

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF THE	)	
VANGUARD GROUP, INC. FOR A	)	CASE NO.
DECLARATORY ORDER REGARDING	)	2020-00209
INVESTMENT FUND OWNERSHIP	)	

ORDER

On July 6, 2020, Vanguard Group, Inc. filed an application requesting an Order declaring that it and its related entities (Vanguard Group) do not need to obtain prior Commission approval pursuant to KRS 278.020(7) for the acquisition of publicly traded voting securities in Kentucky jurisdictional utilities and their parent companies held by mutual funds that jointly own and operate the Vanguard Group. KRS 278.020(7), among other things, requires prior Commission approval of the direct or indirect control of a jurisdictional utility by an entity that owns 10 percent or more of the voting securities of a jurisdictional utility.

Specifically, Vanguard Group requests a declaratory order that (1) in the aggregate of all mutual funds managed by it, Vanguard Group may acquire up to 20 percent beneficial ownership of the outstanding voting securities of a Kentucky jurisdictional utility or its parent company without resulting in a change in utility control that requires Commission approval; (2) an individual mutual fund managed by Vanguard Group may acquire up to less than 10 percent ownership of the outstanding voting securities of a Kentucky jurisdictional utility or its parent company without resulting in a change in utility control that requires Commission approval; and (3) outstanding voting securities held by

mutual funds managed by a third-party independent of Vanguard may be excluded from the aggregate of mutual funds when applying the percentage limitations in evaluating jurisdictional utility ownership and control.

There are no intervenors in this proceeding. Pursuant to 807 KAR 5:001, Section 19(7), this matter is submitted for a decision based on the written record.

#### LEGAL STANDARD

In its application, Vanguard Group requests a declaratory order regarding the applicability of KRS 278.020(7) to acquisition of publicly traded voting securities in Kentucky jurisdictional utilities and their parent companies under a specific set of facts. KRS 278.020(7) provides, in relevant part, that:

No individual, group, syndicate, general or limited partnership, association, corporation, joint stock company, trust, or other entity (an "acquirer"), whether or not organized under the laws of this state, shall acquire control, either directly or indirectly, of any utility furnishing utility service in this state, without having first obtained the approval of the commission. Any acquisition of control without prior authorization shall be void and of no effect. As used in this subsection, the term "control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a utility, whether through the ownership of voting securities, by effecting a change in the composition of the board of directors, by contract or otherwise. **Control shall be presumed to exist if any individual or entity, directly or indirectly, owns ten percent (10%) or more of the voting securities of the utility. This presumption may be rebutted by a showing that ownership does not in fact confer control.**

*Emphasis added.*

Also relevant to this proceeding, the Commission issued a declaratory Order in a previous case<sup>1</sup> finding that an entity similar to Vanguard Group raised a rebuttable presumption of control when an increase to less than 20 percent of beneficial ownership<sup>2</sup> of the outstanding voting securities of a Kentucky jurisdictional utility did not in fact confer actual control under a specific set of facts, including the entity's passive investment policies and practices, compliance with Securities and Exchange Commission (SEC) rules regarding beneficial ownership, and commitments made to the Federal Energy Regulatory Commission (FERC).

### BACKGROUND

Vanguard Group, a Pennsylvania corporation, is registered with the United States Securities and Exchange Commission (SEC) as an investment advisor and transfer agent.<sup>3</sup> Vanguard Group is wholly and jointly owned by United States registered mutual funds and non-United States mutual funds, each of which is an independent legal entity owned by a separate group of shareholders (Vanguard Funds).<sup>4</sup> Vanguard Group represented that each Vanguard Fund portfolio is maintained on behalf of its shareholders for investment purposes, and not for the purpose of managing or controlling portfolio

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<sup>1</sup> Case No. 2015-00389, *Application of T. Rowe Price Associates, Inc. for a Declaratory Order Regarding the Acquisition of Common Stock* (Ky. PSC Mar. 14, 2016).

<sup>2</sup> As defined in Rule 13d-3 of the Securities Exchange Act of 1934, a beneficial owner owns a security through a contract or agreement, and has the power to vote, and/or power to trade or influence trading decisions regarding the security, although the legal title to the security is held by another person. 17 C.F.R. § 240.13d-3.

<sup>3</sup> Application at 2–4.

<sup>4</sup> *Id.* at 3, 5, and Exhibit 2 at 1–2. Vanguard Group, and its affiliates, provide corporate management, administrative, investment management, and distribution services to Vanguard Funds.

companies.<sup>5</sup> Further, each Vanguard Fund is governed by its own board of directors, each has its own investment objectives that are set forth in prospectus and statement of additional information, and no Vanguard Fund coordinates its investment strategy with Vanguard or any other Vanguard fund.<sup>6</sup>

Vanguard Group explained that there are two broad categories of Vanguard Funds. The preponderance of Vanguard Funds are Index Funds in which the investment portfolio matches the composition of a third-party financial market index, such as Standard & Poor's 500 Index.<sup>7</sup> Index Funds are managed with a passive investment strategy based upon mirroring the performance of the benchmark index with holdings that match the benchmark index, as opposed to an active management strategy based on the exercise of investment judgment and stock selection.<sup>8</sup> In contrast, a small portion of Vanguard Funds are Non-Index Funds that are actively managed based upon traditional methods of financial and market analyses, and investment judgment.<sup>9</sup>

Vanguard Group further explained that it serves as an investment advisor with the power to trade investments for all Index Funds (Vanguard Advised Funds), while Non-Index Funds are primarily managed by independent, third-party managers who have the power to trade and proxy voting responsibilities for those funds (Externally Advised Funds).<sup>10</sup> Vanguard Group stated that it does not have voting authority over Vanguard

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<sup>5</sup> *Id.* at 6, 10, and Exhibit 2 at 2.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 8.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* and Exhibit 2 at 2.

<sup>10</sup> *Id.* at 9, and Exhibit 2 at 2.

Advised Funds, but because it has trading authority through a contract or agreement, Vanguard Group is deemed a beneficial owner of Vanguard Advised Funds under securities law.<sup>11</sup> Vanguard Group stated that it is not deemed a beneficial owner of the Externally Advised Funds under securities law because it does not have trading authority or proxy voting power over Externally Advised Funds created through a contract or an agreement.<sup>12</sup> Vanguard Group asserted that because it does not have trading authority or proxy voting power, Vanguard Group does not have any power to influence trading decisions for Externally Advised Funds and thus does not exercise control over Externally Advised Funds or voting securities held by Externally Advised Funds.<sup>13</sup>

The portfolios of some, but not all, Vanguard Funds include voting securities in publicly traded entities that directly or indirectly control Kentucky jurisdictional utilities, including Duke Energy Corporation, parent of Duke Energy Kentucky, Inc.; American Electric Power Company, Inc., parent of Kentucky Power Company; PPL Corporation, parent of Kentucky Utilities Company and Louisville Gas and Electric Company; NiSource, parent of Columbia Gas of Kentucky, Inc.; and Atmos Energy Corporation. Currently, no single Vanguard fund holds 3 percent or more, and Vanguard Funds in the aggregate control less than 20 percent of the voting securities of any Kentucky jurisdictional utility or the parent company of a Kentucky jurisdictional utility.<sup>14</sup>

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<sup>11</sup> *Id.* at 11.

<sup>12</sup> *Id.* at 12.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 10, 18, 20–21.

Vanguard Group recently made the following commitments to the Federal Energy Regulatory Commission (FERC):<sup>15</sup>

1. Vanguard Group will not acquire beneficial ownership, in the aggregate, of equal to or more than 20 percent of the outstanding voting securities of any individual publicly traded utility.

2. Vanguard Funds will not acquire beneficial ownership of more than 10 percent of the outstanding voting securities of any publicly traded utility held in any individual Vanguard Fund.

3. Vanguard Funds will have beneficial ownership of the outstanding voting securities utilities in the ordinary course of business for investment purposes only without the purpose of changing or influencing control of said utilities or parent companies.

Vanguard Funds' publicly filed registration statements expressly state that the funds do not seek to acquire enough of a utility's voting securities to have control over a company's management decisions and do not invest for the purpose of controlling a company's management.<sup>16</sup>

Finally, Vanguard Group committed that if its investment policy changed and it sought to acquire control or influence control of any Kentucky jurisdictional utility or its parent company, Vanguard Group would provide notice to the Commission and obtain Commission approval pursuant to KRS 278.020(7) prior to any acquisition of control.<sup>17</sup>

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<sup>15</sup> *Id.* at 21, and Exhibit 2 at 3.

<sup>16</sup> *Id.* at 22 and Footnote 17. Footnote 17 contains a hyperlink to the Vanguard 500 Index Fund Statement of Additional Information (Statement of Additional Information). Commission Staff filed a copy of the Statement of Additional Information into the case record on August 3, 2020.

<sup>17</sup> *Id.* at 25.

## DISCUSSION

Vanguard Group asserted that it can rebut the presumption in KRS 278.020(7) that control exists from ownership of 10 percent or more of a utility's voting securities on the basis of external and internal limitations that prevent Vanguard from exercising control over Kentucky jurisdictional utilities. Vanguard Group pointed to SEC rules and orders from FERC as external limitations, and the general investment policy adopted by each Vanguard Fund as the internal limitations that demonstrate that beneficial ownership does not in fact confer control over the management and policies of Kentucky jurisdictional utilities.

Vanguard Group explained that, pursuant to SEC rules, any person who beneficially owns 5 percent or more of voting securities must file either a Schedule 13G or Schedule 13D with the SEC, based in part on whether the party intends to act as a passive investor or whether the party intends to exercise control over the target company.<sup>18</sup> Additionally, if a person's beneficial ownership equals or exceeds 20 percent of the outstanding securities, the beneficial owner is no longer eligible to file a Schedule 13G, because the SEC presumes there is intent to control and requires the beneficial owner to file a Schedule 13D.<sup>19</sup> The Schedule 13G filer acquires securities in the ordinary course of business and not with the purpose or effect of changing or influencing control.<sup>20</sup> A Schedule 13D filer acquires securities with the intention or purpose of controlling or influencing the target company's business.<sup>21</sup>

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<sup>18</sup> *Id.* at 18; and 17 C.F.R. § 240.13d-1.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

Here, Vanguard Group stated that it has been eligible to file a Schedule 13G because it is a passive investor in Kentucky jurisdictional utilities and that it will continue to be a beneficial owner eligible to file a Schedule 13G annually in the future.<sup>22</sup> Thus, Vanguard Group argued, SEC rules effectively prevent it from investing for the purpose of exercising control over Kentucky jurisdictional utilities.

Vanguard Group also asserted that commitments set forth in an order entered by FERC prevent Vanguard Group from exercising control over Kentucky jurisdictional utilities. On August 9, 2019, FERC issued an order (FERC Order) granting Vanguard Group, and its related entities, a blanket authorization to acquire voting securities of publicly traded utilities and utility holding companies.<sup>23</sup> FERC incorporated certain commitments made by Vanguard Group into the FERC Order, including a commitment that Vanguard Group will maintain its status as a beneficial owner eligible to file Schedule 13G. Vanguard Group argued that, as applied to this case, these commitments preclude it from taking actions that indicate intent to exercise control over Kentucky jurisdictional utilities, such as appointing members to the utilities' boards of directors, engaging in day-to-day management, or launching a proxy contest to influence a transaction.<sup>24</sup> Because the FERC Order requires Vanguard Group to maintain its eligibility as a Schedule 13G filer, and thus requires that Vanguard Group act as a passive investor, Vanguard Group

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<sup>22</sup> *Id.* at 18-19, 21.

<sup>23</sup> *Id.* at 20-21; and 168 FERC ¶ 62,081 (Aug. 9, 2019). The FERC Order was attached to the application as Exhibit 2.

<sup>24</sup> *Id.* at 21.



argued that the FERC Order prevented Vanguard Group from taking any actions with the intent or purpose of controlling Kentucky jurisdictional utilities.<sup>25</sup>

Last, Vanguard Group asserted that the general investment policy adopted by Vanguard Group and individual Vanguard Funds prohibit investing in companies for the purpose of exercising management or control.<sup>26</sup> According to the general investment policy and procedures governing its beneficial ownership of securities, Vanguard Group and Vanguard Funds do not invest with the purpose or effect of changing or influencing the control of a company.<sup>27</sup> Vanguard Group explained that it includes the following provision in Vanguard Funds' statements:<sup>28</sup>

**Investing for Control.** Each Vanguard fund invests in securities and other instruments for the sole purpose of achieving a specific investment objective. As such, a Vanguard fund does not seek to acquire, individually or collectively with any other Vanguard fund, enough of a company's outstanding voting stock to have control over management decisions. A Vanguard fund does not invest for the purpose of controlling a company's management.

In addition to the external and internal controls that limit Vanguard Group's ability to exercise control over Kentucky jurisdictional utilities, Vanguard Group made a commitment in its application that, if its investment policy changes and it seeks to acquire control or influence control of Kentucky jurisdictional utilities, Vanguard Group will provide notice to the Commission before taking action and will file an application for approval pursuant to KRS 278.020(7).

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<sup>25</sup> *Id.* at 20–21.

<sup>26</sup> *Id.* at 22.

<sup>27</sup> *Id.*

<sup>28</sup> Statement of Additional Information at B-13.

## FINDINGS

Having considered the record and being otherwise sufficiently advised, the Commission finds as follows:

1. Based upon Vanguard Group's general investment policies and practices set forth above, compliance with SEC rules, commitments made in the FERC Order, provisions in Vanguard Fund statements, and the commitment made to the Commission, Vanguard Group's beneficial ownership, in the aggregate, of the voting securities of Kentucky jurisdictional utilities and their parent companies meets the statutory definition in KRS 278.020(7) of a rebuttable presumption that control exists by acquiring 10 percent or more of the voting securities of a utility.

2. Because Vanguard Group provided substantial evidence that rebutted the presumption of control, which is permitted under KRS 278.020(7), Vanguard Group's beneficial ownership of less than 20 percent of outstanding voting securities of Kentucky jurisdictional utilities does not in fact confer actual control. Therefore, Vanguard Group may acquire and hold up to less than 20 percent ownership of a Kentucky jurisdictional utility's voting securities without resulting in a change in utility control requiring Commission approval pursuant to KRS 278.020(7).

3. Based upon the status of Vanguard Advised Funds as individual legal entities, each governed by its own board of directors, and the stated investment policies and practices set forth above, the provisions of KRS 278.020(7) are inapplicable to a single Vanguard Advised Fund with beneficial ownership of less than 10 percent of the voting securities of Kentucky jurisdictional utilities. Therefore, individual Vanguard Advised Funds may acquire and hold up to less than 10 percent ownership of a Kentucky

jurisdictional utility's voting securities without resulting in a change in utility control requiring Commission approval.

4. Based on the investment policies and practices set forth above, investment and proxy voting power for the Externally Advised Funds does not vest in Vanguard Group, but instead belongs to third-party managers, and thus the Externally Advised Funds are outside the control of Vanguard Group. Because Vanguard Group does not have direct or indirect ability to exercise control over Externally Advised Funds, the Externally Advised Funds may be excluded from consideration when aggregating Vanguard Funds' portfolios for the purposes of evaluating Kentucky jurisdictional utility ownership and control, or applying the percentage limitations set forth in KRS 278.020(7).

5. If there are changes to the Vanguard Group's or Vanguard Funds' investment policy, and Vanguard Group or Vanguard Funds seek to acquire control or influence control of Kentucky jurisdictional utilities, Vanguard Group should provide notice to the Commission before taking action and will file an application for approval of the acquisition pursuant to KRS 278.020(7).

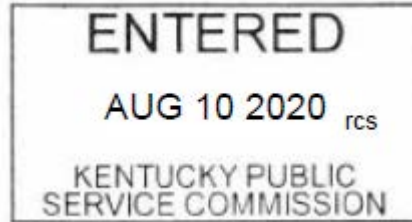
IT IS THEREFORE ORDERED that:

1. Vanguard Group's request for a declaratory Order, as set forth in its application, is granted.

2. If there are changes to Vanguard Group's investment policy and it seeks to acquire control or influence control of any Kentucky jurisdictional utility, Vanguard Group shall provide notice to the Commission and shall file an application for Commission approval pursuant to KRS 278.020(7) prior to the acquisition.

3. This case is closed and removed from the Commission's docket.

By the Commission



ATTEST:



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Acting Executive Director

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