

ClientAlert

Energy, Infrastructure, Project and Asset Finance

January 2010

FERC Requests Comments on Proposed Amendments to its Regulations Related to Control and Affiliation for FPA Sections 203 and 205 Purposes

On January 21, 2010, the Federal Energy Regulatory Commission (FERC) issued a Notice of Proposed Rulemaking (NOPR)¹ in which it proposes to amend its regulations pursuant to Federal Power Act (FPA) sections 203 and 205. As described below, FERC proposes to grant blanket authorization to acquire securities in certain situations under FPA section 203 and to amend the definition of "affiliate" in Part 35 of its regulations. If adopted, the proposals set forth in the NOPR will allow holding companies to acquire less than 20 percent of the voting securities of a public utility without awaiting FERC action on an application for approval under section 203, but subject to an after-the-fact report and compliance with certain conditions that are intended to assure that the holding company does not control the public utility. Compliance with these requirements will exempt the public utility and its affiliates that are the subject of the blanket authorization and the other public utility(ies) and its affiliates that the acquiring company owns from treating each other as affiliates for market power purposes. The NOPR is a very positive step towards clearing up control and affiliation issues for purposes of FPA sections 203 and 205, and, if adopted, the amendments proposed therein will allow more transactions to close quicker and at lower cost.

The NOPR grows out of a petition filed by the Electric Power Supply Association (EPSA) in another docket. In its petition, EPSA requested FERC guidance on the concepts of control and affiliation as they relate to transactions subject to FERC's jurisdiction under FPA sections 203 and 205. EPSA stated that recent FERC decisions had raised concern about when a particular investment transaction might be deemed to convey "control" or would result in "affiliation" for purposes of section 203. EPSA requested that FERC: (i) state that investments in publicly held companies by investors owning less than 20 percent of such companies' voting securities and making Schedule 13G filings with the Securities and Exchange Commission (SEC) will not be deemed to convey control or result in affiliation for section 203 purposes; (ii) confirm that if FERC finds in a section 203 setting that an entity does not control another entity, that finding would apply equally in the market-based rate (MBR) setting to affected MBR sellers and (iii) state that investments by entities upstream of a publicly held company in entities not otherwise related to the publicly held company will not be deemed to be within the knowledge and control of the publicly held company's subsidiaries with MBR authorization and that, therefore, those MBR subsidiaries would not be required to file a notification of change in status or to include generation or inputs to generation owned or controlled by the other entities in future market power analyses.



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¹ *Control and Affiliation for Purposes of Market-Based Rate Requirements under Section 205 of the Federal Power Act and the Requirements of Section 203 of the Federal Power Act*, 130 FERC ¶ 61,046 (2010).

Section 203

In the NOPR, FERC proposes to amend Part 33 of its regulations (related to FPA section 203 applications) to provide a new blanket authorization under FPA section 203(a)(2) to permit “a holding company to acquire ten percent or more, but less than 20 percent, of the outstanding voting securities of a public utility, provided that the holding company files an Affirmation...within ten days of the acquisition of such voting securities.”² FERC also proposes to amend Part 33 of its regulations to also provide a blanket authorization under FPA section 203(a)(1) whereby a public utility whose outstanding voting securities are acquired in a transaction that falls within the FPA section 203(a)(2) authorization discussed above would be pre-authorized to dispose of those securities.³ Similar to the blanket authorization related to FPA section 203(a)(2), in order to be eligible for the blanket authorization under FPA section 203(a)(1), the holding company investor must file an Affirmation.

FERC explains that while the Affirmation it proposes to adopt is similar to SEC Schedule 13G in that it requires that the investor certify its non-control intent, the Affirmation has been tailored to better meet the requirements of the FPA and FERC policy. Specifically, in addition to certifying that an acquisition was not made for the purpose, or with the effect, of changing or influencing control over the public utility, the investor must also commit: “ (i) not to seek or accept representation on the public utility’s board of directors or otherwise serve in any management capacity; (ii) not to request or receive non-public information, either directly or indirectly, concerning the business or affairs of the public utility; (iii) not to solicit, or participate in any solicitation of, proxies involving the public utility; and (iv) not to seek to influence the management or conduct of the day-to-day operations of the public utility in such areas as purchasing or selling electricity or inputs to generation, scheduling power production, including, but not limited to, the dispatching of generation units or scheduling outages, or hiring or fixing compensation of the public utility’s offices, directors and employees.”⁴ As explained in the NOPR, the information requested in and the conditions imposed by the Affirmation are generally consistent with the requirements that are imposed upon applicants seeking pre-authorization on a case-by-case basis for a similar transaction under FPA section 203. Many of the data requirements come from existing regulations under Part 33.

FERC explains that the Affirmation creates a rebuttable presumption for section 203 purposes that an investor does not

control the public utility. FERC made clear, however, that since the Affirmation is a representation by the filer, it does not create a conclusive finding that the investor does not control the public utility. Such a finding would be necessary for the ownership of ten percent or more, but less than 20 percent, of the voting securities of a public utility to not be within the definition of “affiliate.” But, while the affected companies would still technically be considered affiliates, the affected companies would qualify for a waiver of the regulatory requirements pertaining to affiliated companies (as discussed further below).

FERC notes that the blanket authorizations discussed above make no distinction between the securities of publicly traded utilities or securities of privately held utilities. FERC also notes that although EPSA’s petition focused on affiliate compliance issues related to secondary market purchases of a public utility’s voting securities, FERC’s proposed amendments to Part 33 do not distinguish between secondary market purchases and direct acquisitions. FERC seeks comments on whether these proposed section 203 blanket authorizations should (i) focus on acquisitions of voting securities of publicly traded utilities or if they should include acquisitions of privately-held companies as well, and/or (ii) be limited to secondary market transactions or whether they should also apply to direct acquisitions.

Definition of Affiliate

In the NOPR, FERC proposes to amend and make consistent the definition of affiliate in Part 35 of its regulations in both Subparts H (related to sales made pursuant to MBR authority) and I (related to cross-subsidization restrictions on affiliate transactions). Under FERC’s current regulations, an “affiliate” of a specified company includes “[a]ny person that is under common control with the specified company.” FERC proposes to amend the definition to make clear that an affiliate relationship would exist when an investor is able to control a public utility, and further to provide that FERC “may, after appropriate notice and opportunity for hearing, determine that any person is an affiliate of a specified company if it finds that such person exercises directly or indirectly (either alone or pursuant to an arrangement or understanding with one or more persons) such a degree of influence (through ownership of voting securities or otherwise) over the management or policies or operations of the specified company as to make it necessary or appropriate in the public interest that the person be treated as an affiliate.”⁵ FERC also requests comments on its proposal to incorporate the definition of “voting security” used in the Public

² NOPR at P 33.

³ NOPR at P 34.

⁴ NOPR at P 37.

⁵ NOPR at P 57. FERC also explains that “[o]wning, controlling or holding with power to vote less than 10 percent of the outstanding voting securities would continue to create a rebuttable presumption of lack of control.” *Id.*

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Utility Holding Company Act of 2005 (PUHCA 2005) into both Subparts H and I. PUHCA 2005 defines “voting security” as “any security presently entitling the owner or holder thereof to vote in the direction or management of the affairs of a company.”⁶

The proposed modifications to the definition of affiliate discussed above are mostly intended to achieve uniformity of wording between the definitions used for market power purposes and for determining whether cross-subsidization is occurring. The principal substantive difference is that FERC proposes to change the minimum interest that is rebuttably presumed to establish control for Exempt Wholesale Generators from the current five percent ownership standard to the 10 percent used in the rest of its affiliate regulations. FERC states that it does not believe that the proposed definition of affiliate in its cross-subsidization regulations will have an adverse impact on its ability to guard against cross-subsidization.

Under the proposed amendments to Part 33 discussed above, owning, controlling or holding with power to vote ten percent or more, but less than 20 percent, of the outstanding voting securities, where an Affirmation is filed within ten days after the acquisition, would create an affiliate relationship. As explained above, under these circumstances the affected companies would qualify for a waiver of the regulatory requirements pertaining to affiliated companies. Specifically, a public utility would be exempt from the requirement to file a notice of change in status by reason of the transaction or to include the investor’s other affiliates in its market power analysis. Further, such a public utility would not be subject to the affiliate transaction rules for transactions with the investor or the investor’s other affiliates.

Finally, where an investor is not a holding company and therefore not subject to the requirements of FPA section 203(a)(2), FERC proposes to allow investors that are not subject to the blanket authorizations discussed above to file an Affirmation with FERC in order to address concerns related to the requirements of the market-based rate program. FERC explains that this would relieve the public utility of the requirements associated with obtaining and retaining its market-based rate authority discussed above.

Potential Issues and Recommended Course of Action

As stated above, the NOPR is a very positive step towards clearing up control and affiliation issues for purposes of FPA sections 203 and 205. However, identified below are some issues related to the NOPR’s scope and the Affirmation that might warrant comment.

- As explained above, FERC proposes to create a blanket authorization under FPA section 203(a)(2) to allow a holding company to acquire ten percent or more, but less than 20 percent, of the outstanding voting securities of a public utility when an Affirmation is filed ten days after the close of the transaction. FERC states that it is creating a “parallel” blanket authorization under FPA section 203(a)(1) for a public utility. However, the blanket authorization created under FPA section 203(a)(1) is not exactly parallel, as that blanket authorization only authorizes a public utility to dispose of its securities that are acquired in a transaction that falls within the proposed section 203(a)(2) blanket authorization. FERC does not explain why it chose not to grant a blanket authorization to allow a public utility to acquire outstanding voting securities under the same circumstances as a holding company. In this regard, we note that section 203(a)(1)(C) prohibits a public utility from acquiring any security with a value in excess of US\$10 million of any other public utility. If it is possible that an investor would acquire stock in a public utility via a subsidiary that is itself a public utility, such an entity may wish to consider raising this issue in any comments it files.
- As noted herein, a transaction that is exempt from prior FERC authorization pursuant to the blanket authorizations proposed in the NOPR would still create an affiliate relationship for purposes of the MBR regulations under Part 35. There may be an issue in the cross-subsidization regulations because a public utility with captive ratepayers might be required to satisfy the cross-subsidization regulations as to the holding company. An investor may wish to ask FERC to confirm that if a holding company is deemed to have no control over the public utility, the public utility need not comply with the cross-subsidization regulations as to the holding company.
- The Affirmation requires that an investor commit, among other things, that it will not “request or receive non-public information, either directly or indirectly, concerning the business or affairs of the public utility.” Is it feasible for the investor to make this commitment particularly with respect to a closely held company? An investor might wish to suggest that this limitation should only apply to information related to scheduling, pricing, or deciding whether to offer power (which is covered in another condition within the Affirmation).

Comments are due on the NOPR within 60 days of the NOPR’s publication in the Federal Register.

⁶ NOPR at P 60.

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