



January 29, 2010

## FERC Proposes Blanket Authorizations for Acquisitions of up to 20 Percent Interest in Public Utilities

On January 21, 2010, the Federal Energy Regulatory Commission (FERC) issued a notice of proposed rulemaking<sup>1</sup> in which it proposed, in response to a petition for guidance filed by the Electric Power Supply Association (EPSA) in September 2008 (EPSA Petition), to amend its regulations: (1) to adopt blanket authorizations under Section 203 of the Federal Power Act (FPA) for the acquisition of between 10 and 20% of the voting securities of a public utility or of a holding company with a public utility subsidiary by an investor submitting an “Affirmation” regarding control; and (2) to exempt such an investor and the affected company and its public utility subsidiaries from the definition of “affiliate” for the purposes of FERC’s market power analysis, reporting requirements, and affiliate sales restrictions applicable to public utilities with market-based rate authority under Section 205 of the FPA. In the “Affirmation,”<sup>2</sup> the investor would be required to certify that the acquisition was not made for the purpose of gaining control over the company and commit not to seek or exercise control over the company’s management or day-to-day operations. Comments on the NOPR are due 60 days after its publication in the *Federal Register*.

King & Spalding attorneys have represented EPSA in connection with the EPSA Petition.

### I. Background

#### A. FPA Section 203 Authorization Requirements

FPA Section 203 requires prior FERC authorization for mergers, acquisitions, and dispositions involving jurisdictional generation and transmission facilities and for acquisitions of public utility or holding company securities. FERC must approve an application under FPA Section 203 if it finds the proposed transaction will not result in inappropriate cross-subsidization and is consistent with the public interest, *i.e.*, the transaction will not have an adverse impact on competition, rates, or regulation.

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FPA Section 203(a)(5) authorizes FERC to identify classes of transactions that meet these standards and provide expedited review for such transactions. Pursuant to this authority, FERC has granted blanket authorizations—or pre-authorizations—for certain classes of transactions, thereby obviating the need to apply for and obtain prior FERC approval for qualifying transactions. For example, FERC has granted a blanket authorization under FPA Section 203(a)(2) for an acquisition of less than 10% of the outstanding voting securities of a public utility. FERC has also declared, as a matter of general policy, that a transfer of less than 10% of a public utility’s outstanding voting securities is not a transfer of control for the purposes of FPA Section 203(a)(1). In a number of recent decisions, FERC has also relied upon an applicant’s eligibility to file statements of beneficial ownership with the Securities Exchange Commission (SEC) on Schedule 13G<sup>3</sup> as one factor in FERC’s Section 203 analysis of control.

**B. FERC Requirements Applicable to Market-Based Rate Sellers**

FERC allows a public utility to make power sales at market-based rates if the seller and its affiliates lack or have adequately mitigated both horizontal and vertical market power. FERC’s market power analysis attributes to the seller all of the generation and transmission facilities and inputs to electric power production owned or controlled by its affiliates. As a condition of obtaining and retaining market-based rate authority, sellers must timely report to the Commission “any change in status that would reflect a departure from the characteristics the Commission relied upon in granting market-based rate authority,”<sup>4</sup> which includes certain acquisitions of generation or transmission facilities or inputs to electric power production by the seller or any of its affiliates. In addition, FERC has imposed a number of restrictions on market-based rate power sales between affiliated entities and power and non-power goods and services transactions between franchised public utilities with captive customers and their market-regulated power sales and non-utility affiliates.

**C. Definition of “Affiliate”**

FERC’s existing regulations define an “affiliate” of a specified company for market-based rate purposes as any person (1) that owns, controls, or holds with power to vote 10% or more of the specified company’s outstanding voting securities; (2) whose voting securities are owned, controlled, or held with power to vote by the specified company; (3) that has been determined by FERC to be an affiliate of the specified company; or (4) that is under common control with the specified company. These regulations create a rebuttable presumption that, directly or indirectly, owning, controlling, or holding with power to vote less than 10% of a specified company’s voting securities results in a lack of control.

**D. September 2008 EPSA Petition**

In the EPSA Petition, EPSA requested guidance from FERC regarding the concepts of control and affiliation under Sections 203 and 205 of the FPA. EPSA requested, among other things, that FERC clarify that, where an investor directly or indirectly acquires 10% or more but less than 20% of a public utility’s outstanding voting securities and is eligible to file SEC Schedule 13G, such investment would not be deemed to result in a change in control and therefore would not trigger the requirement for prior FERC



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approval under FPA Section 203(a)(1) or to result in affiliation with the public utility for purposes of FERC's market-based rate requirements under FPA Section 205.

FERC held a workshop on issues raised by the EPSA Petition on December 3, 2008, and subsequently solicited written post-workshop comments.

### II. Blanket Authorization Amendments

#### A. Proposed Blanket Authorizations

In the NOPR, FERC explains that, after considering the EPSA Petition, the comments submitted, and the discussions at the workshop, it determined that more formal treatment of these issues through a FERC rulemaking is warranted, in particular, the adoption of additional blanket authorizations. FERC therefore proposes to amend its regulations to adopt a blanket authorization under FPA Section 203(a)(2),<sup>5</sup> and a parallel authorization under FPA Section 203(a)(1),<sup>6</sup> for acquisitions of 10% or more, but less than 20%, of the outstanding voting securities of a public utility or holding company, provided that the acquiring company files the requisite Affirmation. The proposed blanket authorizations make no distinction between the securities of publicly-traded utilities or securities of privately-held utilities, so that each authorization would be available regardless of whether the public utility or holding company whose securities are acquired is publicly- or privately-held.

#### B. Affirmation Contents and Commitments

The Affirmation is a sworn statement signed by a senior executive of the investor certifying that the securities were not acquired and are not held for the purpose or with the effect of changing or influencing the control of the public utility or holding company and that the investor will comply with certain conditions designed to limit its ability to exercise control. FERC states that the Affirmation serves a similar purpose to the SEC's Schedule 13G, but that the Affirmation is more closely tailored to assist FERC in carrying out its statutory responsibilities and therefore requires information and commitments in addition to those contained in the Schedule 13G. The Affirmation would have to be filed within 10 days after the acquisition, and the investor would have to provide a copy of the Affirmation to the company whose securities have been acquired.

The Affirmation requires the filing company to provide information regarding: (1) the number of shares of the voting securities acquired and percent of the total shares outstanding acquired; (2) the name and location of any other public utility that is an affiliate of the investor; and (3) a description and the location of inputs to electric power production that are owned or controlled by the investor or by any affiliate of the investor. The information provided on share ownership in the initial filing must be updated quarterly.<sup>7</sup>

In addition, the investor must commit that it will not take the following actions to demonstrate that it will not attempt to exercise control over the public utility:

- seek or accept representation on the public utility's board of directors or otherwise serve in any management capacity;



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- request or receive non-public information, either directly or indirectly, concerning the business or affairs of the public utility;
- solicit, or participate in any solicitation of, proxies involving the public utility; and
- 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, hiring or fixing compensation of the public utility's officers, directors and employees.

FERC notes that these restrictions are not intended to preclude the investor from exercising its voting rights as a shareholder.

### III. Amendments to “Affiliate” Definition and Market-Based Rate Requirements

FERC also proposes to amend the definition of “affiliate” in Part 35 of its regulations to define an “affiliate” of a specified company as any person that controls, is controlled by, or is under common control with such specified company.<sup>8</sup> It would retain the existing presumption that owning, controlling, or holding with power to vote less than 10% of the voting securities of such company results in a lack of control. Under the proposed amendments, a transaction for which an Affirmation has been filed—that is, where an investor had acquired more than 10% but less than 20% of the public utility's outstanding voting securities<sup>9</sup>—would be deemed to create an affiliate relationship between the public utility and the investor, but the public utility would be exempt from the market-based rate requirements pertaining to affiliated companies. Consequently, a public utility that is the subject of such an Affirmation would not be required to file a notice of change in status or include the investor or the investor's other affiliates in its market power analysis, and it would not be subject to the affiliate transaction rules for transactions with the investor or the investor's other affiliates.<sup>10</sup> This exemption would remain valid only for so long as the information contained in the Affirmation (as modified through subsequent quarterly updates) is true, complete and correct and the reporting person remains in compliance with the commitments that are made in the Affirmation.

<sup>1</sup> Notice of Proposed Rulemaking, *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) (NOPR).

<sup>2</sup> This Affirmation would be submitted on new FERC Form 519-C (Affirmation in Support of Exemption from Affiliation Requirements), which is attached to the NOPR as Appendix A.

<sup>3</sup> Schedule 13G may be filed with the SEC pursuant to Section 13(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m (1934 Act), and the SEC's rules thereunder, 17 C.F.R. § 240.13d-1, by any person that has acquired beneficial ownership of more than 5% but less than 20% of the outstanding voting equity securities of a company that are registered under Section 12 of the 1934 Act and such person certifies that it has not acquired, and does not hold, such securities for the purpose of or with the effect of changing or influencing the control of the issuer.

<sup>4</sup> 18 CFR 35.42(a). A seller must include as part of its notice of change in status or updated market power analysis an asset appendix, which lists the filing entity and all of its affiliates and their associated generation assets as well as electric transmission assets, natural gas intrastate pipelines, and natural gas storage facilities owned or controlled by the entity or its affiliates. 18 C.F.R. pt. 35, subpt. H, app. B.



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<sup>5</sup> Proposed Regulation 18 C.F.R. § 33.1(c)(2)(B). FERC notes that, under the proposal, a public utility whose securities are acquired in a transaction that falls within the proposed FPA Section 203(a)(2) blanket authorization would have no obligation to seek approval under FPA Section 203(a)(1).

<sup>6</sup> Proposed Regulation 18 C.F.R. § 33.1(c)(12)(B).

<sup>7</sup> FERC further proposes that, in the event an investor that has filed an Affirmation, but no longer can or wants to comply with the commitments made therein, the investor would have to file an application under FPA Section 203 to request authorization to retain the securities previously acquired under the blanket authorization. During the pendency of any such proceeding, the investor would not be permitted to acquire any additional voting securities and would have to continue to comply with all of the commitments made in the Affirmation. In addition, depending on the final disposition of the application, the public utility may be required to file a notice of change in status and the restrictions on affiliate transactions may become applicable.

<sup>8</sup> Proposed Regulation 18 C.F.R. §§ 35.36(a)(9), 35.43(a)(1). In addition, as under the current FERC regulations, 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.

<sup>9</sup> In addition, FERC proposes to define the term “voting security” to mean “any security presently entitling the owner or holder thereof to vote in the direction or management of the affairs of a company,” which is the definition of that term under the Public Utility Holding Company Act of 2005. Energy Policy Act of 2005, Pub. L. No. 109-58, § 1261 *et seq.*, 119 Stat. 594 (2005).

<sup>10</sup> FERC notes that, where the investor is not a holding company and therefore not subject to FPA Section 203(a)(2), the investor will not have filed an Affirmation, and the public utility will be affiliated with the investor and its other holdings. FERC proposes to allow investors that are not subject to the blanket authorizations proposed above to also file the Affirmation, which would relieve the public utility of the market-based rate requirements discussed above.

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