File

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

The Honorable John D. Dingell
U.S. House of Representatives
2322 Rayburn House Office Building
Washington, DC 20515

The Honorable Edward J. Markey
U.S. House of Representatives
2108 Rayburn House Office Building
Washington, DC 20515

Dear Congressmen Dingell and Markey:

Thank you for your February 11th letter concerning the Commission's administration of the Public Utility Holding Company Act of 1935. The Commission shares your goal of effectively administering the Act, particularly in light of the crucial importance of our nation's utility industry to our economy and to national security. I very much appreciate your concerns and questions.

In your letter, you raised a number of questions regarding the Commission's administration of the intrastate exemption granted under section 3(a)(1) of the Act. You also asked questions about a number of completed and proposed transactions in the utility industry. At my request, Paul Roye, the Director of the Division of Investment Management, and his staff have prepared the enclosed memorandum that provides the analysis requested in your letter regarding these and other issues.

I hope that the Division's memorandum is helpful to you and your colleagues. As with other issues involving the protection of investors, I welcome the opportunity to share our views on these matters. If you have additional questions or comments, please do not hesitate to contact me at 202/942-0100 or to contact Paul directly at 202/942-0720.

Sincerely,

Bill Donaldson

William H. Donaldson

Enclosure

cc: The Honorable Joe Barton

MEMORANDUM

March 4, 2004

To: Chairman William H. Donaldson

From: Paul F. Roye
Director, Division of Investment Management

Re: Letter of February 11, 2004 From Congressmen John Dingell and Edward Markey

On February 11, 2004, you received a letter from Congressmen John Dingell and Edward Markey asking various questions about the Commission's administration of the intrastate exemption provided by section 3(a)(1) of the Public Utility Holding Company Act of 1935. The Congressmen's letter broadly focuses on two separate issues: investments that are being made by a number of investment banking firms in the utility sector and the need to review various current claims of exemption made by utility holding companies under section 3(a)(1) of the Act. Staff in the Division of Investment Management have prepared this memorandum to assist you in answering these questions.

I. The Commission's Approach to Section 3(a)(1)

Much of the Congressmen's letter focuses on the proper approach to interpreting and administering the section 3(a)(1) exemption, particularly in light of the Commission's recent *Enron*[1] decision. In this section of the memorandum, we outline the Commission's historical approach to interpreting the section 3(a)(1) exemption and explain how we believe the *Enron* decision fits into that precedent.

A. The Commission's Historical Approach to Section 3(a)(1)

Section 3(a)(1) requires the Commission, "unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers" to exempt any holding company if:

> Such holding company, and every subsidiary company thereof which is a public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character and carry on their business substantially in a single State in which such holding company and every such subsidiary company are organized.[2]

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1 *See In the Matter of the Applications of Enron Corp.*, Holding Co. Act Release No. 27782 (Dec. 29, 2003) (hereinafter "*Enron*").

2 PUHCA § 3(a)(1), 15 U.S.C. § 79c(a)(1).

Historically, in reviewing a holding company's attempt to obtain this exemption, the Commission has looked solely at the holding company's place of incorporation, the place of incorporation of its utility subsidiaries, and the states in which its utility subsidiaries conduct business. The states in which the holding company's non-utility subsidiaries conduct business have traditionally not been considered. Indeed, under longstanding Commission precedent, holding companies exempt under section 3(a)(1) have a virtually unlimited ability to diversify into non-utility activities without any limitation on the geographical scope of those activities. The leading treatise on the regulation of utility holding companies states that "nonutility subsidiaries may be organized anywhere and . . . the holding company may itself engage in nonutility activities anywhere."[3]

This precedent goes back to the earliest days of the Commission's administration of the Act. Some of these early cases address whether a holding company's sale of a manufactured product in interstate commerce puts its exemption at risk. For example, in 1936, the Commission concluded that a company incorporated in South Carolina with a single utility subsidiary incorporated and operating in South Carolina did not lose its entitlement to the exemption because it engaged in interstate sales of textiles it manufactured through another subsidiary.[4] The Commission reached virtually identical conclusions in granting exemptions to the International Pulp Company[5] and the Copper Range Company.[6]

The early cases extend beyond the interstate sales of non-utility subsidiaries incorporated in the same state as the holding company and make clear that a holding company that owns non-utility subsidiaries that are incorporated in and operate in different states than the holding company may also claim an exemption under section 3(a)(1). Most notably, in 1937, the Commission granted an exemption to the Southeastern Indiana Corporation.[7] The company, which was incorporated in Indiana, owned a single public-utility subsidiary, which was also incorporated in and operating exclusively in Indiana. The company also owned a number of non-utility subsidiaries

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3 Douglas W. Hawes, *Utility Holding Companies* at 3-12 (1984 and Supp. 1987).

4 *In the Matter of Monarch Mills*, 1 S.E.C. 822 (1936). The Commission noted that "[t]he only interstate activities of the applicant are in connection with the sale of the textile products of its South Carolina plants. These sales are effected through New York commission merchants." *Id.* at 823. The Commission then rejected the notion that this "should prevent it from obtaining the exemption under Section 3(a)(1) to which it would otherwise be entitled." *Id.*

5 *In the Matter of International Pulp Co.*, 1 S.E.C. 906 (1936).

6 *In the Matter of Copper Range Co.*, 2 S.E.C. 61 (1937). In *Copper Range*, the Commission definitively stated that "this Commission has indicated in numerous cases that it does not deem that interstate activities in such non-public utility phases of its business should prevent the applicant from obtaining the exemption under Section 3(a)(1) to which it otherwise would be entitled." *Id.* at 62.

7 *In the Matter of Southeastern Indiana Corp.*, 2 S.E.C. 156 (1937).

incorporated in Indiana and Ohio that variously provided bus and telephone service in Indiana, Ohio and Kentucky. In granting the company's request for an intrastate exemption, the Commission stated that:

> [S]uch non-public utility (as defined in Section 2(a)(5)) activities of the applicant do not deprive it of its intrastate character so far as the public utility aspect of its business is concerned, and that so long as all of its public utility subsidiaries are organized under the laws of Indiana and confine their public utility business to that State, it will be entitled to the exemption provided by Section 3(a)(1).[8]

The *Southeastern Indiana* decision thus made it clear that utility holding companies could engage in non-utility activities through subsidiaries incorporated in any state without losing their intrastate exemption. During the 1940s and 1950s, the Commission granted intrastate exemptions to companies that engaged in substantial non-utility activities in other states. For example, in 1945, the Commission granted an intrastate exemption to a Kansas corporation that owned two public-utility subsidiaries that operated in Kansas and non-utility subsidiaries that, among other things, were incorporated in and provided telephone service in Arkansas, Kansas, Indiana, Missouri, New Jersey, Ohio and Pennsylvania.[9] The non-utility subsidiaries represented most of the company's business. The Commission found it clear "that such non-utility activities do not deprive [the applicant] of its intrastate character so far as the public utility aspects of its business are concerned."[10] Likewise, in 1955, the Commission granted an intrastate exemption to a Massachusetts corporation that owned a single public-utility subsidiary in Massachusetts but also owned subsidiaries, some incorporated in other states, that engaged in substantial coal mining operations (including activities related to the transportation and distribution of coal, and the conversion of the coal into gas and other products) throughout the eastern United States.[11] Neither the notice nor the order contains any substantial legal analysis of the claim for exemption, suggesting that both the Commission and the applicant thought granting the exemption to be non-controversial in spite of the applicant's substantial interstate, non-utility activities. The Commission

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8 *Id.* at 157.

9 *See In the Matter of United Utilities, Inc.*, Holding Co. Act Release No. 6045 (Sept. 14, 1945) (order approving the sale of certain utility assets in Colorado that might have caused the company to lose its entitlement to the intrastate exemption) ("Sale Order") and *In the Matter of United Utilities, Inc.*, Holding Co. Act Release No. 6162 (Oct. 25, 1945) (order granting exemption under section 3(a)(1)). The Sale Order makes clear that United Utilities' telephone operations produced over 75% of the holding company's gross revenues.

10 Sale Order, *supra* (citing *Southeastern Indiana Corp.).*

11 *See In the Matter of Eastern Gas & Fuel Associates*, Holding Co. Act Release No. 12786 (Jan. 25, 1955) (notice of application for an exemption under section 3(a)(1)) and Holding Co. Act Release No. 12807 (Feb. 28, 1955) (order granting exemption under section 3(a)(1)). According to the notice, the company owned subsidiaries in Massachusetts, Delaware, Virginia, Connecticut, Pennsylvania, West Virginia, New Jersey and, perhaps surprisingly, a collier incorporated in Liberia.

has uniformly applied this approach from the 1960s through the early years of this decade.

Given the language of section 3(a)(1), it might well have been within the Commission's discretion to decide these cases in a way other than it did, and confine the non-utility activities of exempt intrastate holding companies to the same state in which the holding company and its material utility subsidiaries were incorporated. Indeed, there are a few aberrational decisions in which the Commission rejected exemptions that seem to fall within this line of precedent.[12] However, the policy of not looking at the non-utility activities of a holding company when analyzing its claim to the intrastate exemption clearly goes back to the earliest days of the Commission's administration of PUHCA – a time when the individual commissioners who considered and decided these matters likely were familiar with the specific details surrounding the enactment of PUHCA and the goals that Congress was seeking to achieve through the Act.[13]

In the context of the goals of the Act, this approach makes sense. One of the overriding concerns of PUHCA is to give federal regulators jurisdiction over the utility operations of multistate holding companies that no single state can effectively regulate. In particular, PUHCA is meant to ensure that if a state does not have jurisdiction over both the holding company and the utility that does business in its state – a situation that will occur if the holding company is incorporated in a state different than that in which the utility subsidiary is incorporated – a federal regulator with access to all the holding company's books and records can step in to monitor and police affiliate transactions.[14] In general, the Commission has concluded that, where the holding company and all its

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12 *See Houston Natural Gas Corp.*, 3 S.E.C. 664 (1938). In *Houston Gas*, the Commission appropriately denied the applicant an exemption under section 3(a)(1) because, although all the applicant holding company's subsidiaries were incorporated in and operated exclusively in Texas, the holding company itself was incorporated in Delaware. *Id.* at 667. However, the decision includes a lengthy discussion in which the Commission opined that, because the company sold its securities in numerous states and sent interstate mail and made interstate telephone calls, it was not entitled to the intrastate exemption. *Id.* at 667-68. Literally applied, this analysis would deny the section 3(a)(1) exemption to virtually all companies – it is hard to comprehend how any company could conduct its business, whether today or in 1938, without engaging in some interstate administrative activities. The discussion in *Houston Natural Gas* is therefore better understood either as unpersuasive dicta or as an attempt by the Commission to explain why it mattered, for purposes of the statute, that the holding company and its utility subsidiaries were incorporated in different states.

13 Commissioners during this period included William O. Douglas, George Matthews and Robert Healy. James Landis was Chairman of the Commission from September 1935 through September 1937, the period during which the earliest of the cases establishing this precedent under section 3(a)(1) were decided.

14 "It is plain, therefore, that Congress directed the exemption under Section 3(a)(1) solely to holding companies organized in the same state as its subsidiaries; it purposely withheld that exemption from holding companies which control operating utilities in states other than its domicile . . . in order to assure necessary regulation not otherwise forthcoming." *In the Matter of Houston Natural Gas Corp.*, 3 S.E.C. 664, 667 (1938).

material utility subsidiaries are incorporated in the same state, this concern does not arise, and an exemption from PUHCA is warranted.[15]

B. The *Enron* Decision

In our view, the Commission's recent decision denying Enron an exemption under section 3(a)(1) is entirely consistent with the Commission's historical approach to interpreting and administering section 3(a)(1). As is well-known, prior to its bankruptcy, Enron was a very large holding company that owned a variety of businesses throughout the globe. Enron acquired Portland General, an electric utility incorporated in Oregon, as part of a merger with the utility's parent in 1997. At that point, Enron reincorporated itself in Oregon and claimed exemption under section 3(a)(1) of the Act pursuant to rule 2 under the Act. By early 2002, as a consequence of its bankruptcy filing, Enron was no longer able to make the financial filings required by rule 2, and thus filed an application seeking an order of exemption under section 3(a)(1).

The Commission ultimately denied Enron's application. None of the parties in the matter disputed that Enron engaged in non-utility activities throughout the world.[16] Rather, given that all parties agreed that both Enron and Portland General were incorporated in Oregon, the dispute between the parties focused on how Portland General's wholesale, out-of-state sales of electricity should be characterized for purposes of determining whether the utility was predominantly intrastate in character as well as how much weight should be placed on the fact that Portland General held interests in a generating plant and certain other utility assets located outside of Oregon.

In denying the application, the Commission also did not discuss or analyze the nature of Enron's non-utility businesses, their places of incorporation or the states in which they conducted business. Rather, the Commission's opinion focused exclusively on the nature and location of Portland General's utility operations. The Commission ultimately concluded that such a large percentage of Portland General's revenues were derived from out-of-state sales of electricity that the company was not, for purposes of section 3(a)(1), predominantly intrastate in character. In reaching this conclusion, the Commission noted that, among other things, "when a public utility engages in a large amount of out-of-state activity, there is a potential for the utility to escape effective regulation even if a state regulator controls the utility's in-state activity."

In sum, in focusing on the place of the utility's activities, rather than the place of the holding company's activities, the Commission's approach in *Enron* falls squarely

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[15] The Commission retains the authority under section 3 and rules 2 and 6 to revoke an otherwise-warranted intrastate exemption if doing so is necessary to protect the public interest or the interests of investors or consumers.

[16] Indeed, Enron's application for the exemption contained a detailed description of the worldwide extent of its non-utility activities. *See* Enron Corp., Form U-1 Application-Declaration under the Public Utility Holding Company Act of 1935, Item 1, Section I.A (Feb. 28, 2002) (available via EDGAR).

within its section 3(a)(1) precedent. Had the Commission intended to change the law by looking to the location of the holding company's activities, its decision would have been an easy one – as noted above, there was no dispute as to the fact that Enron's business activities, in contrast to Portland General's, took place predominantly outside of Oregon. Given the traditional approach employed by the Commission in *Enron*, we therefore believe that, in assessing applications for exemption under section 3(a)(1) of the Act, we should continue to focus on the state of incorporation of the holding company, the state of incorporation of its material utility subsidiaries and the location of the activities and sources of revenue of those utility subsidiaries. To the extent that other issues are relevant, we believe that these cannot be considered under the objective criteria of section 3(a)(1) itself, but rather pursuant to the separate language of section 3(a) that permits the Commission to deny a holding company an exemption to which it is otherwise entitled if it finds that the exemption would be "detrimental to the public interest or the interest of investors or consumers."[17]

II. Investments by Non-Utility Companies in Utilities

The Congressmen's letter also notes that, in the past year, investment banking firms and similar types of entities have announced an increasing number of investments in utilities and utility holding companies. In particular, the letter notes a proposal by Texas Pacific Group ("TPG") to invest in Portland General Electric and a similar proposal by Kohlberg Kravis Roberts & Co. L.P. ("KKR") to invest in UniSource Energy Group. The letter also notes KKR's existing investments in International Transmission Company and DPL Inc. The letter asks how transactions of this type have been analyzed under the Act and whether such investments are consistent with the Commission's recent denial of an exemption to Enron.

The *Enron* opinion, as discussed above, denied three requests for exemption made by Enron. The Congressmen's questions essentially ask whether exemptions should similarly be denied to companies making investments of the type outlined above. In order to address these questions, it is necessary to understand when a holding company requires an exemption under the Act. Accordingly, before discussing the investments and transactions identified in the Congressmen's letter, we provide an analysis of when a holding company is required either to obtain an exemption or to register under the Act.

A. Ownership Structures under Section 2(a)(7) of the Act

Section 2(a)(7) defines a holding company as:

> Any company which directly or indirectly owns, controls, or holds with power to vote, 10 per centum or more of the outstanding voting securities of a public-utility company or of a company which is a holding company....

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[17] We note that we vigorously review the non-utility activities of newly registered holding companies to ensure that they remain within the restrictions imposed by section 11(b) of the Act.

Notably, section 2(a)(7) does not directly address the ownership of a utility's or holding company's non-voting securities (such as debt securities or most types of limited partnership interests) and does not expressly require that ownership of such securities be included in an analysis of whether an entity falls within this part of the definition of holding company. However, the section does also give the Commission the authority to determine a "person" to be a holding company if, "after notice and opportunity for hearing," it concludes that the person has the ability:

> directly or indirectly to exercise (either alone or pursuant to an arrangement or understanding with one or more other persons) such a controlling influence over the management or policies of any public-utility or holding company as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that such person be subject to the obligations, duties, and liabilities imposed in this title upon holding companies.

The Commission thus has the necessary authority to examine all the facts that might suggest that someone controls a utility or utility holding company, including that person's ownership of the non-voting securities of the utility.

A company that either falls within this definition or is otherwise declared to be a holding company must either obtain an exemption pursuant to section 3 of the Act or register pursuant to section 5 of the Act. Thus, a key question for entities making investments in the utility sector is often whether, after making the investment, they will fall within the definition of holding company. If they conclude that their proposed investment will not result in their coming within the definition of holding company, they need not take further action (*i.e.*, either register under the Act or obtain an exemption from it), for the Act will not apply to them. Thus, a company in this situation will not need to show that it is entitled to any exemption from the Act or show that it meets the integration requirements of the Act or conforms to the limits that the Act places on the non-utility businesses and activities of a holding company.

The Commission has not addressed the meaning of section 2(a)(7) in recent years. The staff has, however, issued a number of no-action letters during the past ten years under section 2(a)(7). In these letters, the staff has agreed not to recommend enforcement action to the Commission for an entity's failure to register under the Act in situations in which the entity has acquired up to 9.9% of the voting securities of a utility or utility holding company and has also made a significant investment in the non-voting securities of the utility or utility holding company.

In analyzing requests of this type, the staff has carefully examined the rights attaching to the non-voting securities to ensure that ownership of those securities does not give the investor control over the utility. The staff has also examined the nature and identity of the other holders of the utility's voting securities in an effort to ensure that the investor does not indirectly control the utility through its control of these other holders (and, typically, that control is, in fact, exercised by the holder of the majority of the

voting interests). The most prominent example of this sort of no-action letter is the one issued to Berkshire Hathaway Inc. ("Berkshire") in 2000.[18]

In the Berkshire Hathaway letter, the staff agreed not to recommend any enforcement action in which it would seek to deem Berkshire Hathaway Inc. and certain subsidiaries that are consolidated with it for accounting purposes ("Berkshire Group") to be a holding company under section 2(a)(7) of the Act as a result of Berkshire's investment in MidAmerican Energy Holding Company ("MEHC'). MEHC, as a result of its ownership of MidAmerican Energy Company ("MidAmerican"), a public utility under the Act, was itself a holding company.[19] Specifically, the request to the staff for no-action relief (the "Request") stated that MEHC, an Iowa corporation, is a holding company that claims exemption under section 3(a)(1) of the Act by filing Form U-3A-2 pursuant to rule 2. MEHC has one indirect public-utility subsidiary, MidAmerican, also an Iowa corporation. MidAmerican is engaged in the generation, transmission and distribution of electric energy principally in Iowa and Illinois, and in the distribution of natural gas at retail in Iowa, Illinois, South Dakota and Nebraska. The Request states that, as explained in MEHC's Form U-3A-2, both MEHC and MidAmerican are predominantly intrastate in character and carry on their business substantially in Iowa.[20]

The Request described a proposed transaction in which 9.9% of the outstanding common stock of MEHC would be acquired by Berkshire Hathaway, with the remaining common stock being acquired by David L. Sokol, MEHC's Chairman and Chief Executive Officer; Gregory E. Abel, President and Chief Operating Office of MEHC; and Walter Scott, Jr., a current member of the Board of Directors of MEHC, together with his children and trusts for their benefit and other family interests (collectively with Mr. Scott, the "Scott Family Interests").[21] Berkshire also proposed to acquire (i) between $454.772 million and $800 million aggregate principal amount 11% Trust Issued Preferred Securities issued by a statutory trust to be formed and owned by MEHC ("Trust Securities"), and (ii) shares of Zero Coupon Convertible Preferred Stock ("Convertible Preferred Stock") of MEHC for an aggregate purchase price of approximately $1.22 billion.

At issue in the Request was whether, given the Berkshire Group's ownership of slightly less than 10% of the common (voting) stock of MEHC, the Convertible Preferred

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18 *See Berkshire Hathaway, Inc.*, S.E.C. No-Action Letter (March 10, 2000); *Evercore MTC Investment, Inc.*, S.E.C. No-Action Letter (November 25, 2003); *General Electric Capital Corp.*, SEC No-Action Letter (April 26, 2002); *kl Ventures*, SEC No-Action Letter (July 28, 2003); *SW Acquisition, L.P.* (April 12, 2000). *See also* the no-action letters cited in note 22, *infra*.

19 Analogously, the letter sought assurances that the staff would not recommend an enforcement action in which it would seek to deem MEHC or MidAmerican to be subsidiaries of the Berkshire Group under section 2(a)(8) of the Act as a result of Berkshire's investment in MEHC.

20 Request at 3.

21 Mr. Sokol, Mr. Abel and the Scott Family Interests are referred to collectively as the "Other Investors," and are referred to, together with the Berkshire Group, as the "Investors."

Stock constituted voting securities for purposes of the Act and thereby could potentially push Berkshire's ownership of voting securities over the 10% threshold. Additionally, the Request addressed whether exercising the rights granted to the Preferred Convertible Stock and those incident to ownership of 9.9% of the common stock under the factual circumstances described in the Request would result in the Berkshire Group's exercising such a "controlling influence" over MEHC and MidAmerican that the Commission would find it "necessary or appropriate in the public interest or for the protection of investors or consumers" to conclude that Berkshire was a holding company over MEHC and that MEHC and MidAmerican were subsidiaries of the Berkshire Group.

As noted above, under section 2(a)(7) of the Act, there is a presumption that ownership of 10% or more of voting securities creates a holding company/subsidiary relationship. Importantly, section 2(a)(17) of the Act defines "voting security" in pertinent part to mean "any security presently entitling the owner or holder thereof to vote in the direction or management of the affairs of a company." Conversely, ownership of less than 10% of the voting securities does not create such a relationship, unless the owner of the securities exercises such a controlling influence over the company in question that the Commission finds it necessary and appropriate to regulate the companies as a holding company and subsidiary company under the Act.

In the request, Berkshire argued that its proposed investment would not create a holding company relationship because the Berkshire Group would not own, control or hold with power to vote 10% of more of the outstanding voting securities of MEHC. Specifically, in addition to its common equity interest, Berkshire represented that its remaining equity interest in MEHC would be in the form of Convertible Preferred Stock that was not a voting security within the meaning of section 2(a)(17) of the Act. The Convertible Preferred Stock would not vote with the common stock and would not vote separately as a class, except to a limited extent. Berkshire also argued that the approval rights associated with the Convertible Preferred Stock were more limited than those associated with limited partnership interests that the Commission staff had previously agreed not to treat as voting securities in past grants of no-action relief.[22] In support of its request, Berkshire also provided a detailed description of the rights associated with the Convertible Preferred Stock.[23]

See, e.g., *Torchmark Corporation*, S.E.C. No-Action Letter (January 19, 1996); *Commonwealth Atlantic Limited Partnership*, S.E.C. No-Action Letter (October 30, 1991); *Nevada Sun Peak Limited Partnership*, S.E.C. No-Action Letter (May 14, 1991); *Colstrip Energy Limited Partnership*, S.E.C. No-Action Letter (June 30, 1988). *See also Western Resources, Inc.*, S.E.C. No-Action Letter (November 24, 1997) (board seats coupled with a large economic ownership interest do not by themselves create a holding company/subsidiary relationship within the meaning of the Act).

Specifically, "[t]he consent of a majority of the outstanding shares of Convertible Preferred Stock will be required . . . for any of the following (in each case referring to a transaction or series of related transactions):

Corporate financial matters –

The staff ultimately issued a no-action letter to Berkshire. In sum, the rights attendant to Berkshire's ownership of the Convertible Preferred Stock, combined with its ownership of 9.9% of the voting securities of MEHC and the nature of its relationship with the company, did not give it a degree of control over the company sufficient to require that Berkshire be declared a holding company. Based on our responses to other, similar requests for no-action relief, the staff has analyzed other proposed investments in the utility sector in a similar fashion.

B. Pending and Existing Investments in the Utility Sector

The Congressmen's letter asks how we would analyze other proposed investments

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- The making of capital expenditures outside the annual budget approved by the MEHC board, in each case for a consideration or involving expenditures in excess of $50 million (per transaction or series of related transactions, but otherwise not cumulatively);

- The issuance, grant or sale, or the repurchase, of any equity securities (or any equity-linked securities or obligations of MEHC (or securities convertible into or exchangeable or exercisable for any such equity securities);

Significant corporate transactions –

- The sale, lease, exchange, mortgage or other disposition (including any spinoff or split-up) of any business or assets having a fair market value of 25% or more of the fair market value of the business or assets of MEHC and its subsidiaries taken as a whole, the merger or consolidation of MEHC with any person, a liquidation, dissolution or winding-up of MEHC or any recapitalization or reclassification of the securities of MEHC;

- The acquisition of any business or assets (by way of merger, acquisition of stock or assets or otherwise);

Passive investment and structure of the company -

- Transactions with officers, directors, stockholders and affiliates of MEHC except (i) to the extent effectuated on terms no less favorable to MEHC than those obtainable in an arm's length transaction with an unaffiliated person or (ii) in the case of cash compensation arrangements, which are approved by the entire board of directors of MEHC (with the directors elected by the holders of the Convertible Preferred Stock having no separate veto right);

- The removal as CEO of MEHC of the person occupying that position (expected to be Mr. Sokol) on the date of closing of the merger (the "Initial CEO"); and

- The appointment or removal of any person as CEO of MEHC after the removal, resignation, death or disability of the Initial CEO (the consent of the holders of the Convertible Preferred Stock as to matters set forth in this clause not to be unreasonably withheld).

in utility companies under the Act, including proposed investments by TPG in Portland General and by KKR in UniSource. Neither of these transactions has been formally presented either to the staff or to the Commission for review. However, based on our reading of the descriptions of the proposed transactions in the press and elsewhere, it seems likely that these transactions will be structured in a way analogous to the investment structures in Berkshire Hathaway and other similar matters. Assuming that this proves correct, and that TPG's investment in Portland General, for example, is structured in a such a way that it is not a holding company under the Act, TPG would not be required to obtain an exemption under section 3(a)(1) or otherwise divest its other holdings in order to satisfy the requirements of the Act.[24] While we continue to believe investments of the type described in the Berkshire Hathaway Request are acceptable under the Act, and do not require that the investor either register or obtain an exemption under the Act, it is impossible to state how we will likely react to either TPG's proposed investment or KKR's proposed investment until they are presented for our review.[25]

The Congressmen's letter also asks for our views with respect to KKR's interests in DPL, a holding company that owns Dayton Power & Light, and International Transmission Company, a company that owns transmission assets in Michigan and is involved in developing transmission facilities elsewhere in the United States. While KKR did not seek the staff's or the Commission's approval of either of these

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[24] The Congressmen's letter specifically asks whether TPG's groups other activities would meet the standards of section 3(a)(1) and, if not, whether we believe that TPG is prepared to divest those interests to satisfy the requirements of the Act. We are aware that TPG has interests, some controlling, in a wide range of businesses, including the Burger King restaurant chain. As outlined above, were TPG to fall within the definition of holding company in section 2(a)(7), the Commission, under its existing precedent, would not consider those businesses in determining whether to grant the company an exemption. More broadly, were TPG to fail to meet the requirements of the exemption, and thus be required to register, it seems clear that these businesses would not be "functionally related" to its utility activities for purposes of section 11, and that the Act would require TPG to divest them. *See, e.g., E.On AG* Holding Company Act Release No. 35-27539 (analyzing E.On's other business and activities and requiring it to divest those not functionally related to its utility business). We assume that the potential complexity of these analyses and the risk that it might become necessary to divest a significant portion of its investment interests are among the reasons why an investor such as TPG structures its investments in utility businesses in a way not likely to lead to the conclusion that it is a utility holding company for purposes of section 2(a)(7).

[25] In each case, we believe that the Act will, in fact, require our review of the transaction in some fashion. First, because we believe that Enron is likely to register in the near future, its sale of Portland General must be reviewed under section 12(d) of the Act. Indeed, in Enron's pending application under the Act for the approval of various transactions necessary to implement its Plan of Reorganization, the company commits to seek separate approval for any sale or disposition of its interest in Portland General. Second, UniSource is a holding company that owns three public utility subsidiaries. Any person acquiring a greater than 10% voting interest in UniSource will therefore need to seek approval of the transaction under sections 9 and 10 of the Act. Saguaro Utility Group L.P. (of which KKR affiliates will be limited partners owning an approximate 62% interest) has announced that it will be seeking Commission approval for the transaction under the Act. The staff and Commission will thus have the opportunity to review each of these proposed transactions pursuant to the standards of the Act.

investments, we are aware from various public sources that affiliates of KKR own a 4.9% voting interest in DPL, along with unexercised warrants to purchase another 19.2% voting interest in DPL, and hold an approximate 66.5% limited partnership interest in the entity that effectively controls International Transmission Corp.[26] Based on this information, it seems likely that KKR has relied on the relative smallness of its current voting interest in DPL, and on its inability to run the day-to-day affairs of ITC as a limited partner, to conclude that it is not itself a holding company under the Act. We anticipate that we will carefully review KKR's interests in DPL and International Transmission as part of our review of any application we receive in connection with a proposed acquisition of UniSource and its three utility subsidiaries. A key part of that review will undoubtedly focus on whether KKR or its affiliates control any of these utility companies and, if so, whether KKR or some intermediate holding company should be required to register and become subject to the statutory requirements, including physical integration.

III. Review of Existing Exemptions Pursuant to Section 3(a)(1)

Finally, the Congressmen's letter notes that, in light of the *Enron* decision, it is an appropriate time for the Commission to review existing exemptions under section 3(a)(1) to determine whether the utility holding companies operating pursuant to that exemption continue to meet its requirements. The Congressmen request that we provide them with the results of any such review.

As described above, we do not believe that the Commission's decision in *Enron* changed the law regarding section 3(a)(1) in any material way. We have thus not engaged in any significant review of the business activities and locations of exempt holding companies' non-utility subsidiaries, as we believe that the Commission's precedent continues to state clearly that such activities are not relevant to the question of whether a particular holding company can claim exemption pursuant to section 3(a)(1). We likewise have not examined the non-utility business activities of companies that are not holding companies for purposes of the Act, as these companies are not required to obtain an exemption under the Act.[27] As the Commission's opinion makes clear, however, it is important for both the staff and the Commission to review exempt entities' compliance with the requirements of the exemption on a regular basis. We agree that it is important to conduct such reviews, and we do so.

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[26] The Staff has generally not considered limited partnership interests to be voting securities under the Act. *Supra* note 22

[27] Thus, for example, we have not examined the non-utility business activities of Berkshire Hathaway and its affiliates, as we currently have no reason to believe that Berkshire Hathaway is a holding company for purposes of the Act. As noted above, MEHC, the holding company for MidAmerican, does claim exemption pursuant to section 3(a)(1). As outlined below, MEHC makes an annual filing on Form U-3A-2, and we review that form to determine if it raises any questions with respect to MEHC's continuing ability to claim exemption under the Act.

Most importantly, utility holding companies that claim the 3(a)(1) exemption pursuant to rule 2 are required to file an annual statement on Form U-3A-2 . Those filings are due annually prior to March 1. As is the case every year, staff in the Division review these filings carefully to determine if they raise any questions as to any holding company's exempt status under the Act. In conducting these reviews, we focus most specifically on data regarding potential interstate sales of electricity at wholesale by the holding company's utility subsidiaries – the type of sales that were central in the *Enron* proceeding. We are committed to following up any concerns that we have based on these filings.

In addition to our review of the holding companies' annual filings on Form U-3A-2, staff in the Division are also analyzing ways in which Form U-3A-2 can be updated. In particular, the staff is analyzing ways to clarify the data requests on the form so that it will be more readily apparent if a holding company's utility subsidiaries are engaging in practices that may raise an issue concerning its continuing claim to exemption under the Act. We hope to recommend proposed form amendments to the Commission so that it can propose the necessary rule amendments and obtain comment from interested parties. We believe that such amendments will significantly improve the staff's and the Commission's ability efficiently and effectively to monitor exempt holding companies, and we thus are developing our proposal as quickly as possible.

Finally, the Congressmen's letter asks that we review the merger of Central and Southwest with American Electric Power pursuant to the test annunciated in *Enron*. We note, however, that following the merger, the new company registered under the Act. Since the merged company did not seek an exemption under the Act, the tests outlined in *Enron* are not applicable to it.[28] The District of Columbia Court of Appeals did, however, ultimately remand the merger to the Commission, concluding that the Commission had not adequately explained its conclusions that the two utilities were integrated and that they were in the same area or region.[29] We expect that the record in that matter will be reopened sometime this spring and that the Commission will reassess the permissibility of the merger shortly thereafter.

IV. Conclusion

I hope that the above provides an adequate explanation of how the staff is reviewing the various issues raised in Congressmen Dingell's and Markey's letter. We on the staff remain committed to administering and enforcing the Act in accordance with its statutory requirements as interpreted by the Commission. I would be pleased to meet with you, with Congressmen Dingell or Markey or with members of their staffs to explain further any of the issues addressed in this memorandum.

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[28] Indeed, prior to the merger, both companies were registered under the Act, and the resulting company remained registered.

[29] *See National Rural Electric Cooperative Ass'n v. SEC*, 276 F.3d 609 (D.C. Cir 2002).