121 FERC ¶ 61,060
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Morgan Stanley

Docket Nos. EC07-45-000
EC07-45-001
EC07-45-002

ORDER ON REQUEST FOR BLANKET AUTHORIZATIONS
UNDER SECTION 203 OF THE FEDERAL POWER ACT

(Issued October 18, 2007)

1. On December 29, 2006, as amended on May 15, 2007, and on August 15, 2007, Morgan Stanley and certain of its non-utility affiliates[1] (collectively, Applicants) filed an application seeking renewed Federal Power Act (FPA)[2] section 203(a)(2) blanket authorization for the acquisition, directly or indirectly, of securities[3] of electric utility companies, transmitting utilities or of any holding company in a holding company system

[1] Morgan Stanley's non-utility affiliates for purposes of this application are all of its subsidiaries except the following: Morgan Stanley Capital Group, Inc. (Capital Group); the four entities owned by Capital Group and authorized to sell power at market-based rates (Power Contract Finance, L.L.C., Power Contract Finance II, Inc., Power Contract Finance II, L.L.C., and Utility Contract Funding II, LLC); and the three entities in which Capital Group has ownership interests (Naniwa Energy LLC, South Eastern Electric Development Corp. and South Eastern Generating Corp.), which own and operate exempt wholesale generators (EWGs). The non-utility affiliates that are Applicants are described in Attachment D to the August 15, 2007 filing (Supplemental Filing).

[2] 16 U.S.C. § 824b (2000), *amended by* Energy Policy Act of 2005 (EPAct 2005), Pub. L. No. 109-58, §1289, 119 Stat. 594 (2005).

that includes an electric utility company or transmitting utility (collectively, Utilities), subject to certain proposed limitations. Applicants seek renewal, for three years, of those aspects of the temporary blanket authorization granted by the Commission (Current Authorization)[4] that have not been superseded by the Order No. 669 series.[5] Applicants also request section 203(a)(1) authorization for any electric utility company, transmitting utility, or any holder of utility voting securities to sell such securities to Applicants without prior Commission approval, subject to certain limitations.[6] In this order, we grant the request for certain blanket authorizations under section 203(a)(2), subject to certain conditions, deny the request for waiver of the ten percent limitation applicable to the blanket authorization granted under 18 C.F.R. § 33.1(c)(2)(ii), and dismiss the request for blanket authorization under section 203(a)(1), as discussed below.

2. On February 7, 2006, the Commission granted Morgan Stanley blanket authorization under section 203(a)(2) for a one-year period to acquire and hold an unlimited amount of voting securities in connection with its dealer/trader activities, fiduciary holdings, underwriting activities (subject to certain limitations), and hedging activities (subject to a commitment not to vote in excess of ten percent of such shares).[7]

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[3] For purposes of this order, the term "securities" is used consistent with the meanings and limitations given it in EPAct 2005.

[4] *Morgan Stanley*, 114 FERC ¶ 61,119 (2006), *reh'g denied*, 115 FERC ¶ 61,302 (2006).

[5] *Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006) (collectively, Order No. 669).

[6] Alternatively, Applicants request that the Commission confirm that Applicants' acquisitions of the passive investments in Utilities are within the scope of the blanket authorization granted under FPA section 203(a)(2) and require no further authorization under FPA section 203(a)(1). Response to Deficiency Letter at 3, n.10.

[7] *Morgan Stanley*, 114 FERC ¶ 61,119 (2006) (Current Authorization Order). The Current Authorization is based on the authorization given to The Goldman Sachs Group, Inc. in a companion order issued at the same time as the Current Authorization Order. *See The Goldman Sachs Group, Inc.*, 114 FERC ¶ 61,118 (2006) (Docket Nos. EL06-27-000 and EC06-38-000).

On December 29, 2006, Morgan Stanley submitted an application seeking renewal of its Current Authorization and also blanket authorization under section 203(a)(1).

3. On February 6, 2007, the Commission issued an order granting an interim extension of Applicants' Current Authorization pending Commission review of additional information and a further order of the Commission.

I. Background

A. Description of the Applicants

1. Morgan Stanley

4. Morgan Stanley, a holding company under the Public Utility Holding Company Act of 2005, is a financial services firm with subsidiaries and both utility and non-utility affiliates. Its wholly-owned subsidiary, Capital Group, and four subsidiaries of Capital Group have Commission authorization to sell power at market-based rates but are not Applicants. Applicants state that these subsidiaries do not own or control generation or transmission facilities, or a public utility with a franchised service territory. Capital Group has ownership interests in three subsidiaries that own and operate EWGs. Capital Group and certain affiliates are subject to regulation by the Commission as public utilities under the FPA.

5. Morgan Stanley describes its non-utility business as providing, among other things, investment banking services; securities underwriting and distribution; financial advisory services, including advice on mergers and acquisitions, restructurings, real estate and project finance. Morgan Stanley engages in selling, trading, financing and market-making activities in equity securities and related products, including securities futures products, fixed income securities and foreign exchange and commodities products. It also engages in real estate investment management, aircraft financing, benchmark indices and risk management analytics and research.

2. Non-utility Affiliates

6. Applicants state that Morgan Stanley's non-utility affiliates fall into one of four business segments: Institutional Securities; Global Wealth Management Group (GWMG); Asset Management Group; and Discover. Activities that Institutional Securities engages in include investment banking; sales, trading, financing and market-making activities; and other activities such as providing benchmark indices and risk management analytics and research to corporate and individual customers. GWMG's activities include retail brokerage accounts, investment advisory programs for separately managed accounts, mutual fund asset allocation programs, and GWMG discretionary

accounts.[8] Applicants state that Morgan Stanley conducts its asset management business mainly under the Morgan Stanley Investment Management and Van Kampen Brands (collectively, Asset Management Group). According to Applicants, the non-utility affiliates that are part of the Asset Management Group manage investment products, such as U.S. open- and closed-end registered investment companies, unit investment trusts, private investment funds and separately managed accounts. Applicants state that Discover issues credit cards that compete with other bank-issued credit cards, but that Applicants are not seeking section 203 blanket authorization for this business segment.

B. Request for Blanket Authorization

7. Applicants seek blanket authorization under section 203(a)(2) for Morgan Stanley and its non-utility affiliates to acquire and hold an unlimited amount of utility voting securities, subject to certain conditions. Applicants request that the Commission exclude certain utility voting securities to be acquired by Morgan Stanley under the requested blanket authorization from the ten percent limit set forth in 18 C.F.R. § 33.1(c)(2)(ii).[9] The Commission will treat this as a request for a waiver of the ten percent limitation applicable to the blanket authorization granted under the regulations. Applicants also seek blanket authorization under section 203(a)(1) for any electric utility company, transmitting utility, or holders of utility voting securities to sell such securities to Morgan Stanley or its non-utility affiliates.[10] Applicants also state that if Morgan Stanley

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[8] Applicants state that approximately 20 percent of GWMG's United States advisory assets are held in GWMG Discretionary Accounts in which clients can give their financial adviser or investment representative full investment discretion and, in some cases, proxy voting rights with respect to their accounts and that, as to GWMG, it is only requesting authorization under 203(a)(2) for the Discretionary Accounts activity. Response to Deficiency Letter at 9.

[9] *Id.* at 4-5.

[10] It is not clear that all of these transactions would require prior Commission approval under section 203(a)(1). The Commission stated in its recently issued Supplemental Policy Statement (which was issued after this application was filed) that it would presume that dispositions of less than ten percent of a public utility's securities would not constitute a change in control if: (1) after the transfer, the acquirer and its affiliates and associate companies, directly or indirectly, in aggregate will own less than ten percent of such public utility, and (2) the facts and circumstances do not indicate that such companies would be able to directly or indirectly exercise a controlling influence over the management or policies of the public utility. *FPA Section 203 Supplemental Policy Statement*, 120 FERC ¶ 61,060 at P 57 (2007) (Supplemental Policy Statement).

(continued)

subsequently seeks to add an entity to the list of applicants covered by this Application, Morgan Stanley will notify the Commission of that proposed entity's name.[11]

8. Specifically, Applicants seek blanket authorization under sections 203(a)(1) and 203(a)(2) for a period of three years to acquire an unlimited amount of utility voting securities in the following circumstances:

- When acting as a fiduciary on behalf of individual, corporate, and institutional customers;

- When such securities are provided as collateral for a loan or for purposes of liquidation in connection with an antecedent debt; and

- In connection with trading activities, including market-making customer facilitation and prime brokerage activities, the provision of trade execution services for customers, and in connection with its principal or proprietary trading or investing.[12]

9. Applicants state that they seek blanket authorization for the acquisition of "publicly- and privately-traded Utility Securities where such securities are not acquired for the purpose nor with the effect of changing or influencing the control of the public utility."[13] Applicants further state that "[a]cquisitions of publicly- or privately-traded Utility Securities for the purpose or with the effect of changing or influencing the control of the public utility are not covered by the Application."[14] In this regard, Applicants state that they seek authorization subject to the following conditions:

Applicants ask for the blanket authorization under section 203(a)(1) to avoid the need for a prior section 203 filing on behalf of a public utility for those investments where (arguably) a change of control could take place.

[11] Response to Deficiency Letter at 3, n.9.

[12] *Id.* at 3.

[13] *Id.* at 28.

[14] *Id.*

(i) Morgan Stanley will acquire and hold the utility voting securities in the ordinary course of business and as a passive investor (i.e., not to gain control of the Utilities);

(ii) Morgan Stanley will contemporaneously file Schedule 13Gs (if applicable to such utility voting securities) with the Commission as they do with the Securities and Exchange Commission (SEC);

(iii) Morgan Stanley will conduct independent assessments of the information barriers used to disaggregate the holding of certain business units within the Applicants for purposes of filing Schedules 13D and 13G;[15]

(iv) Morgan Stanley will maintain governing policies reasonably designed to prevent the non-utility affiliates from aggregating their respective security holdings in order to exercise control over any Utility without proper internal authorization and notification to the Commission, and will timely advise the Commission of any material change in the policies upon which this Application is based; and

(v) To the extent that any proposed transaction or change of investment purpose with respect to an existing passive investment entails an intent to or effect of exerting control over facilities subject to the Commission's jurisdiction, an application for Commission approval under section 203(a) will be filed.[16]

10. Applicants state that non-utility affiliates do not take controlling interests in unaffiliated utilities, and that certain regulatory regimes are in place to prevent such control. Applicants state that Morgan Stanley is subject to regulatory oversight by the SEC prohibiting the non-utility affiliates from aggregating securities to exercise control without proper authorization or disclosure. Applicants state that they disclose their

[15] Applicants state that Schedules 13D and 13G provide information concerning the acquiring person's intention and purposes with respect to the issuer of the security. The SEC requires the person acquiring a security to report investments undertaken with the intention of exerting control or with the effect of exerting control on Schedule 13D. However, Applicants note that in order to file a Schedule 13G, an investor must certify that the securities were not acquired for the purpose or with the effect of changing or influencing control over the issuer. Response to Deficiency Letter at 11.

[16] *Id.* at 4.

ownership of publicly traded securities on Schedule 13G because Morgan Stanley, in the majority of its businesses, acts as a passive investor, as defined by the SEC.[17]

11. Applicants also propose that for purposes of this application the Commission adopt the following definition for "passive investment:" The acquiring entity has a principal business other than producing, selling or transmitting electric power; and the acquiring entity did not acquire the interest for the purpose of, and by such acquisition, the acquiring entity did not have the effect of, managing, directing or controlling the issuers' day-to-day activities, such as conducting wholesale power activities, transmitting electric power in interstate commerce, or operating a Commission-jurisdictional entity.[18]

1. Investment Advisory Services, Funds and Accounts

12. Applicants state that the Asset Management Group and Morgan Stanley & Co. Incorporated (MS&Co.), in its capacity as investment adviser to the GWMG Discretionary Accounts, are registered investment advisors with the SEC and are regulated under the Investment Advisers Act of 1940 (Advisers Act).[19] Applicants state that the Asset Management Group and MS&Co., with respect to the GWMG Discretionary Accounts, are fiduciaries, and owe customers the duty to avoid or disclose conflicts of interest. They further state that as fiduciaries, the Asset Management Group and MS&Co., with respect to the GWMG Discretionary Accounts, generally have a duty to monitor and advise the customer regarding performance and material events affecting the underlying investments, including the duty to refrain from entering into securities transactions for personal gain that are inconsistent with client interests. For discretionary accounts, as circumstances may dictate, they may be obliged to initiate appropriate, affirmative action to advance the customer's interests.[20]

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[17] Applicants state that the SEC has set no bright lines as to what conduct may constitute an attempt to exercise control, but it has provided guidance that such conduct would include any activity designed to replace the issuer's management or influence the day-to-day operations of the issuer's business. *Id.* at 12.

[18] *Id.*

[19] 15 U.S.C. § 80b-1 *et seq.* (2000).

[20] Response to Deficiency Letter at 21.

13. Applicants state that the Asset Management Group manages three categories of investments: (1) registered investment companies;[21] (2) non-registered private investment funds; and (3) separately managed accounts for institutional and individual investors. Applicants state that the Asset Management Group is limited in the types of investment activities it can engage in based on the investment objectives, policies, and strategies of these investments. Additionally, Applicants state that such objectives, policies, and strategies are disclosed in the registration statement filed by a registered investment company with the SEC, the private offering memorandum issued by a private investment fund, and the investment advisory agreement between a client and the unit of the Asset Management Group managing the separate account.[22] Applicants state that the Investment Company Act of 1940 (1940 Act)[23] requires management contracts with each registered investment company to be renewed annually, and the board of directors or trustees has the right to terminate the management contract at any time, without penalty, with 60 days notice.[24] Also, Applicants state that the 1940 Act and the Advisers Act require Asset Management Group to manage its clients' investments as a fiduciary in the best interests of the client. Thus, Applicants contend that the Asset Management Group can only invest in accordance with the terms of the agreements entered into between itself and its clients and not for personal gain.[25] The Applicants state that from time to time circumstances may arise in which the best interest of the client requires Morgan Stanley to take a more active role in the governance or strategic direction of an issuer. In these limited circumstances the Morgan Stanley personnel responsible for the client would have to both obtain authorization from the client and obtain internal approvals including that of Morgan Stanley's Legal and Compliance Department before proceeding.[26]

14. Applicants state that, as to GWMG, the request for blanket authorization under 203(a)(2) applies only to the GWMG Discretionary Accounts. Applicants state that GWMG sponsors several other investment advisory programs, for which they do not seek

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[21] The Asset Management Group manages open-end and close-end U.S. registered investment companies (each, a registered investment company). *Id.*

[22] *Id.* at 21-24.

[23] 15 U.S.C. § 80a-1 *et seq.* (2000).

[24] Response to Deficiency Letter at 22.

[25] *Id.* at 21.

[26] *Id.* at n.30.

blanket authorization, including GWMG Advisory Accounts, Separately Managed Accounts, and mutual fund asset allocation programs. Applicants state that Morgan Stanley does not beneficially own or control securities held in the retail brokerage accounts, the Separately Managed Accounts, and the mutual fund programs, and that these security holdings do not trigger any obligations under PUHCA 2005 or FPA section 203 for Morgan Stanley. Therefore, Applicants state that the Application does not pertain to or request authorization concerning any securities held in such accounts or programs.

15. Applicants state that the Asset Management Group also sponsors unit investment trusts (UITs) through Van Kampen Funds, Inc., a registered broker dealer. Applicants state that the investment objectives and policies for the pool of securities are disclosed in a registration statement that the UIT files with the SEC.[27]

16. Applicants state that the regulatory regime that governs Asset Management Group and MS&Co. ensures that investments affecting control are not made without all proper disclosures and authorizations. Applicants state that the Asset Management Group and MS&Co. may only exercise control over companies in which they invest, consistent with their responsibilities as an adviser and fiduciary, as well as the investment policies and restrictions disclosed to and agreed upon by their clients.[28]

17. Further, Applicants state that Morgan Stanley has Investment Management Proxy Voting Policy and Procedures that provide guidelines on how the advisory entities of the Asset Management Group (Covered Entities) may vote proxies as part of its management of clients' accounts that provide for discretionary investment management services. Under this policy, the Covered Entities may only vote proxies in accordance with SEC regulations, fiduciary principles and in their clients' interests. Applicants also note that MS&Co. outsources to Institutional Shareholder Services (ISS), a third party that researches how a proxy should be voted for the GWMG Discretionary Accounts. Absent unusual circumstances, MS&Co. votes in a manner consistent with ISS's policy guidelines and vote recommendations. Thus, Applicants maintain that MS&Co.'s voting decisions with respect to shares held in the discretionary accounts are insulated from potential conflicts of interest.[29]

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[27] *Id.* at 23.

[28] *Id.* at 23-24.

[29] *Id.* at 30-31.

2. Accepting Collateral and Liquidating Previous Loans

18. With respect to securities held as collateral or for liquidation, as a matter of the terms of such security interest, Applicants assert they have no right to exercise control over the voting securities merely because such securities are pledged as collateral for a loan.[30]

3. Trading Activities

19. Applicants state that the sales and trading affiliates are subject to regulations by the SEC and self-regulatory organizations (SROs) that restrict their ability to exercise control over issuers of securities. Applicants state that sales and trading affiliates that are registered broker-dealers and all affiliates that trade securities and related products within the Sales and Trading aggregation unit are subject to regulation by the SEC under the Securities Act of 1933,[31] the 1934 Act,[32] and the Advisers Act. Applicants state that the Advisers Act requires non-utility affiliates that are broker-dealers and which exercise voting authority over client proxies to adopt policies and procedures reasonably designed to ensure that the sales and trading affiliate votes proxies in the best interests of clients.[33] Sales and trading affiliates are also required to disclose to clients information about those policies and procedures, and to disclose to clients how they may obtain information on how these affiliates have voted their proxies.[34]

20. Applicants state that such sales and trading affiliates are also subject to the rules of SROs, such as the National Association of Securities Dealers, Inc. (NASD), and the New York Stock Exchange (NYSE),[35] and are obligated to recommend investments to their clients based on the client's investment objectives, financial status and risk tolerance. Applicants state that with the exception of advisory accounts, the broker-dealers

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[30] *Id.* at 29.

[31] 15 U.S.C. § 77a (2000).

[32] 15 U.S.C. § 78a (2000).

[33] Response to Deficiency Letter at 24.

[34] *Id.*

[35] We note that in July 2007, the NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange were consolidated in a new organization, the Financial Industry Regulatory Authority (FINRA).

generally do not have, and cannot take, discretion over investment decisions, and each client of Morgan Stanley retains all investment making authority over all its accounts. Thus, Applicants state that these laws and rules prevent the broker-dealer affiliates from pursuing investment strategies in utility voting securities through non-discretionary brokerage accounts or through non-discretionary GWMG Advisory Accounts or acquiring or exercising control over a utility.[36]

21. Applicants state that they conduct broker-dealer and market-making activities primarily through MS&Co., which is a registered broker dealer and an investment advisor with the SEC. Applicants state that for purposes of Schedule 13G filings, the Sales and Trading aggregation unit includes Morgan Stanley's holdings and holding on behalf of clients in the GWMG Discretionary Accounts.[37] Applicants state that as registered broker-dealers with the SEC, certain of the non-utility affiliates in the Sales and Trading aggregation unit are subject to regulations by the SEC and rules promulgated by NASD and NYSE, as well as complying with fiduciary duties similar to those governing the Asset Management Group if registered as an investment adviser.

4. Aggregation Units and Informational Barriers

22. Morgan Stanley divides its non-utility affiliates into aggregation units: Asset Management, Sales and Trading, and Private Strategic Investment – as allowed by SEC regulations. Applicants state that filers of SEC Schedule 13G normally attribute security holdings to the parent for those business units under common control. However, Applicants state that the SEC allows a filer to divide its affiliates into aggregation units based on whether the affiliates exercise voting and investment powers over the securities independently from other affiliates. Applicants state that filers can demonstrate such independence by erecting "informational barriers" between affiliates pursuant to written policies and procedures reasonably designed to prevent the flow of information to and from the business units.[38]

23. Applicants state that Morgan Stanley's governing policy establishes information barriers between the three aggregation units to prevent the flow of information to and from other business units.[39] Applicants state that Morgan Stanley's policies and

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[36] Response to Deficiency Letter at 24-25.

[37] *Id.* at 18.

[38] *Id.* at 13-14, n.35.

[39] *Id.* at 14.

procedures satisfy the SEC's policy on disaggregation of security holdings.[40] Applicants state that Morgan Stanley's internal policy is reasonably designed to prevent communication of confidential and material non-public information across the barriers between the aggregation units absent compliance with Morgan Stanley's "Wall Crossing" procedure.[41] Applicants state that the information barriers (and the protocols and procedures by which Morgan Stanley implements and maintains them) separating the aggregation units are subject to SEC audit and inspection rights.[42]

24. Applicants explain that Morgan Stanley's Wall Crossing procedure is designed to prevent the misuse of inside information and to avoid conflicts of interest. In particular, Morgan Stanley prohibits its employees from trading, encouraging others to trade, or recommending securities of other financial instruments based on inside information under any circumstances. Morgan Stanley describes this information barrier as a "wall" that separates the employees of the non-utility affiliates on the public side from those on the private side.[43] Applicants state that each wall crossing is recorded with the Morgan Stanley Control Group, which serves as a buffer between the business units to control and coordinate communications between these areas and ensure applicable laws and rules are followed.[44] Further, Applicants state that these requirements apply to both publicly- and privately- traded securities.[45]

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[40] *Id.* at 13 (citing SEC Amendments to Beneficial Ownership Reporting Requirements, Release No. 34-39538, n.9 (Jan. 12, 1998) (1998 SEC Release).

[41] *Id.* at 14.

[42] *Id.* at 16.

[43] *Id.* at 19. Morgan Stanley states that "public side" means the status of employees who are not permitted in the normal course of their duties to receive, or have access to, inside information. "Private side" means the status of those employees who work in or for its investment banking division or who otherwise work in the same physical space and receive inside information in the normal course of their duties. Morgan Stanley states that public side and private side employees may only communicate inside information in accordance with Morgan Stanley's "Wall Crossing" procedure.

[44] *Id.*

[45] *Id.* at 20.

25. Applicants state that Morgan Stanley also reviews its aggregation units for compliance with applicable regulatory requirements and business objectives.[46] Applicants describe these reviews as including analysis of the business objectives of each of the aggregation units, the communications that occur among business unit employees, and analysis of whether Morgan Stanley needs to revise the configuration of the aggregation units or the information barriers, or both, that separate them to continue to reflect Morgan Stanley's on-going business needs. Additionally, Applicants state that its aggregation units are physically separated from each other or have communication policies to inhibit the flow of information. Applicants further state that Morgan Stanley has polices on physical and information barriers that create separations within the aggregation units.[47] Also, in accordance with SEC policy, Applicants state that the aggregation units were established with different officers, directors, and employees who were involved in the exercise of voting and investment powers.[48]

26. Applicants state that even though the information barriers allow the filing of Schedule 13G without regard to aggregate holdings across separated business units, Applicants are not prohibited from exerting aggregated voting interests under exceptional circumstances. Applicants commit that they will not rely on the blanket authority sought in their Application in circumstances involving acquisitions of public utility securities with an intent to exercise control over the issuer. In those circumstances, they commit to file an application for prior Commission approval under FPA section 203(a)(2).[49]

II. Notice of Filings

27. Notice of the application filed December 29, 2006 was published in the *Federal Register*, 72 Fed. Reg. 1,717 (2007), with interventions and protests due on or before January 19, 2007. None was filed.

28. Notice of Applicants' Response to Deficiency Letter was published in the *Federal Register*, 72 Fed. Reg. 30,582 (2007), with interventions and protests due on or before June 5, 2007. None was filed.

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[46] *Id.* at 16.

[47] *Id.* at 17.

[48] *Id.*

[49] *Id.* A public utility may also need to file an application under section 203(a)(1).

29. Notice of Applicants' Supplemental Filing was published in the *Federal Register*, 72 Fed. Reg. 49,708 (2007), with interventions and protests due on or before August 29, 2007. None was filed.

III. Discussion

30. Applicants request blanket authorization under FPA sections 203(a)(1) and 203(a)(2) to acquire unlimited amounts of utility voting securities under certain circumstances and conditioned on such ownership not conveying a right to control the jurisdictional activities of the issuer. We grant blanket authorization under section 203(a)(2), deny the request for a waiver of the ten percent limitation applicable to the blanket authorization granted under 18 C.F.R. § 33.1(c)(2)(ii), and dismiss the request for blanket authorization under section 203(a)(1).

A. Standard of Review Under Section 203

31. Section 203(a)(1) requires a public utility to obtain prior authorization for a disposition of its jurisdictional facilities effected through a sale of its assets or a change in control over jurisdictional facilities resulting from a disposition or acquisition of securities. Section 203(a)(2) requires prior Commission authorization for holding companies to acquire certain securities with values in excess of $10 million of transmitting utilities, electric utility companies or holding companies containing such entities.

32. Section 203(a)(4) of the FPA provides that the Commission must approve a jurisdictional transaction if it finds that the transaction "will be consistent with the public interest."[50] The Commission's analysis of whether a section 203 transaction is consistent with the public interest generally involves consideration of three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.[51] In addition, the

[50] 16 U.S.C. § 824b (2000), *amended by* EPAct 2005, Pub. L. No. 109-58, § 1289, 119 Stat. 594, 982-83 (2005).

[51] *See Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (1996), FERC Stats. & Regs., Regulations Preambles July 1996-Dec. 2000 ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement); *see also Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, 65 Fed. Reg. 70,983 (2000), FERC Stats. & Regs., Regulations Preambles July 1996-Dec. 2000 ¶ 31,111 (2000), *order on reh'g*,

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Commission must determine that the transaction "will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest."[52] The Commission's regulations establish verification and informational requirements for applicants that seek a determination that a transaction will not result in inappropriate cross-subsidization or pledge or encumbrance of utility assets.[53]

B. Blanket Authorization Under Section 203(a)(1)

33. Relying on the Commission's decision in *Capital Research Management Company*,[54] Applicants request authorization under 203(a)(1) for any electric utility company, transmitting utility, or any holder of utility voting securities to sell such securities to Applicants without prior Commission approval, subject to certain limitations. Essentially, like *CRMC*, Applicants request blanket authority under section 203(a)(1) on behalf of unknown public utilities for Applicants' securities acquisitions, to the extent that such acquisitions could be deemed to accomplish a disposition of jurisdictional facilities.

34. We dismiss the request for blanket authorization under section 203(a)(1). While the Commission granted *CRMC*'s request for blanket authorization under 203(a)(1), we have since clarified that transactions that do not transfer control of a public utility or jurisdictional facilities do not fall within the "or otherwise dispose" language of section 203(a)(1)(A) and thus do not require approval under 203(a)(1)(A).[55] With the conditions we impose in granting Applicants' request for section 203(a)(2) authorization, we find that the proposed transactions will not result in the change in control of a public utility or jurisdictional facilities, or the sale, lease or merger of a public utility or jurisdictional

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Order No. 642-A, 66 Fed. Reg. 16,121 (2001), 94 FERC ¶ 61,289 (2001); *see also* Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005).

[52] 16 U.S.C. § 824b(a)(4) (*amended by* EPAct 2005).

[53] 18 C.F.R. § 33.2 (2007).

[54] *Capital Research and Management Co.*, 116 FERC ¶ 61,267 (2006) (*CRMC*).

[55] FPA section 203 Supplemental Policy Statement at P 37.

facilities.[56] Therefore, we dismiss, as unnecessary, Applicants' request for authorization as to 203(a)(1).

C. Blanket Authorization Under Section 203(a)(2)

1. Effect on Competition

a. Applicants' Analysis

35. Applicants state that the proposed authorizations will have no adverse effect on competition because the transactions will not result in control over a public utility. Applicants state that fiduciary holdings are managed solely in the interests of the beneficial owners and not in the interest of the fiduciary. Further, Applicants state that the authorizations involve passive investors and passive investments, and thus would not convey control of day-to-day operations of jurisdictional facilities. Applicants state that any utility voting securities held as part of dealer or trading activities generally are transitory interests and are not segregated, so the holder does not have the ability or incentive to exercise control over the issuer.[57] In addition, Applicants state that its non-utility affiliates will not acquire horizontal or vertical market power as a result of the proposed authorizations because the interests they acquire will not entail transfer of control over generation or transmission facilities. Thus, Applicants assert that granting the blanket authority will have no adverse effect on competition.

b. Commission Determination

36. We find that Applicants' representation concerning the purpose of their investments, as supported by their compliance with the regulations described above, in conjunction with the proposed conditions as modified herein, provide assurance that the proposed transactions will not result in a change in control over a public utility or jurisdictional facilities.

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[56] We note that the proposed transactions do not implicate sections 203(a)(1)(C) or 203(a)(1)(D), which apply to public utilities' acquisitions of public utility securities and generating facilities.

[57] Response to Deficiency Letter at 39-40.

(1) Investment Advisory Services, Funds and Accounts

37. Our determination regarding the fiduciary activities of Asset Management Group and GWMG Discretionary Accounts relies upon Applicants' representations regarding limits imposed by the SEC under the Advisers Act and 1940 Act in terms of the types of investment activities that can be engaged in, based on the investment objectives, policies, and strategies of these investments. This information must be disclosed in a registration statement, the private offering memoranda, or the investment advisory agreements. Applicants must also comply with the 1940 Act which mandates provisions in management contracts to potentially limit the duration of the contract by the board of directors or trustees, and also imposes fiduciary duties on the Asset Management Group. Applicants must also comply with Morgan Stanley's Investment Management Proxy voting Policy and Procedures which ensure that voting is in compliance with SEC regulations.

38. With respect to GWMG Discretionary Accounts, MS&Co. outsources to a third party, ISS, the research on how a proxy should be voted. Applicants state that absent unusual circumstances, MS&Co. votes in a manner consistent with ISS's policy guidelines and vote recommendations. We rely on this representation as support that MS&Co. is insulated from potential conflicts of interest, and therefore is not exercising control over the GWMG Discretionary Accounts. We will require MS&Co. to document the instances in which it does not vote in accordance with ISS, the reason for the decision not to do so, and the vote that was cast in these circumstances. We further require MS&Co. to retain these records for a period of five years.

39. However, our order is premised, in part, on our understanding that investment advisors subject to the Advisers Act must maintain detailed books and records of securities and trades and holdings on behalf of their clients for a period of not less than five years.[58] In addition, registered investment companies subject to regulation under the 1940 Act are required by SEC regulations to maintain detailed records of securities transactions and portfolio holdings permanently.[59] Our approval is based on the condition that the Applicants will continue to follow the SEC recordkeeping requirements as they currently exist or may change from time to time, and that failure to follow those requirements will constitute a violation of this Commission's order.

[58] *See* 17 C.F.R. § 275.204-2 (2007).

[59] *See id.* at §§ 270.31a-1, 270.31a-2.

(2) Accepting Collateral and Liquidating Previous Loans

40. We will grant the request to hold unlimited amounts of securities held as collateral for a loan subject to the condition that the authorization confers no control over the issuer on the Applicants. However, with respect to securities obtained through liquidation in connection with an antecedent debt, we grant authorization to hold those securities under the same conditions applicable to authorizations for such holdings by banks pursuant to 18 C.F.R. §§ 33.1(c)(9)(iii) and (iv). Therefore, securities held as a result of such a liquidation: (1) may not be held for a period of more than two years; (2) the holding of the securities does not confer a right to control,[60] positively, or negatively, the operations through debt covenants or any other means, the operation or management of the public utility or public utility holding company, except as to customary creditor's rights or as provided under the United States Bankruptcy Code; and (3) the holder files with the Commission on a public basis and within 45 days of the close of each calendar quarter, as a separate filing regarding utility securities obtained through liquidation in connection with a loan, both its total holdings and its holdings as principal, each by class, unless the holdings within a class are less than one percent of outstanding shares, irrespective of the capacity in which they were held. Moreover, we will hold Applicants to their commitment to file an application under section 203 if Morgan Stanley forecloses on a security interest that results in an acquisition of control.[61]

(3) Trading Activities

41. As discussed above, the sales and trading affiliates are subject to regulations by the SEC and SROs that restrict their ability to exercise control over issuers of securities. Applicants assert that the Advisers Act requires non-utility affiliates that are broker-dealers and which exercise voting authority over client proxies to adopt policies and procedures reasonably designed to ensure that the sales and trading affiliate votes proxies in the best interest of clients.[62] Sales and trading affiliates are also required to disclose to clients information about those policies and procedures, and to disclose to clients how

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[60] In keeping with the Commission's decision in *Baltimore Refuse Energy Systems Company*, if a bankruptcy or foreclosure proceeding could cause the holder to acquire control, such acquisition requires prior Commission authorization under section 203(a)(1). 40 FERC ¶ 61,366, at 61,118, n.11 (1987).

[61] Response to Deficiency Letter at 30.

[62] *Id.* at 24.

they may obtain information on how these affiliates have voted their proxies.[63] Our determinations here are also based on Applicants' representations that Morgan Stanley's sales and trading affiliates are also subject to the rules of SROs, such as the NASD, and the NYSE, and are obligated to recommend investments to their clients based on the client's investment objectives, financial status and risk tolerance.

42. In a companion order issued today in *The Goldman Sachs Group, Inc.*,[64] Goldman Sachs requested similarly unlimited authority to acquire and hold public utility securities in its capacity as a designated specialist. It appears that Applicants refer to the same function as a "market maker" without providing further explanation.[65] Our determination regarding securities acquired through Applicants' activities as a designated specialist or market-maker is conditioned on Applicants' filing of Schedule 13G with respect to the securities acquired, the existence of aggregated units and compliance with related policies. In addition, the authorization in *Goldman* is conditioned on each market maker also being subject to oversight and audit of its trading activities pursuant to its "dealer of last resort" responsibilities by the SEC and various exchanges. This oversight provides additional assurance that the securities will not be obtained to exercise control of the public utility. Further, the Commission will be able to monitor the levels of public utility security acquisitions and holding by individual market makers through the Schedule 13G and quarterly reporting requirements and will also be able to monitor investment intent through the Schedule 13G and 13D filings.

43. With respect to Applicants' activities as a market maker, designated specialist, or its equivalent, authorization under section 203(a)(2) to acquire and hold an unlimited amount of public utility securities is granted, subject to the following conditions: each market maker must be subject to oversight and audit of its trading activities pursuant to its "dealer of last resort" responsibilities by the SEC and various exchanges; each market maker must file Schedule 13G and 13D filings with the Commission at the same time such filings are submitted to the SEC; and each market maker must file, no later than 45 days after the end of each quarter, with the Commission a separate report showing the

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[63] *Id.*

[64] 121 FERC ¶ 61,059 (2007) (Goldman Sachs).

[65] Although Morgan Stanley does not describe the restrictions on control required of market makers, we note that the term "market maker" is defined by statute, 15 U.S.C. § 78c(a)(38), and is subject to regulation by the SEC and rules by the stock exchanges, 17 C.F.R. § 240.11a1-5.

amount of public utility securities held as of the end of each quarter and as a percentage of the outstanding shares.

(4) Investment Activities as Principal

44. With respect to Private Strategic Investment, Applicants state that Morgan Stanley conducts other investment activities as principal for its own account, including certain non-utility affiliates, referred to in the Application as "Private Strategic Investment Affiliates."[66] The Commission has historically required transaction-specific approval for the acquisition of voting securities held as principal,[67] and more recently authorized blanket approval up to a ceiling of ten percent in the Commission's regulations in 18 C.F.R. § 33.1(c)(2)(ii).[68] Applicants have not provided sufficient evidence to support why they should not be subject to the ten percent limitation. Accordingly, we deny Applicants' request for unlimited blanket authority under section 203(a)(2) for Private Strategic Investment, and will grant blanket authority subject to the ten percent limitation.

(5) Conclusion

(i) Schedule 13G

45. The submission of Schedule 13G filings applies to all proposed transactions involving publicly-traded securities registered under section 12(b) of the 1934 Act. When any person acquires, directly or indirectly, beneficial ownership of five percent or more of any class of securities of a publicly-traded company, the person must file a disclosure report with the SEC on either a Schedule 13D or 13G.[69] Applicants state that

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[66] Response to Deficiency Letter at 18.

[67] *UBS AG, Bank of America, N.A.*, 103 FERC ¶ 61,284 (2003).

[68] 18 C.F.R. § 33.1(c)(2)(ii) (2007).

[69] Section 13(d) of the 1934 Act and 17 C.F.R. § 240.13d-1 *et seq.* "Beneficial owner" of a security is one who has voting or investment power. Under section 16, beneficial owners of ten percent or more of any class of security are required to disgorge any profits on "short-swing" trades, that is, purchases and sales made within a six-month period. In that provision, the definition of "beneficial owner" excludes broker-dealers, investment companies, investment advisers, and others who hold the securities for the benefit of third parties or in fiduciary accounts, as long as such securities are acquired without the purpose or effect of changing or influencing control over the issuer." 17 C.F.R. § 240.16a-1(a)(1) (2007).

non-utility affiliates disclose their ownership of securities on Schedule 13G in the ordinary course.[70] In order to qualify to file a Schedule 13G, the filer must be able to certify that it "has acquired such securities in the ordinary course of business and not with the purpose nor with the effect of changing or influencing the control over the issuer, nor in connection with or as a participant in any transaction having such purpose or effect."[71]

46. Applicants state that the disclosure of ownership on Schedule 13D is the exceptional circumstance because Morgan Stanley, in the majority of its businesses, acts as a "passive investor" as defined by the SEC.[72] We conclude that governing documents require an investment purpose or intent that does not include exercising control over the issuing utility except in unusual circumstances, in which case Morgan Stanley is required to file a Schedule 13D with the Commission, and if appropriate, obtain prior authorization from the Commission. Consistent with its representation, Applicants must file with the Commission any Schedule 13G or 13D filings made with the SEC that are relevant to the blanket authorization granted in this order.

(ii) Additional Considerations

47. Applicants state that they will notify the Commission if they seek to add a non-utility affiliate entity to the list of Applicants covered by this Application. Therefore, we conclude that, if the subsidiaries are substantially identical to entities authorized in this order and, therefore, are subject to the same restrictions on exercising control described above as are applicable to that kind of entity or to that activity authorized herein, the as-yet unidentified subsidiaries are authorized to engage in the proposed transactions authorized herein. For instance, an entity holding mutual funds must be registered with the SEC under the 1940 Act, and subject to Morgan Stanley's express statement that they are seeking this blanket authorization "for Applicants to acquire publicly- and privately-traded Utility Securities where such securities are not acquired for the purpose nor with the effect of changing or influencing the control of the public utility."[73] If the entity that

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[70] Response to Deficiency Letter at 11-12.

[71] 17 C.F.R. § 240.13d-1(b)(1)(i) (2007). "Control," as defined in the SEC's regulations, means "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise." *Id.* § 240.12b-2.

[72] Response to Deficiency Letter at 12.

[73] *Id.* at 28.

is proposed to be covered by the blanket authorization we grant here is not subject to restrictions on control, then a new application under section 203(a)(2) must be filed. Notice of a new entity to be covered by this blanket authorization, providing the name, functions, and regulatory safeguards as discussed in this order that are applicable to that entity, as well as a reiteration of Morgan Stanley's commitment to not acquire securities that will result in a transfer of control of a public utility, must be filed on a quarterly basis within 45 days of the end of the quarter.

48. Additionally, we find that Applicants' representation concerning the purpose of their investments, as supported by their compliance with the regulations described above, in conjunction with the proposed conditions as modified herein, provide assurance that the proposed transactions will not result in a change in control over a public utility. However, as stated in the Supplemental Policy Statement, we will not rely solely on Applicants' statements pursuant to SEC regulation.[74] Applicants have stated that "[i]n circumstances involving Utilities and…[Applicants'] intent to exercise control over the issuer, Morgan Stanley will not rely on the blanket authority sought by this application and an application for Commission approval under FPA section 203[(a)(2)] would be filed."[75]

49. Applicants describe Morgan Stanley's internal policies and procedures on information barriers and code of conduct, which apply to both publicly-traded and privately-traded securities, that are designed to prevent the non-utility affiliates from coordinating business activities that could lead to control over security issuers. Applicants represent that they follow established SEC guidelines regarding disaggregation of securities, maintain policies and procedures establishing information barriers between and among its aggregation units, and provide for inspection and assessment of such policies and procedures. We condition our authorization on the continued adherence to, and the continued existence of, these policies and procedures.

50. Additionally, in order for the Commission to monitor the proposed transactions for potential changes in control over public utilities, the Commission will continue to require Morgan Stanley to file quarterly reports for itself and its affiliates, by electric utility company, transmitting utility or holding company, within 45 days after the close of each calendar quarter disclosing: (1) holdings of voting securities acquired under the requested authorization and held as principal, and (2) total holdings of voting securities

[74] Supplemental Policy Statement at P 41 (*citing CRMC*, 116 FERC ¶ 61,267 (2006)).

[75] Response to Deficiency Letter at 17.

irrespective of the capacity in which such securities are held. The reports will be subject to a *de minimis* threshold of one percent.

51. Based on Applicants' representations and under the conditions we impose in this order, the Commission finds that the proposed transactions will have no adverse effect on competition because the transactions will not result in the consolidation of generation assets that would increase concentration in any relevant market, and they will not result in any combination of upstream or downstream assets that could create or enhance vertical market power. The authorizations granted in this order are subject to the condition that Applicants must not acquire control over a public utility whose securities they acquire.

2. Effect on Rates

a. Applicants' Analysis

52. Applicants state that the proposed transactions will not result in Morgan Stanley or any of its non-utility affiliates acquiring control over the jurisdictional activities of any electric utility company, transmitting utility, or holding company. Thus, Applicants assert that they will not have the ability to set or otherwise impact the rates of any such utility or holding company.[76]

b. Commission Determination

53. Applicants have shown that nothing in the Application indicates that rates to customers will increase as a result of the proposed transactions. Because Applicants represent that they will not acquire control over jurisdictional activities of any electric utility company, transmitting utility, or holding company, they will not be able to cause a change in rates. For this reason, we find that the proposed transactions will have no adverse effect on rates.

3. Effect on Regulation

a. Applicants' Analysis

54. Applicants state that their acquisition of utility voting securities will not result in a change in the activities or corporate structure of the utilities that will impact their jurisdictional status under the FPA or applicable state laws. Applicants state that entities currently subject to the Commission's or state jurisdiction will continue to be subject to

[76] *Id.* at 43.

such jurisdiction. Applicants add that it is not aware of any state regulatory jurisdiction over acquiring utility voting securities subject to the requested blanket authorization.[77]

b. Commission Determination

55. The Commission finds that neither state nor federal regulation would be impaired by the proposed transaction. As discussed above, the requested blanket authorization for the acquisition and disposition of securities will not result in a change of control of public utilities, and thus would not affect the Commission's or any state commission's ability to regulate the affected companies. We note that no state commission argued that the proposed blanket authorization would adversely affect its ability to regulate any affected company. Our review indicates that the proposed investments are in the ordinary course of an investment management business and not for the purpose of obtaining control of a public utility, and therefore should not affect the state commission's authority to regulate a public utility over which the commission has jurisdiction.

4. Cross-subsidization and Encumbrance of Utility Assets

a. Applicants' Analysis

56. Applicants state that no member of the Morgan Stanley family has any captive ratepayers and no corporate family member operates or controls a traditional public utility. Thus, Applicants assert that the acquisition of utility voting securities will not give them or their non-utility affiliates any ability to direct the utilities in which they hold an interest to cross-subsidize associated non-utility companies or encumber their assets.[78] Applicants state that the proposed transactions, at the time of the transaction or in the future, will not result in: (1) transfers of facilities between a traditional utility associate company with wholesale or retail customers served under cost-based regulation and an associate company; (2) new issuances of securities by traditional utility associate companies with wholesale or retail customers served under cost-based regulation for the benefit of an associate company; (3) new pledges or encumbrances of assets of a traditional utility associate company with wholesale or retail customers served under cost-based regulation for the benefit of an associate company; and (4) new affiliate contracts between non-utility associate companies served under cost-based regulation,

[77] *Id.*

[78] *Id.*

other than non-power goods and services agreements subject to review under sections 205 and 206 of the FPA.[79]

b. Commission Determination

57. We find that Applicants have demonstrated that they will not obtain control over any entity for which they acquire securities under the proposed transactions. Further, Applicants have provided adequate assurance that the proposed transactions under the blanket authorization will not result in cross-subsidization of a non-utility associate company or pledge or encumbrance of utility assets for the benefit of an associate company. The transactions under the blanket authorization do not involve transactions between public utilities with captive customers and their market-regulated or non-utility affiliates, and do not permit any control over utility rates or practices that may affect rates. Applicants do not, and will not as a result of the proposed transactions, control any franchised public utility assets.

The Commission orders:

(A) The prior extension of the Current Authorization in Docket No. EC07-45-000 on February 6, 2007 is hereby terminated as of the date of this order.

(B) Applicants' request for blanket authorization under FPA section 203(a)(1) is dismissed, as discussed in the body of this order.

(C) Applicants' request for blanket authorization under FPA section 203(a)(2) is granted for a period of three years from the date of this order, as discussed in the body of this order.

(D) Applicants' request for a waiver of the ten percent limitation applicable to the blanket authorization granted under 18 C.F.R. § 33.1 (c)(2)(ii) is denied.

(E) The foregoing authorization is without prejudice to the authority of the Commission or any other regulatory body with respect to rates, service, accounts, valuation, estimates, or determinations of costs, or any other matter whatsoever now pending or which may come before the Commission.

(F) Nothing in this order shall be construed to imply acquiescence in any estimate or determination of costs or any valuation of property claimed or asserted.

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[79] *Id.* at 40-41.

(G) Applicants are subject to audit to determine whether they are in compliance with the representations, conditions and requirements upon which the authorizations are herein granted and with applicable Commission rules, regulations and policies. In the event of a violation, the Commission may take action within the scope of its oversight and enforcement authority.

(H) The Commission retains authority under sections 203(b) and 309 of the FPA to issue supplemental orders as appropriate.

(I) Applicants shall file with the Commission contemporaneous with filing at the SEC the Schedule 13D and 13G filings that are relevant to the authorizations granted in this order. Any changes in the information provided on the initial Schedule 13G must be reflected in an annual amended filing due within 45 days of the end of each calendar year. Applicants shall file with the Commission any comment letter or deficiency letters received from the SEC that concern Schedule 13G-related compliance audits conducted by the SEC. Such filings shall be made in this docket or in appropriate sub-dockets of this docket.

(J) Morgan Stanley shall file with the Commission on a quarterly basis, within 45 days of the end of the quarter, the three separate reports as follows: (1) a report of holdings as a result of liquidations; (2) a report of holdings by a market-maker; and (3) a report of holdings as a fiduciary. Each report should list the holdings of the utility voting securities, stated in terms of the number of shares held and as a percentage of the outstanding shares.

(K) If a new entity is to be covered by this blanket authorization, Morgan Stanley must provide notice in a report with the name, functions, and regulatory safeguards applicable to that entity, as well as a reiteration of Morgan Stanley's commitment not to acquire securities that will result in a transfer of control of a public utility, on a quarterly basis, within 45 days of the end of the quarter.

(L) Applicants must inform the Commission, within 30 days, of any material change in circumstances that would reflect a departure from the facts, policies, and procedures the Commission relied upon in granting the request and specifying the terms and conditions under which the blanket authorization is set forth in section 33.1(c)(5) of the Commission's regulations will be available to them.

(M) Applicants shall retain the records of their transactions concerning public utility securities as required under the Advisers Act and the 1940 Act for five years.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.