January 27, 2000

By letter dated January 14, 2000, you request our assurance that we would not recommend that the Commission take any enforcement action under Section 7 of the Investment Company Act (the “1940 Act”) if Pengrowth Energy Trust (“Energy Trust”) treats its subsidiary, Pengrowth Corporation (the “Operating Company”), as a majority-owned subsidiary for purposes of Section 3(a)(1)(C) under the 1940 Act and, therefore, does not register as an investment company.

Facts

The Pengrowth Group includes three Canadian entities: Pengrowth, an operating oil and gas company; Energy Trust, which finances the operating company; and a management company that provides managerial and administrative services (the “Management Company”) to Pengrowth and Energy Trust. Energy Trust wishes to publicly offer its securities in the United States without registering as an investment company under the 1940 Act.

Energy Trust finances the Operating Company by issuing and selling beneficial interests (“Trust Units”) and investing most of the proceeds in royalty units issued by the Operating Company. Each royalty unit represents the right to receive a pro-rata portion of 99% of all royalty income, which is essentially the gross revenues of the Operating Company less costs, taxes and payments to a reserve. Energy Trust owns approximately 99.96% of the royalty units outstanding, and the royalty units constitute approximately 85% of the Energy Trust’s assets.

The Operating Company has issued 100 shares of common stock, all of which are owned by the Management Company. Pursuant to a Unanimous Shareholder Agreement dated December 2, 1988 (the “Voting Agreement”), however, the Management Company has transferred all of its voting power with respect to the Operating Company to holders of the Trust Units and royalty units, except that the Management Company has retained the power to elect two of the Operating Company’s five directors. In addition, the trustee of Energy Trust agreed in the Voting Agreement not to vote the royalty units that it holds. Each Trust Unit issued by Energy Trust carries one vote, and the Trust Unit holders have the power to elect three of the Operating Company’s five directors, as well as to decide all other matters regarding the Operating Company that are subject to shareholder votes.

Analysis

Section 3(a)(1)(C) of the 1940 Act defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 percent of the value of such issuer's total assets. Section 3(a)(2) defines "investment securities" to include, in relevant part, all securities except those issued by majority-owned subsidiaries of the owner which (i) are not investment companies and (ii) are not relying on Section 3(c)(1) or Section 3(c)(7) of the 1940 Act. Section 2(a)(24) defines "majority-owned subsidiary" of a person as a company 50 percent or more of the outstanding voting securities of which are owned by such person or by a company which is a majority-owned subsidiary of such person. Section 2(a)(42) defines "voting security" to mean, in pertinent part, any security presently entitling the owner or holder thereof to vote for the election of directors of a company.

In Farley, Inc. (pub. avail. Apr. 15, 1988), we stated that we would not recommend enforcement action to the Commission if a company treated its subsidiary, Fruit of the Loom, Inc., as a majority-owned subsidiary, and therefore did not register as an investment company. The company represented that, even though it would own less than 50 percent of the voting power to elect directors of Fruit of the Loom, it would, through a voting agreement with another large shareholder of Fruit of the Loom, have voting control of the subsidiary.

Based on Farley, you argue that if Energy Trust had the voting power to elect a majority of the board of directors of the Operating Company, then the Operating Company would be deemed a majority-owned subsidiary of Energy Trust under Section 2(a)(24). You further argue that, as a result, Energy Trust would not be an investment company within the meaning of Section 3(a)(1)(C) because approximately 85 percent of its assets would not be investment securities.

You contend that the same result would obtain if voting control of the Operating Company were held not by Energy Trust itself, but by its owners -- that is, by the owners of the Trust Units. You argue that Section 3(a)(1)(C) is designed to exclude from the definition of "investment company" operating companies in which the investors have the power to elect directors who will, on their behalf, direct the management of the enterprise. You suggest that, under the circumstances presented, investors in Energy Trust are essentially investing in the Operating Company, and that treating the Operating Company as a majority-owned subsidiary of Energy Trust, and not treating Energy Trust

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2 Farley relied on Section 3(a)(3), the precursor of Section 3(a)(1)(C). For purposes of this letter, there are no material differences between Section 3(a)(1)(C) and its precursor.
as an investment company for purposes of Section 3(a)(1)(C), therefore would be consistent with the purpose of the provision.

Without necessarily agreeing with your legal analysis, we would not recommend any enforcement action if Energy Trust treats the Operating Company as a majority-owned subsidiary for purposes of calculating the 40 percent test in Section 3(a)(1)(C) of the 1940 Act. Please note that this position is based on the facts and representations set forth in your letter, particularly that: (1) Energy Trust owns at least 99% of the outstanding royalty units, with such royalty units constituting approximately 85% of Energy Trust’s assets; (2) effectively all the voting authority with respect to all matters, except the authority to elect a minority of the directors of the Operating Company, resides with the owners of the Trust Units (that is, with the owners of Energy Trust); and (3) the owners of Energy Trust will hold such voting authority in proportion to their ownership interests in Energy Trust.

Any different facts or representations may require a different conclusion. Further, this response expresses the Division’s position on enforcement action only and does not purport to express any legal or interpretive conclusion on the questions presented.

Martin Kimel
Senior Counsel
January 14, 2000

Douglas J. Scheidt, Esq.
Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Pengrowth Energy Trust

Dear Mr. Scheidt:

We represent Pengrowth Energy Trust (the “Trust”), an Alberta, Canada trust that is the financing arm of a Canadian operating oil and gas company. We hereby request on behalf of the Trust your advice that the staff of the Division of Investment Management (the “Staff”) will not recommend that the Securities and Exchange Commission (the “Commission”) take enforcement action under the Investment Company Act of 1940, as amended (the “Act”), if the Trust were to conduct public offerings of its securities in the United States without registering as an investment company under the Act.

Facts

Structure

The Pengrowth group of entities, with an asset base in excess of $800 million CDN (approximately $553 million U.S.), includes an operating oil and gas company, the Trust (which finances the operating company), and a management company that provides advisory, management and administrative services to the other two entities.
Pengrowth Corporation (the "Operating Company") is an Alberta corporation, incorporated in 1987. It is engaged in the business of acquiring, owning and managing working interests and royalty interests in petroleum and natural gas properties, including tangible facilities such as pipelines, plants and equipment associated with production.

The Trust was created pursuant to a Trust Indenture dated December 2, 1988, as amended, between the Operating Company and Montreal Trust Company of Canada. It finances the Operating Company by issuing and selling beneficial interests ("Trust Units") and investing most of the proceeds in royalty units ("Royalty Units") issued by the Operating Company. The Royalty Units are issued pursuant to a Royalty Indenture dated as of December 2, 1988, as amended, between the Operating Company and Montreal Trust Company of Canada. Each Royalty Unit represents the right to receive a pro-rata portion of 99% of all "Royalty Income," which is essentially gross revenues of the Operating Company, less costs (including debt service), taxes and payments to a reserve. The Trust owns approximately 99.96% of the Royalty Units outstanding, and such Royalty Units constitute approximately 85% of the Trust's assets and revenues.

In addition to Royalty Units, the Trust owns real property consisting of oil and gas processing facilities which were acquired from the Operating Company in 1998 in a sale and leaseback transaction. Such facilities were transferred from the Operating Company to the Trust to reduce the level of permanent indebtedness associated with holding the facilities in the Operating Company and to capture additional tax deductions for Unitholders of the Trust in the form of capital cost allowance which would otherwise be held captive in the Operating Company. These processing facilities constitute approximately 15% of the assets and revenues of the Trust. As with the assets and revenues of any oil and gas enterprise, the relative percentage of the Trust's assets and revenues attributable to the Royalty Units and processing facilities will fluctuate depending on the current market prices for oil and gas.

Under the Trust Indenture, the Trust may also acquire securities of issuers other than the Operating Company. The Board of Directors of the Operating Company has restricted these purchases to securities of issuers whose oil and gas properties are attractive acquisition candidates. As of December 31, 1998, such securities of other issuers consisted of marketable securities representing less than 0.4% of the Trust's total assets.

Pengrowth Management Limited (the "Management Company" and, together with the Trust and the Operating Company, the "Pengrowth Group") is an Alberta corporation which, pursuant to the provisions of an agreement (the "Management Agreement") dated as of April 29, 1997, among it, the Operating Company and the Trust, provides advisory, management and administrative services exclusively to the Operating Company and the Trust, advising them with respect to the acquisition, development, administration, operation and disposition of oil and natural gas properties and other related assets.
**Voting Rights**

The Operating Company has issued and outstanding 100 common shares, all of which are owned by the Management Company. Mr. James Kinnear, a Director and the Chief Executive Officer of the Operating Company and the Management Company, is the beneficial owner of 96% of the issued capital of the Management Company, the remaining 4% being owned by another Director of the Management Company. All voting rights with respect to the Operating Company are governed by the terms of a Unanimous Shareholder Agreement dated as of December 2, 1988 (the “Voting Agreement”). Pursuant to the Voting Agreement: (a) holders of Trust Units and holders of Royalty Units are entitled to one vote per Trust Unit and Royalty Unit held by them on any matter put before the shareholders of the Operating Company; (b) the Trustee of the Trust agrees, however, that it shall have no voting rights in respect of the Royalty Units held by the Trust, and that all such rights shall be exercised solely by the holders of Trust Units; and (c) the Management Company agrees that it shall have no voting rights with respect to the Operating Company except, for so long as the Management Company is a party to the Management Agreement, the right to elect 2 out of the 5 directors of the Operating Company. As a result, voting power with respect to the Operating Company is vested solely in the holders of Trust Units and Royalty Units, subject only to the right of the Management Company to elect 2 out of 5 directors. As of October 29, 1999, there were outstanding 55,610,379 Trust Units (each representing an equal beneficial interest in the Trust) and 18,940 Royalty Units entitled to vote at the meetings of shareholders of the Operating Company, so that effectively, holders of Trust Units had 99.96% of the voting power of the Operating Company, subject only to the right of the Management Company to elect 2 out of 5 directors. The owners of the Trust hold voting authority in the Operating Company in proportion to their interests in the Trust.

**Tax Advantages**

The Pengrowth Group was organized to provide an efficient Canadian tax mechanism for the distribution of net oil and gas revenues to its investors in a way that could not be achieved by a direct investment in common shares of the Operating Company. Conventional oil and gas companies typically reinvest substantially all of their cash flow to fund continuing exploration and development activities. To the extent that these companies make dividend payments to Canadian resident investors, those dividend payments will be taxable in the hands of the investors and are not deductible by the company. Income retained within these companies will be taxable but can be sheltered by offsetting the income against tax pools created through the acquisition of petroleum

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* We acknowledge the possibility that the percentage of the voting power of the Trust Unitholders could be reduced by the issuance by the Operating Company to persons other than the Trust of additional Royalty Units. The Trust understands that this letter is predicated on the assumption that the Trust Unitholders will always have at least 99% of the voting power of the Operating Company.
properties, through the conduct of development and exploration activities or through the existing resource allowance and other permitted deductions.

The structure of the Pengrowth Group effectively moves certain tax pools from the Operating Company to the Trust, where they are offset against distributions made to holders of Trust Units. The tax sheltered portion of the distributions is considered to be a return of capital. The sheltered (or reduced capital loss) distributions are not currently taxable but are recaptured in the form of additional capital gains on the ultimate sale by the investor of the Trust Units. The return of capital treatment on a portion of the distributions to Trust Unitholders and the deductibility of Royalty payments by the Operating Company are features which could not be accomplished through the direct payment of dividends by the Operating Company.

**Objectives**

Value creation for investors in the Pengrowth Group has been accomplished through active management of approximately 40 separate asset acquisitions over the past ten years and the conduct of efficient operations on an increasingly high percentage of properties. Management believes that there are and will continue to be attractive opportunities for the Pengrowth Group to acquire additional significant oil and gas assets. Acquisitions will require funding generated by the sale of additional Trust Units, and Management is seeking the ability to access the United States capital markets by way of a public offering for that purpose. If, however, the Trust were deemed to be an “investment company” under the Act, it would be effectively prohibited by Section 7(d) of the Act from making a public offering of Trust Units in the United States.

**Legal Analysis**

The Trust is not an investment company within the intendment of Section 3(a)(1)(A) of the Act. However, Royalty Units issued by the Operating Company constitute more than 40% in value of the Trust’s total assets and, if they were “investment securities” as defined in Section 3(a)(2), the Trust would be an investment company within the meaning of Section 3(a)(1)(C). Section 3(a)(2) excludes from the definition of “investment securities” securities of majority-owned subsidiaries that are operating companies, and the Operating Company should be deemed to be a majority-owned subsidiary of the Trust. Hence, since the Trust does not own or propose to acquire investment securities exceeding 40% of the value of its total assets, it is not an investment company.

**Discussion**

Section 3(a)(1)(C) of the Act defines investment company to include any issuer which is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer’s total assets (exclusive of Government securities and cash items)
on an unconsolidated basis. Section 3(a)(2) defines “investment securities” to include, among other things, all securities except securities issued by majority-owned subsidiaries of the owner which (i) are not investment companies and (ii) are not relying on the exception from the definition of investment company in Section 3(c)(1) or 3(c)(7) of the Act. Section 2(a)(24) defines “majority-owned subsidiary” of a person as a company 50 per centum or more of the outstanding voting securities of which are owned by such person or by a company which is a majority-owned subsidiary of such person. Section 2(a)(42) defines “voting security” to mean, in pertinent part, any security presently entitling the owner or holder thereof to vote for the election of directors of a company.

It is clear, reading Sections 2(a)(24) and 2(a)(42) together, that a majority-owned subsidiary is defined with reference to the ability to elect a majority of its board of directors. This voting control need not be held by reason of the ownership of securities; rather it may arise under a voting agreement.

In Farley, Inc., 1988 WL 234210 (S.E.C.), a holding company proposed to transfer securities of its majority-owned operating subsidiary to the controlling shareholder of the holding company, so that following the transfer the holding company would own less than 50% of the voting securities of the operating subsidiary. The holding company and its controlling shareholder executed a voting agreement which provided that so long as the controlling shareholder owned any voting securities of the operating subsidiary such securities would be voted by the holding company. In the incoming letter counsel pointed out that the Section 2(a)(24) definition of majority-owned subsidiary clearly permits upward aggregation (i.e., ownership by a majority-owned subsidiary is attributed to its parent) and asserted that downward aggregation (ownership by the parent being attributed to its majority-owned subsidiary) should also be permitted. The Staff took a no-action position, agreeing that based on these facts, the operating subsidiary may be treated as a majority-owned subsidiary of the holding company for purposes of Section 3(a)(1)(C) of the Act.

Based on the foregoing, it is clear that, in the case of the Pengrowth Group, if the Trust had the voting power to elect a majority of the board of directors of the Operating Company, the Operating Company would be a majority-owned subsidiary of the Trust, the Royalty Units of the Operating Company owned by the Trust would not be investment securities and, therefore, the Trust would not be an investment company within the meaning of Section 3(a)(1)(C) of the Act. We believe that the fact that the holders of Trust Units rather than the Trust itself have the power to elect a majority of the board of directors of the Operating Company should not change this result. If anything, having the voting power directly in the hands of the Trust Unitholders, rather than in the Trustee, is actually a clearer case of operational control by the Trust Unitholders as equity investors. It is perfectly consistent with the purpose and the spirit of the Act to permit downward aggregation, so that the voting rights of the Trust Unitholders under the Voting Agreement are attributed to the Trust, with the result that the Operating Company is a majority-owned subsidiary of the Trust and its securities (Royalty Units) owned by the Trust are not investment securities.
It is fundamentally sound to conclude that, under the definitional sections of the Act, the Operating Company is a majority-owned subsidiary of the Trust. Section 3(a)(1)(C) is designed to exclude from its coverage operating enterprises in which the investors have the power to elect the directors who will, on their behalf, direct the management of the business in which they have chosen to invest. This is precisely the situation with the Pengrowth Group. The fact that the form of the enterprise is not of the conventional corporate parent-subsidiary nature should not detract from its substance as an operating oil and gas enterprise that is structured to provide tax advantages for its investors and that is managed by a board of directors whose majority is investor-elected.

Conclusion

Based on the foregoing, we respectfully request that the Staff confirm that it will not recommend that the Commission take any enforcement action under the Act if the Trust were to make public offerings in the United States without registering as an investment company under the Act.

In accordance with Release No. IC-6330, seven additional copies of this letter are enclosed. Please call John K. Whelan at (212) 238-8810 or Steven A. Meetre at (212) 238-8673 if we may be of assistance to you in connection with this request.

Very truly yours,

JKW:ma
Enclosures
MEMORANDUM

TO: 2(a)(24) File
FROM: Stephan N. Packs
DATE: July 16, 1998
SUBJECT: Majority Owned Subsidiary

Elizabeth Krentzman of Deloitte & Touche asked whether a 50% owned entity constitutes a majority owned subsidiary under Section 3 of the Investment Company Act of 1940. Section 2(a)(24) of the Act says:

"Majority-owned subsidiary" of a person means a company 50 per centum or more of the outstanding voting securities of which are owned by such person, or by a company which, within the meaning of this paragraph, is a majority-owned subsidiary of such person.¹

I found no Commission or staff positions on point. On June 11, I told Krentzman that we agreed that, at least for purposes of Section 3, a 50% owned entity could be considered to be a majority owned subsidiary under Section 2(a)(24).²

¹ This definition is the same as in the original Act.
² It should be noted that this interpretation of majority-owned subsidiary is not consistent with various accounting rules and principles. For example, the definition of majority-owned subsidiary in Regulation S-X requires ownership of more than 50% of the outstanding voting shares. See Reg. § 210.1-02(m). Additionally, it conflicts with Statement of Financial Accounting Standards No. 94 regarding consolidation of financial statements of majority-owned subsidiaries, which is required when there is ownership of over 50% of the outstanding shares of another company. See November 7, 1997 Investment Management letter to Chief Financial Officers.