities . . . Given such person's potential to influence or change control of the issuer, we are proposing an amendment that would, in specified circumstances, deem the holder of a cash-settled derivative security to be the beneficial owner of the reference security* [emphasis added][14]

Private Equity's Concealment of Limited Partners Threatens Competition

FERC precedent generally exempts private equity and other financial firms from disclosing their investors if they attest that the investors are passive.[15] But in a recent filing, Public Citizen revealed shortcomings in FERC's decision to allow the identities of such investors to remain secret. We noted that one private equity firm, Blue Owl Capital, owns roughly 20% of the capital for at least *three* separate, competing private equity firms that control significant power generation assets.[16] But because FERC does not compel the disclosure of Blue Owl's massive financial stakes across multiple competing firms, it is not reported and not required to be included in any power market screens. This glaring oversight leaves the Commission's jurisdictional power markets vulnerable to anti-competitive behavior. The Commission must compel the public disclosure of all limited partner investors in private equity structures to ensure an accurate tabulation of economic interest in its jurisdictional power markets. Furthermore, the assumption that a large investor in a private equity firm can be passive is mistaken, as private equity firm have significant self-preservation incentive to accommodate the investor's priorities to ensure they remain as an investor and not, say, withdraw its capital to invest in a rival firm. The size and magnitude of the capital investment conveys influence and control.

FERC Must Disallow Investors From Controlling Seats On the Boards of Multiple Utilities

Several months ago we informed the Federal Trade Commission that FERC allowed the private equity giant Blackstone to simultaneously controls seats on the board of directors of the public utilities Northern Indiana Public Service Company and

[14] *Modernization of Beneficial Ownership Reporting*, pages 52-56, www.sec.gov/files/rules/proposed/2022/33-11030.pdf
[15] See, for example, AES Creative Res., L.P., 129 FERC ¶ 61,239.
[16] https://elibrary.ferc.gov/eLibrary/filelist?accession_number=20240318-5158

FirstEnergy, in violation of the Clayton Act.[17] FERC must establish rules disallowing investors from simultaneously controlling seats on the board of directors of multiple public utilities.

Improve disclosure for Bank Holding Companies and Other Investment Managers

Bank holding companies and other financial firms that act as investment managers for public utilities or entities seeking to control public utilities often represent their management as passive, and therefore exempt from being classified as an affiliate. But as we saw with the case of JP Morgan Chase, the adamant representations of passive, non-controlling status were contradicted by the plain language contained in the investment advisory agreement and limited liability agreement of the managed entity.[18] To avoid confusion, the Commission should compel any entity acting as an investment advisor to publicly disclose both the investment management agreement between itself and the entity seeking to acquire a public utility, and the disclosure of all relevant limited liability agreements.

Investment Managers Receiving Blanket Authorizations Must Be Disallowed From Controlling FERC-jurisdictional Assets

In a forthcoming protest in the Section 203 proceeding involving BlackRock's acquisition of Global Infrastructure Partners,[19] Public Citizen will raise competition concerns about BlackRock controlling significant generation assets at the same time that the company has been granted blanket authorization to own up to 20% of any public utility's voting shares. There are significant conflicts and potential detrimental impacts on competition to allow an investment manager the size of BlackRock to obtain blanket authorizations at the same time that it directly manages and controls large fleets of Commission-jurisdictional power assets. The Commission must disallow blanket authorizations for any investor that simultaneously owns and controls generation.

[17] www.citizen.org/article/public-citizen-letter-to-ftc-on-blackstone/
[18] www.citizen.org/article/september-2023-pc-letter-to-the-federal-reserve-on-jp-morgan/
[19] Docket No. EC24-58.

A Technical Conference Is Needed To Assess The Effectiveness of the Commission's Blanket Waiver Policy

In 2022, Public Citizen raised concerns about the size and scope of investment managers like BlackRock and Vanguard, and requested that the Commission perform or compel some form of basic analysis to determine whether the blanket authorizations are in the public interest, and whether they threaten competition or just and reasonable rates.[20] Just this month, it was reported that the Federal Deposit Insurance Corporation is "scrutinizing whether index-fund giants BlackRock, Vanguard and State Street are sticking to passive roles when it comes to their investments in U.S. banks" and revaluating that agency's version of blanket authorizations.[21] The Commission should schedule a technical conference to explore the adequacy of its current blanket authorization policy, and invite representatives from the Federal Trade Commission, the FDIC and consumer advocates to participate.

Respectfully submitted,

Tyson Slocum

Tyson Slocum, Energy Program Director
Public Citizen, Inc.
215 Pennsylvania Ave SE
Washington, DC 20003
(202) 454-5191
tslocum@citizen.org

[20] www.citizen.org/article/challenge-to-blackrocks-waivers-to-control-up-to-20-of-utilities/
[21] Andrew Ackerman, "Regulator Probes BlackRock and Vanguard Over Huge Stakes in U.S. Banks," The Wall Street Journal, April 2, 2024, www.wsj.com/finance/regulation/regulator-probes-blackrock-and-vanguard-over-huge-stakes-in-u-s-banks-b9f58619