FERC Issues Rehearing Orders Addressing Affiliate Transactions, Blanket Authorizations, and Market-Based Rate Authority

On July 17, 2008, the Federal Energy Regulatory Commission (“FERC”) issued Order Nos. 707-A (affiliate transaction regulations) and 708-A (Federal Power Act Section 203 blanket authorizations). The orders are relatively short and affirm the previously adopted regulations, with several expansions and clarifications discussed below. A notable aspect of Order No. 707-A is FERC’s decision to find that previously granted waivers of affiliate transaction rules for public utilities with no captive customers do not operate as waivers of the affiliate rules to public utilities that provide transmission service over jurisdictional transmission facilities.

At the July 17 meeting FERC also issued Order No. 697-B, providing clarification of a somewhat narrow, but significant, provision contained in Order No. 697-A. Those orders address guidelines for market-based rate (“MBR”) authorizations and preparation of market power studies.

Order No. 707-A – Affiliate Transaction Regulations

The Order No. 707 affiliate transaction rules apply to franchised utilities that have captive customers or that own or provide transmission service over FERC-jurisdictional transmission facilities. In Order No. 707-A, FERC affirmed the Order No. 707 affiliate transaction rules, including the “asymmetrical pricing” rules and the centralized service company “at cost” rule for the provision of non-power goods and services. FERC also extended and clarified the application of these pricing rules, denied several requests to extend the rules, stated it will consider waiver requests on a case-by-case basis, and rejected requests for additional reporting requirements.

Captive Customers Include Wholesale Customers. FERC refused to exclude wholesale customers from the definition of captive customers. FERC reasoned that, while wholesale customers with fixed rate contracts may be adequately protected from the risk of affiliate transaction abuse, it was not prepared to generically exclude wholesale customers from the definition of captive customers. However, as with other matters, FERC will consider waivers on a case-by-case basis.

---

1 Asymmetrical pricing refers to the requirement that non-power goods and services provided by (1) a franchised utility to non-utility affiliates be priced “at the higher of cost or market price” and (2) non-utility affiliates to a franchised utility not be “at a price above market.”

2 “At cost” pricing refers to the requirement that centralized service companies provide non-power goods and services to franchised utility affiliates at cost.
Transmission Providers Without Captive Customers. As mentioned above, a notable aspect of Order No. 707-A is FERC’s refusal to exempt franchised public utilities that do not have captive customers but that own or provide transmission service over jurisdictional transmission facilities. Even if a franchised public utility has received a waiver of the Order No. 697 market-based rate affiliate restrictions because it has no captive customers, that utility will need to seek an Order No. 707 waiver demonstrating that its transmission customers are adequately protected against affiliate transaction abuse. FERC reasoned that transmission customers are entitled to customer protection and should not have to bear costs of inappropriate cross subsidization. Because the Order No. 707 regulations have the same restriction as the Order No. 697 regulations with respect to transactions between franchised public utilities and their market-regulated power sales affiliates, this calls into question the effectiveness of prior waivers of the “asymmetrical pricing” provisions granted to public utilities that have no captive customers but which own or operate transmission systems.

Single-State Holding Companies – Shared Services. FERC extended the “at cost” pricing rule to single-state holding companies that do not have centralized service companies. Affiliates within such single-state holding companies thus may provide other affiliates in the system corporate general management and administrative services (i.e., services akin to those provided by a centralized service company in multi-state holding company systems) at cost. An important condition to this rule, however, is that such services may not be provided to unaffiliated third parties. The reason for this condition is that a market price is determinable (and hence the “at the higher of cost or market price” and the “no higher than market” rules are readily adaptable) in cases where such services are provided to third parties. In addition, FERC required that such single-state holding company systems to use “rigorous accounting and cost-allocation procedures” in connection with use of the “at cost” pricing rule. The extension of the “at cost” pricing rule is not applicable to multi-state holding companies that do not have centralized service companies.

Types of Services and Goods Subject to “At Cost” Rule. The “at cost” rule applies only to administrative, managerial, financial, accounting, recordkeeping, legal or engineering services. This “necessarily applies also to charges for a limited set of goods in the form of supplies and equipment acquired to support administrative and management functions, as well as office space and other general overhead items.” The “at cost” rule does not apply to “inputs for utility operations, such as fuel supply, construction or real estate” (which FERC considers to have clearly identifiable market prices), or “to the implementation of major projects that are easily susceptible to competitive bidding, such as construction projects.”

Transactions Between Franchised Utility Affiliates Outside Scope of Rules. FERC confirmed that the Order No. 707 affiliate rules do not apply to transactions between two or more franchised public utilities. FERC stated that such transactions are not covered by Order No. 707 rules, which apply only to transactions between franchised public utilities and either a market-regulated power sales affiliate or a non-utility affiliate. FERC stated that it will consider whether pricing restrictions for transactions between franchised utility affiliates are necessary on a case-by-case basis, and that such transactions may raise a different type of cross-subsidization issue — namely, whether the customers of one franchised public utility would be subsidized at the expense of the customers of the other franchised public utility.

---

3 A single-state holding company is a holding company that derives no more than 13 percent of its public utility company revenues from outside a single state (excluding revenues derived from exempt wholesale generators, foreign utility companies, and qualifying facilities (“QFs”)).
Special Purpose Financing Entities. FERC deferred consideration of the implications of the affiliate rules for special-purpose entities created for financing purposes, such as bankruptcy-remote entities. FERC intends to obtain additional industry input and, thereafter, issue a guidance order on this subject.

QF Mandatory Purchase Pricing Not Affected. FERC clarified that the affiliate rule requiring pre-authorization for affiliate electric energy sales does not apply to the mandatory purchase obligation sales from QFs under the Public Utility Regulatory Policies Act of 1978 (“PURPA”). FERC stated that this pre-authorization requirement would not apply to QF sales under contracts based on a PURPA mandatory purchase obligation when the QF has market-based rate authority.

Fuel Adjustment Clause Regulation Not Affected. FERC clarified that the pricing rules do not apply to fuel purchases covered by FERC fuel adjustment clause (“FAC”) regulations. FERC reasoned the Order No. 707 pricing rules were not needed in such instances because the FAC regulations incorporate extensive oversight measures.

No Materiality Threshold. FERC declined to adopt a materiality threshold ($1 million or 1 percent of utility gross revenues was proposed) for transactions covered by the affiliate rules. However, FERC left open the possibility for future consideration of this issue after it has more experience with the rules.

Order No. 708-A – Section 203 Blanket Authorizations

Order No. 708 in large part granted mirror image blanket authorizations to public utilities under Section 203(a)(1) that it had granted in Order No. 669/669-A to holding companies under Section 203(a)(2). In Order No. 708-A, FERC affirmed the blanket authorizations it granted in Order No. 708 and expanded several of those authorizations, as discussed below.

Transfers of Voting Securities. FERC extended the blanket authorization for public utilities to transfer outstanding voting securities to any holding company granted blanket authorization under 18 CFR 33.1(c)(2)(ii), subject to the aggregate 10 percent limitation, to “any person other than a holding company” so long as that person and its affiliates meet the 10 percent limit. However, for non-holding companies, the Commission determined that additional reporting requirements are necessary and, in an order released concurrently with Order No. 708-A, requested comments on the scope and form such reporting requirements should take. FERC stated that the extension of this blanket authorization will not take effect until a FERC decision on reporting requirements becomes effective.

Transfers of Wholesale Contracts. FERC modified the blanket authorization for public utilities to acquire or dispose of jurisdictional contracts by removing the phrase “the parties to the transaction are neither associate nor affiliate companies.” The Commission reasoned that the other restrictions on the blanket authorization prevent any rate or cross-subsidization impact affecting captive generation or transmission customers.

4 Order Requesting Supplemental Comment, 124 FERC ¶ 61,049 (2008).
**Internal Corporate Reorganizations.** FERC granted clarification that the blanket authorization for internal corporate reorganizations applies to a transfer of assets from a non-traditional utility subsidiary (a public utility without captive customers that does not own or control transmission facilities) to another non-traditional utility subsidiary where only one subsidiary survives the transaction.

**Hedging – No Change in Regulations.** FERC declined to limit the blanket authorizations for transactions involving financial hedging. FERC also refused to codify a definition of hedging, noting that various other regulators (e.g., Commodities Futures Trading Commission, Internal Revenue Service) have defined hedging and have established rules and policies regulating those activities. However, FERC indicated that it generally will follow those principles with respect to blanket authorizations under FERC rules.

**Order No. 697-B – Market-Based Rates for Wholesale Sales**

As noted above, in Order Nos. 697 and 697-A FERC established new guidelines for MBR authorizations and preparation of market power studies. A number of parties filed requests for clarification of language contained in a footnote to Order No. 697-A (footnote 208), which addresses how simultaneous transmission import capability is to be allocated among competing suppliers when calculating the indicative (horizontal) screens in a market power analysis. That footnote, which triggered considerable concern among many MBR sellers, stated that when performing the indicative screens any simultaneous transmission import capability first should be allocated to the MBR seller’s uncommitted remote generation. Any remaining capability then would be allocated to uncommitted competing supplies. This approach reflected a significant departure from the historic practice of allocating import capability on a *pro rata* basis among competing suppliers, and would have resulted in horizontal screen violations for a number of MBR sellers.

In Order No. 697-B FERC granted the requests for rehearing with regard to footnote 208. In particular, FERC affirmed its traditional policy that when performing the indicative screen analysis, MBR sellers may allocate import capability on a *pro rata* basis (after accounting for the seller’s firm transmission rights), *i.e.*, based on the relative shares of the seller’s (and its affiliates’) and competing suppliers’ uncommitted generation capacity in first-tier markets.