

FEDERAL RESERVE SYSTEM

Fortis S.A./N.V.

Fortis, N.V.

Fortis Brussels S.A./N.V.

Fortis Bank S.A./N.V.

All of Brussels, Belgium

Order Approving Notice to Engage in  
Activities Complementary to a Financial Activity

Fortis S.A./N.V. (“Fortis”), a financial holding company (“FHC”) for purposes of the Bank Holding Company Act (“BHC Act”), Fortis, N.V., Fortis Brussels S.A./N.V., and Fortis Bank S.A./N.V. (collectively, “Fortis”) have requested the Board’s approval under section 4 of the BHC Act<sup>1</sup> and the Board’s Regulation Y<sup>2</sup> to provide energy management services (“Energy Management Services”) to owners of power generation facilities under energy management agreements (“EMAs”) as an activity that is complementary to the financial activities of engaging as principal in commodity derivatives and providing financial and investment advisory services for derivatives transactions.<sup>3</sup>

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<sup>1</sup> 12 U.S.C. § 1843.

<sup>2</sup> 12 CFR Part 225.

<sup>3</sup> In connection with its acquisition of Cinergy Marketing & Trading LP (“CMT”) from Duke Energy Corp., Fortis received approval to engage in the United States in physical commodity trading activities, on a limited basis, as an activity that is complementary to the financial activity of engaging in commodity derivatives activities. See Board Letter to David R. Sahr, Esq., dated September 29, 2006. In addition to its physical commodity trading activities, CMT, now Fortis Energy Marketing & Trading GP (“FEMT”), also serves as an energy manager under EMAs with several power generators. At the time Fortis’s request was approved, Fortis was informed that FEMT’s activities under the EMAs would continue to be reviewed for permissibility as an FHC activity.

## Background

Regulation Y permits bank holding companies (“BHCs”) (i) to act as principal in derivative contracts based on financial and nonfinancial assets (“Commodity Derivatives Activities”) and (ii) to provide information, statistical forecasting, and advice with respect to any transaction in foreign exchange, swaps, and similar transactions; commodities; and any forward contract, option, future, option on a future, and similar instruments (“Derivatives Advisory Services”).<sup>4</sup> Energy Management Services combine many of these permissible financial activities and other activities that the Board has not previously determined to be permissible for a BHC. Energy Management Services generally entail acting as a financial intermediary for a power plant owner to facilitate transactions relating to the acquisition of fuel and the sale of power by the power plant owner and providing advice to assist the owner in developing its risk-management plan.

The BHC Act, as amended by the Gramm-Leach-Bliley Act (the “GLB Act”), permits BHCs that qualify as FHCs to engage in an expanded set of activities that are defined by statute to be financial in nature,<sup>5</sup> as well as any additional activity that the Board determines, in consultation with the Secretary of the Treasury, to be financial in nature or incidental to a financial activity.<sup>6</sup>

The BHC Act also permits FHCs to engage in any activity that the Board determines is complementary to a financial activity and does not pose a

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<sup>4</sup> 12 CFR 225.28(b)(8) and (b)(6).

<sup>5</sup> 12 U.S.C. § 1843(k)(4). This set of financial activities includes any activity that the Board had determined to be closely related to banking, by regulation or order, prior to November 12, 1999. Commodity Derivatives Activities and Derivatives Advisory Services were determined to be closely related to banking before that date and, accordingly, providing those services are financial activities for purposes of the BHC Act. 12 U.S.C. § 1843(k)(4)(F).

<sup>6</sup> 12 U.S.C. § 1843(k)(1)(A).

substantial risk to the safety or soundness of depository institutions or the financial system generally.<sup>7</sup> The Congress intended that the Board use this complementary authority to allow FHCs to engage, on a limited basis, in activities that, although not necessarily financial in nature, are so meaningfully connected to financial activities that they complement those activities. In this way, FHCs would not be disadvantaged by market developments if commercial activities evolve into financial activities or competitors find innovative ways to combine financial and nonfinancial activities. The BHC Act provides the Board with exclusive authority to determine that an activity is complementary to a financial activity.

The BHC Act further provides that any FHC seeking to engage in a complementary activity must obtain the Board's prior approval. In reviewing such a proposal, the BHC Act requires the Board to consider whether performance of the activity by the FHC can reasonably be expected to produce public benefits that outweigh possible adverse effects.<sup>8</sup> The Board has approved physical commodity trading ("Physical Commodity Trading") for Fortis and other FHCs, on a limited basis, as an activity that is complementary to the financial activity of engaging in Commodity Derivatives Activities.<sup>9</sup>

Fortis currently engages in Commodity Derivatives Activities and Derivatives Advisory Services (as noted, both financial activities) in the

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<sup>7</sup> 12 U.S.C. § 1843(k)(1)(B).

<sup>8</sup> 12 U.S.C. § 1843(j)(2)(A).

<sup>9</sup> Board Letters to Gregory A. Baer, Esq., dated April 24, 2007 (Bank of America Corp.); Paul E. Glotzer, Esq., dated March 27, 2007 (Credit Suisse Group); and Elizabeth T. Davy, Esq., dated April 13, 2006 (Wachovia Corporation); and Société Générale, 92 Federal Reserve Bulletin C113 (2006); Deutsche Bank AG, 92 Federal Reserve Bulletin C54 (2006); JPMorgan Chase & Co., 92 Federal Reserve Bulletin C57 (2006); Barclays Bank PLC, 90 Federal Reserve Bulletin 511 (2004); UBS AG, 90 Federal Reserve Bulletin 215 (2004); and Citigroup Inc., 89 Federal Reserve Bulletin 508 (2003).

United States and has requested approval to provide Energy Management Services as an activity that is complementary to those activities.

#### Fortis's Energy Management Services

Under FEMT's current EMAs, FEMT, as energy manager, assists power plant owners by providing transactional and advisory services. The transactional services consist primarily of FEMT acting as a financial intermediary, substituting its credit and liquidity for those of the owner to facilitate the owner's purchase of fuel and sale of power. FEMT's advisory services include providing market information to assist the owner in developing and refining a risk-management plan for the plant.

FEMT provides services under an EMA within a strategic framework established by the owner. The owner, in consultation with FEMT, establishes an energy-management plan and risk-management policy to govern how the generation facility should be operated. The energy-management plan sets out the amount of power the plant should generate and determines how the plant will meet its reliability obligations to the power transmission grid. The plant owner must approve all commodity contracts, including all contracts for the purchase of fuel or the sale of electricity. In some cases, authority to enter into power or fuel contracts may be delegated to FEMT if the contracts satisfy specific criteria established by the owner; other contracts must be approved by the owner. The owner also maintains the right, subject to FEMT's right of first refusal, to market and sell power directly to third parties. The owner ultimately retains all decisionmaking authority, including decisions relating to the facility's generation output and, in particular, whether the facility should be shut down for any period of time.

An EMA's compensation structure reflects this allocation of responsibilities. When the facility is in operation, FEMT is typically compensated on a monthly basis at the greater of a monthly fixed fee or a stated percentage of

the spread between delivered fuel prices and the realized power revenues (adjusted to reflect certain fees and costs). When the facility is not in operation, FEMT is not responsible for the fixed costs of the facility and is not entitled to revenues or other compensation, apart from the monthly fees.

FEMT does not provide day-to-day operational services to the facility. Those tasks are generally performed by the owner or by an operator who is hired directly by the owner and is not affiliated with FEMT. The operator manages and maintains the facility on a daily basis, which typically includes providing labor and support services. The operator provides FEMT with information on the operating status of the facility, maintenance issues that might affect the availability of the facility to generate power, and scheduled outage and maintenance periods.

FEMT may buy fuel for the facility from third parties and enter into a mirror transaction for the fuel with the owner. The owner may then sell the power generated by the facility to FEMT, and FEMT generally resells the power in the market. In these circumstances, FEMT would be acting as the financial intermediary for the owner, providing credit and liquidity support, including posting any required collateral for transactions. Because FEMT substitutes its name and credit rating for the owner's, the terms of the transactions are generally more favorable than the owner could negotiate on its own.

In addition, FEMT assumes responsibility for administrative tasks related to the fuel and power transactions so that the owner does not have to maintain an administrative infrastructure to support its transactions with third parties. These services include arranging for third parties to provide fuel transportation or power transmission services, scheduling those services, and resolving any resulting imbalances; ensuring that fuel deliveries and power sales are properly coordinated; negotiating contracts with and monitoring the credit support and collateral requirements of the owner's counterparties; assisting in

complying with power tariffs; and paying fuel suppliers. FEMT also may enter into transactions with third parties as necessary to ensure that the owner meets its power generation obligations to the power grid in accordance with the energy-management plan.

FEMT may also provide risk-management and hedging services to the owner in connection with both the purchase of fuel and the sale of power. These transactions may be entered into with third parties back to back (with FEMT in the middle) or may be direct hedging transactions between the owner and FEMT in which FEMT retains the risk that the owner is hedging. In the first type of transaction, the owner would inform FEMT of its intention to hedge the price of fuel or power for a specified term, and FEMT would then solicit bids or offers. After reviewing the competing bids or offers, the owner would make a selection and direct FEMT to enter into the transaction with that counterparty. FEMT and the owner then would enter into a mirror transaction so that FEMT would not retain any risk exposure on the overall transaction. In the second type of transaction, FEMT would submit the offer for a hedging transaction to the owner, who can accept or reject the offer. If the owner accepts the proposal, FEMT may enter into the transaction directly with the owner. All these transactions would be governed by International Swaps and Derivatives Association master agreements between the owner and FEMT. The owner may also enter into hedging transactions directly with a third party without FEMT's involvement.

FEMT generally provides two types of market-information services to the owner. First, FEMT provides market and risk information to assist the owner in developing its risk-management plan and strategy. Because FEMT is a direct market participant, it has access to information that may help the owner refine its risk-management strategies. Second, FEMT provides the owner with day-to-day market information that the owner, in consultation with the operator of the power

facility, uses to determine its short-term dispatch guidelines (i.e., the amount of power the facility should generate to meet its contractual requirements and reliability obligations).

#### Energy Management as a Complementary Activity

For the reasons set forth below, the Board believes that Energy Management Services are complementary, within the meaning of the GLB Act, to the financial activities of Commodity Derivatives Activities and Derivatives Advisory Services. Energy Management Services would add to these financial activities a number of agency and administrative services that would facilitate providing Commodity Derivatives Activities and Derivatives Advisory Services on behalf of the plant owner. This combination of services would complement and enhance Fortis's Commodity Derivatives Activities and Derivatives Advisory Services by allowing Fortis to offer power plant owners an integrated approach to managing the commodity-related aspects of their business. Many owners need assistance in devising energy-management strategies and a market participant that can substitute its credit and liquidity for the owner's to facilitate transactions, and they would prefer to receive those services from a single source. Fortis also would gain additional information about energy markets in the course of providing Energy Management Services that would improve Fortis's ability to manage its own commodity risks and to advise its clients on their commodity-related activities.

A number of non-BHC participants in the energy trading markets, including diversified financial services companies, offer Energy Management Services to clients in connection with their commodity derivatives business. These companies can, and regularly do, provide Energy Management Services to owners. Permitting FHCs to provide these services in connection with their commodity derivatives business and commodity trading activities, therefore, would enable

FHCs to offer the same integrated services that are provided by a number of their competitors.

Based on the foregoing and all other facts of record, the Board concludes that Fortis's Energy Management Services complement its Commodity Derivatives Activities and Derivatives Advisory Services.

#### Risks and Public Benefits of Energy Management Services

As noted above, to authorize Fortis to provide Energy Management Services as a complementary activity under the GLB Act, the Board must determine that the activities do not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally. In addition, the Board must determine that the performance of Energy Management Services by Fortis "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."<sup>10</sup>

Moreover, the Board previously has stated that complementary activities should be limited in size and scope relative to an FHC's financial activities.<sup>11</sup>

Revenues attributable to FEMT's Energy Management Services have been small relative to Fortis's total revenues on a consolidated basis. To limit the size, scope, and safety and soundness risks of Energy Management Services, Fortis has committed that the revenues attributable to FEMT's Energy Management

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<sup>10</sup> 12 U.S.C. § 1843(j)(2)(A).

<sup>11</sup> See 68 Federal Register 68493, 68497 (Dec. 9, 2003); see also 145 Cong. Rec. H11529 (daily ed. Nov. 4, 1999) (Statement of Chairman Leach) ("It is expected that complementary activities would not be significant relative to the overall financial activities of the organization.").



Services will not exceed 5 percent of Fortis's total consolidated operating revenues.<sup>12</sup>

Fortis's authority to provide Energy Management Services is subject to several conditions that limit the responsibilities and potential liabilities Fortis may assume under an EMA. Specifically, Fortis may only act as energy manager if the relevant EMA provides that:

- The owner retains the right to market and sell power directly to third parties, which may be subject to the energy manager's right of first refusal;
- The owner retains the right to determine the level at which the facility will operate (i.e., to dictate the power output of the facility at any given time);
- Neither the energy manager nor its affiliates guarantee the financial performance of the facility; and
- Neither the energy manager nor its affiliates bear any risk of loss if the facility is not profitable.

Permitting Fortis to engage in Energy Management Services in the limited amounts and situations described above would not appear to pose a substantial risk to Fortis, depository institutions, or the U.S. financial system generally. As an energy manager, Fortis would enter into the same type of commodity derivatives transactions that it is permitted to enter into currently, only it would enter into these transactions to facilitate the business strategies of a third-party owner. Through its existing authority to engage in Commodity Derivatives Activities, Fortis already may incur the price risk of commodities. Allowing Fortis to expand its activities to enter into back-to-back commodity transactions in connection with advice given as part of its Energy Management

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<sup>12</sup> Total operating revenues are defined as net interest income and all non-interest revenue, including net securities gains but excluding extraordinary items.

Services would not appear to increase its potential exposure to commodity price risk but only to counterparty risk. Granting Fortis the authority to act as an energy manager also would not expand its ability to engage in Physical Commodity Trading beyond what has been authorized by the Board. The potential safety and soundness risks of entering into these transactions are already mitigated by the limits imposed on Fortis's Commodity Derivatives Activities and Physical Commodity Trading by regulation and order.<sup>13</sup>

In addition, Fortis would remain subject to the securities, commodities, and energy laws and to the rules and regulations (including the anti-fraud and anti-manipulation rules and regulations) of the Commodity Futures Trading Commission and the Federal Energy Regulatory Commission generally and specifically to the extent applicable to Fortis's Energy Management Services.

The advisory services Fortis would provide under the EMAs also would not expose it to significant additional risks. The added risk to Fortis from providing these services would principally be legal and reputational risks that are generally present in any contractual relationship. Because Fortis would assume specific responsibilities under an EMA, it could be subject to claims for breach of contract if it fails to perform its duties under the contract or does so in a negligent fashion (e.g., by providing bad advice).

The Board believes that Fortis has the managerial expertise and internal control framework to manage the risks of providing Energy Management Services. Fortis has shown it has the expertise and internal controls necessary to

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<sup>13</sup> The scope of Fortis's Commodity Derivatives Activities is limited by the restrictions in 12 CFR 225.28(b)(8)(ii) and its Physical Commodity Trading is limited by its commitment to the Board that the market value of commodities it holds as a result of these activities will not exceed 5 percent of its consolidated tier 1 capital and by several other commitments designed to address potential risks associated with the activities.

effectively integrate the risk management of Energy Management Services into its overall risk-management framework.

As noted above, to approve this proposal, the Board must find that the public benefits from Fortis's performance of these services outweigh the potential adverse effects, such as undue concentration of resources, decreased or unfair competition, or conflicts of interests. Approval of the proposal would likely benefit Fortis's customers by enhancing its ability to provide efficiently a full range of commodity-related services consistent with existing market practice. Approval would likely enable Fortis to improve its understanding of physical commodity and commodity derivatives markets and its ability to serve as an effective competitor in those markets.

The Board has considered the market for Energy Management Services and the potential adverse effects arising from Fortis's provision of those services. Fortis's Energy Management Services should not result in an undue concentration of resources or other adverse effects on competition because the market for Energy Management Services is regional or national in scope. Any potential conflicts of interests associated with Fortis's Energy Management Services should be mitigated by the anti-tying provisions in section 106 of the Bank Holding Company Act Amendments of 1970.

For these reasons, and based on Fortis's policies and procedures for monitoring and controlling the risks of Energy Management Services, the Board concludes that consummation of the proposal does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally and can reasonably be expected to produce benefits to the public that outweigh any potential adverse effects.

Conclusion

Based on all the facts of record, including the representations and commitments made by Fortis to the Board in connection with the notice, and subject to the terms and conditions set forth in this order, the Board has determined that the notice should be, and hereby is, approved. The Board's determination is subject to all the conditions set forth in Regulation Y and to the Board's authority to require modification or termination of the activities of a BHC or any of its subsidiaries as the Board finds necessary to ensure compliance with, or to prevent evasion of, the provisions and purposes of the BHC Act and the Board's regulations and orders issued thereunder. The Board's decision is specifically conditioned on compliance with all the commitments made in connection with the notice, including the commitments and conditions discussed in this order. The commitments and conditions relied on in reaching this decision shall be deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

By order of the Board of Governors,<sup>14</sup> effective December 4, 2007.

*(signed)*

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Robert deV. Frierson  
Deputy Secretary of the Board

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<sup>14</sup> Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.