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FERC Clarifies Rules for Market-Based Rate Power Sales in Order No. 697-B

On December 18, 2008, the Federal Energy Regulatory Commission (FERC) issued its Order No. 697-B,¹ which, in addressing requests for rehearing and clarification of Order No. 697-A,² further refines rules for market-based rate sales of electric energy, capacity and ancillary services.³ In Order No. 697-B, FERC:

- Revises the definition of “affiliate” for purposes of its market-based rate regulations by eliminating the separate definition for exempt wholesale generators (EWGs), so that the same definition, using a 10 percent voting interest threshold, applies to both EWGs and non-EWGs;
- Clarifies that market-based rate sellers should, for purposes of their market power analysis, allocate their long-term transmission reservations to themselves only up to the uncommitted first-tier generation capacity owned, operated or controlled by the seller and its affiliates;
- Declines to clarify that “sites for new generation capacity development” includes only sites for which permits for a generation plant have been obtained or construction of a plant has commenced;
- Revises the standard market-based rate tariff provision governing sales by mitigated sellers at the metered boundary of the market in which they are subject to mitigation; and
- Confirms that a contract for a fixed quantity of energy (as opposed to a long-term contract for capacity) does not trigger the change in status reporting requirement to the extent that the contract does not confer control.

I. Affiliate Definition

Market-based rate sellers are generally required to report “affiliation” with entities that own or control generation or inputs to generation, and to include their affiliates’ generation and inputs to generation in the

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market power analyses required in order to obtain, and to retain, market-based rate authority. In Order No. 697-A, FERC adopted separate definitions of “affiliate” for EWGs and non-EWGs. Specifically, a person was deemed to be an “affiliate” of an EWG if it owned, controlled, or held with power to vote five percent or more of the EWG’s voting securities, or if the EWG owned, controlled, or held with power to vote five percent or more of its voting securities. In contrast, the definition for non-EWGs employed a 10 percent threshold. In response to arguments on rehearing that it had erred in adopting separate definitions of “affiliate” for EWGs and non-EWGs, FERC first issued a notice requesting supplemental comments and then, in Order No. 697-B, eliminated the separate definition for EWGs. FERC made clear that this revision to the definition of “affiliate” was without prejudice to its providing further guidance on issues of “control” and “affiliation” in case-specific and generic proceedings.

II. Horizontal Market Power

FERC’s horizontal market power analysis consists of two generation market power screens: the Pivotal Supplier Analysis and the Wholesale Market Share Screen. If an entity fails to pass either of the screens, there is a presumption of horizontal market power and further analysis is required. Order No. 697-B provides clarification with respect to a number of issues regarding the implementation of this analysis.

A. SIL Clarification

When performing the screen analysis for a given geographic market (*i.e.*, a balancing authority area), market-based rate sellers must consider imports of their own and affiliated generation from adjacent, first-tier markets. In Order No. 697-B, FERC clarified that sellers must allocate their seasonal and longer transmission reservations to themselves from the calculated SIL only up to the uncommitted first-tier generation capacity owned, operated or controlled by the seller and its affiliates.

FERC requires sellers to consider long-term transmission reservations (*i.e.*, longer than one month) when calculating SIL. In Order No. 697-B, FERC clarified that “month” in this context means a calendar month, and is not limited to a 28-day period, as language in Order No. 697-A implied.

B. Control

In performing their market power screens, sellers must include all generation owned or controlled by the seller and its affiliates. FERC clarified that it will require a seller that owns a generation facility, but claims that it does not control the facility, *e.g.*, due to a contractual arrangement that transfers control, to seek a “letter of concurrence” from the other party that identifies the degree to which each party controls a facility and to submit this letters with its filing. Absent agreement between the parties regarding control, FERC stated that it may request additional information, including, but not limited to, copies of any contracts that allege to transfer control.



III. Vertical Market Power

FERC also considers whether sellers can exercise vertical market power, either through owning, controlling, or operating transmission facilities or through the ability to erect barriers to entry through ownership or control of inputs to electric power production such as intrastate natural gas pipelines, storage, or distribution facilities, sites for new generation capacity development, physical coal supply sources or ownership of, or control over, who may access the transportation of coal supplies. In Order No. 697-B, FERC rejected requests for clarification that the term “sites for new generation capacity development” should mean only sites with respect to which permits for new generation have been obtained or where construction of new generation is underway. Instead, FERC said, this term “should be construed to include ownership of land that could potentially be used for generation.” FERC did clarify, however, that “sites for new generation capacity development” does not include land that cannot be used for generation capacity development, *e.g.*, due to zoning requirements.

IV. Affiliate Abuse

FERC also imposes additional restrictions on public utilities with a franchised service territory and captive customers and their power sales affiliates with market-based rate authority (or “market-regulated” affiliates), to prevent the utility from providing its market-regulated affiliates with undue preferences, or from unduly discriminating against non-affiliates, *e.g.*, prohibiting it from sharing certain classes of employees with its market-regulated affiliates. In Order No. 697-B, FERC clarified that risk management personnel may be shared and may perform risk management activities on behalf of both the franchised public utility and its market-regulated affiliates, provided that the risk management personnel do not act as a conduit for sharing non-public information regarding the transmission system or transmission customers.

V. Mitigation

FERC imposes mitigation on sellers that are found, or presumed, to have market power in a given market by requiring them to charge cost-based rates in that market. In Order No. 697-B, FERC clarified the intent of standard tariff language applicable to mitigated sellers regarding sales at the metered boundary between a market in which the seller has, or is presumed to have, market power, and a market in which it does not have market power. Explaining that this language was meant to prevent an affiliate of a mitigated seller from selling power that was purchased at a market-based rate at the metered boundary back into the balancing authority area in which the seller has been found, or presumed, to have market power, FERC revised the language to state that “if the Seller wants to sell at the metered boundary of a mitigated balancing authority area at market-based rates, then neither it nor its affiliates can sell into that mitigated balancing authority area from the outside.” A mitigated seller is required to update its tariff with the revised provision the next time that it files revised tariff sheets, a triennial review, or a change in status report.



VI. Reporting Requirements

FERC conditions its grant of market-based rate authority on the seller's compliance with a number of reporting requirements, including an obligation to report to FERC in a timely manner any change in status that would reflect a departure from the characteristics that FERC relied upon in granting market-based rate authority, *e.g.*, ownership or control of generation capacity that results in net increases of 100 MW or more. In Order No. 697-A, FERC clarified that a change in status also includes long-term firm capacity purchases that result in net increases of 100 MW or more. In Order No. 697-B, FERC clarified that entering into a long-term contract to purchase a fixed amount of energy (*e.g.*, a firm, liquidated damages power purchase contract) that does not confer control over a particular generation facility is not a reportable change in status.

¹ *Market-Based Rates For Wholesale Sales Of Electric Energy, Capacity And Ancillary Services By Public Utilities*, Order No. 697-B, 125 FERC ¶ 61,326 (2008).

² *Market-Based Rates For Wholesale Sales Of Electric Energy, Capacity And Ancillary Services By Public Utilities*, Order No. 697-A, FERC Stats. & Regs. ¶ 31,268 (2008).

³ *See Market-Based Rates For Wholesale Sales Of Electric Energy, Capacity And Ancillary Services By Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252 (2007).

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