UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Cross-Subsidization Restrictions on Affiliate Transactions	Docket No. RM07-15-000

COMMENTS ON NOTICE OF PROPOSED RULEMAKING OF THE AMERICAN PUBLIC POWER ASSOCIATION AND THE NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

The American Public Power Association (APPA) and the National Rural Electric Cooperative Association (NRECA) respectfully submit comments on the Notice of Proposed Rulemaking (NOPR) issued in this proceeding on July 20, 2007.[1]

The Commission should adopt the proposed codification of its rules against cross-subsidization in affiliate transactions. The Commission should clarify; however, that the final rule (1) also protects transmission customers against cross-subsidization, in accord with existing Commission policy, (2) does not apply to electric cooperatives and (3) does not foreclose the possibility of supplemental cross-subsidization restrictions on affiliate transactions on a case-by-case basis. Finally, the Commission should require after-the-fact reporting of non-power goods and services transactions among affiliates.

Description of APPA and NRECA

APPA is the national service organization representing the interests of not-for-profit, publicly owned electric utilities throughout the United States. More than 2,000 public power systems provide over 16 percent of all kilowatt-hour sales to ultimate

[1] 72 Fed. Reg. 41,644 (July 31, 2007). By Notice of Extension of Time (Aug. 17, 2007), the Commission extended the date for comments on the NOPR to September 6, 2007.

customers, and do business in every state except Hawaii. Public power systems own about 10 percent of the nation's electric generating capacity, but they purchase nearly 70 percent of the power used to serve their ultimate consumers. Public power systems own about eight percent of the nation's high-voltage transmission lines, but many must use the transmission facilities of public utilities to move their power supplies to their loads. APPA and the public power systems that it represents therefore have a vital interest in the structure of the electric utility industry and its competitive health. APPA has participated actively in numerous dockets before this Commission concerning wholesale competition issues.

NRECA is the not-for-profit national service organization representing approximately 930 not-for-profit, member-owned rural electric cooperatives. The great majority of these cooperatives are distribution cooperatives, which provide retail electric service to over 37 million consumer-owners in 47 states. Kilowatt-hour sales by rural electric cooperatives account for approximately 10 percent of total electricity sales in the United States. In addition, NRECA members include approximately 65 generation and transmission (G&T) cooperatives that supply wholesale power to their distribution cooperative owner-members. Both distribution and G&T cooperatives were formed to provide electric service to their owner-members at the lowest reasonable cost consistent with adequate and reliable service. While some electric cooperatives generate their own power and sell limited power in excess of their members' needs to third parties in wholesale markets, most cooperatives are net buyers of power. Overall, cooperatives purchase nearly half of their energy requirements from other wholesale suppliers.

Introduction and Summary

APPA and NRECA strongly support the NOPR's goals of continuing to impose affiliate restrictions consistent with existing Commission policy, expanding the coverage of those restrictions to address the existing "gap in coverage," and codifying those restrictions in regulations.[2] The Commission should therefore adopt the proposed rule, but clarify the final rule in three respects:

- To ensure that no gap in coverage remains, and consistent with existing Commission policy, the Commission should clarify that the final rule protects transmission customers as well as "captive customers" against cross-subsidization.
- Consistent with existing Commission policy, the Commission should confirm that the final rule does not apply to electric cooperatives.[3]
- The Commission should clarify that the final rule does not foreclose the Commission from imposing additional cross-subsidization restrictions on affiliate transactions on a case-by-case basis, *e.g.*, in utility mergers.

In the NOPR, the Commission also seeks comment on whether it should impose after-the-fact reporting requirements on non-power goods and services transactions covered by the proposed restrictions. As argued below, the Commission should require additional reporting.

---

[2] *See* NOPR, P 15.

[3] Because municipal utilities are not regulated as public utilities under Part II of the Federal Power Act, *see* 16 U.S.C. § 824(f), the proposed rule by its terms does not apply to them.

Comments

A. The Commission should continue, expand, and codify in its regulations generic cross-subsidization restrictions on affiliate transactions.

As noted in the NOPR, the Commission has adopted prophylactic cross-subsidization restrictions with respect to market-based rate authorizations under section 205 of the Federal Power Act (FPA)[4] and utility merger proceedings under FPA section 203.[5] In the instant rulemaking proceeding, the Commission proposes "to continue imposing affiliate restrictions, to expand the coverage of those restrictions, and to codify them in our regulations."[6]

APPA and NRECA have previously supported and continue to support the Commission's adoption of generic regulations imposing cross-subsidization restrictions on affiliate transactions.[7] The NOPR is correct that there is a "gap in coverage" in the Commission's existing regulations and policies.[8] Generic regulations will help the Commission discharge its responsibility of ensuring that transactions authorized under FPA section 203 do not result in cross-subsidization of non-utility companies, that all rates subject to the Commission's jurisdiction are just and reasonable, and that all captive customers are protected.[9] The proposed rule goes a long way toward plugging that gap in coverage and ensuring that the statutory requirements are met.

---

[4] 16 U.S.C. § 824d. *See* Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities, Order No. 697, 72 Fed. Reg. 39,903 (July 20, 2007), *reh'g pending.*

[5] 16 U.S.C. § 824b. *See, e.g., National Grid plc*, 117 FERC ¶ 61,080, PP 64-66 (2006) (authorizing merger upon requirement of implementation of code of conduct for all utility subsidiaries of merged company addressing both power and non-power goods and services transactions).

[6] NOPR, P 15.

[7] *See* FPA Section 203 Supplemental Policy Statement, 72 Fed. Reg. 42,277, P 22 (Aug. 2, 2007).

[8] NOPR, P 15.

[9] *Id.*, P 16.

Accordingly, the Commission should adopt the proposed rule, subject to the clarifications outlined below.

B. The Commission should clarify in the final rule the scope and effect of the cross-subsidization restrictions.

1. The Commission should clarify that the final rule protects transmission customers against cross-subsidization.

The affiliate restrictions proposed in the NOPR would apply "to all franchised public utilities with captive customers and their market-regulated and non-utility affiliates and would address both power and non-power goods and services transactions between the utility and its affiliates."[10] The proposed restrictions would:

> (1) Require the Commission's approval of all power sales by a franchised utility with captive customers to a market-regulated power sales affiliate;
>
> (2) require a franchised public utility with captive customers to provide non-power goods and services to a market-regulated power sales affiliate or a non-utility affiliate at a price that is the higher of cost or market price;
>
> (3) prohibit a franchised public utility with captive customers from purchasing non-power goods or services from a market-regulated power sales affiliate or a non-utility affiliate at a price above market price (with the exception of (4)); and
>
> (4) prohibit a franchised public utility with captive customers from receiving non-power services from a centralized service company at a price above cost.[11]

As the NOPR observes,[12] the first three of these proposed restrictions are consistent with and mirror the affiliate restrictions the Commission adopted in Order No. 697, the final rule in the market-based rate rulemaking.[13] The fourth restriction, applying

---

[10] *Id*.

[11] *Id*. *See also* 18 C.F.R. § 35.44 (proposed).

[12] NOPR, P 16.

[13] *Compare* 18 C.F.R. § 35.44(a), (b)(1), (b)(2) (proposed) *with* Order No. 697, 72 Fed. Reg. at 40,040 (to

to centralized service companies in a holding-company system, does not appear in Order No. 697, but the Commission has imposed it in merger orders under FPA section 203[14] and reaffirmed its importance in Order No. 667, the final rule adopting regulations implementing the Public Utility Holding Company Act of 2005 (PUHCA 2005).[15] The NOPR states that "codifying [this fourth restriction] in the regulations along with the other affiliate restrictions … will eliminate any gaps in coverage and ensure uniformity in the restrictions being applied."[16]

The Commission should clarify one aspect of the final rule, however, to ensure that the goals of eliminating gaps and uniformity of restrictions are achieved. The proposed regulations define a "franchised public utility" as "a public utility with a franchised service obligation under state law"[17] and a "captive customer" as "any wholesale or retail electric energy customers served under cost-based regulation."[18] This definition of "captive customer" is identical to that adopted in the market-based rate final rule, Order No. 697,[19] the Commission's FPA section 203 regulations as amended in Order No. 669-A,[20] and the PUCHA 2005 final rule, as amended in Order No. 667-A.[21]

---

be codified at 18 C.F.R. § 35.39(b), (e)(1), (e)(2)).

[14] *See, e.g., National Grid*, 116 FERC ¶ 61,080, at P 66.

[15] Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, Order No. 667, 70 Fed. Reg. 75,592, PP 167-74 (Dec. 20, 2005), *order on reh'g*, Order No. 667-A, 71 Fed. Reg. 28,446 (May 16, 2006), *order on reh'g*, Order No.667-B, 71 Fed. Reg. 42,750 (July 28, 2006).

[16] NOPR, P 16.

[17] 18 CFR § 35.43(a)(2) (proposed).

[18] *Id*. at § 3.43(a)(1) (proposed).

[19] *See* Order No. 697, 72 Fed. Reg. at 40,039 (to be codified at 18 C.F.R. § 35.36(a)(6)). *See also id.,* PP 478, 482.

[20] *See* Transactions Subject to FPA Section 203, Order No. 669-A, 71 Fed. Reg. 28,422, PP 142, 147 (May 16, 2006), *order on reh'g*, Order No. 669-B, 71 Fed. Reg. 42,579 (July 27, 2006).

[21] *See* Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility

Nonetheless, the Commission recognized in both the FPA section 203 rule and the PUHCA 2005 rule that transmission customers, while not technically "captive customers," must be protected against cross-subsidization along with captive wholesale and retail customers.[22] In Order No. 669-A, the Commission, adopting the language proposed by APPA and NRECA, included regulatory language "to cover public utilities that own or provide transmission service over Commission-jurisdictional transmission facilities."[23] The Commission reaffirmed that position in Order No. 667-A by concluding that the exemption from the Commission's PUHCA 2005 regulations for "non-traditional utilities" must be limited to jurisdictional utilities that have no captive customers, are not affiliated with such utilities that have captive customers, *and* "do not own Commission-jurisdictional transmission facilities or provide Commission-jurisdictional transmission services or that are not affiliated with persons that own Commission-jurisdictional transmission facilities or provide Commission-jurisdictional transmission services."[24]

Accordingly, the Commission should clarify the regulatory text in the final rule to ensure that, consistent with existing Commission affiliate cross-subsidization policy and the Commission's existing FPA section 203 and PUHCA 2005 regulations, the new generic cross-subsidization regulation explicitly protects transmission customers.

2. The Commission should confirm that the final rule does not apply to electric cooperatives.

In the final rule in the market-based rate rulemaking, Order No. 697, the

---

Holding Company Act of 2005, Order No. 667-A, 71 Fed. Reg. 28,446, P 17 (May 16, 2006), *order on reh'g*, Order No.667-B, 71 Fed. Reg. 42,750 (July 28, 2006).

[22] *See e.g.*, Order No. 669-A at PP 142, 147; Order No. 667-A at P 17.

[23] Order No. 669-A at P 147. *See* 18 C.F.R. § 33.1(c)(1)(i), (1)(ii), (5)(ii)(D), (6); *id*. § 33.2(j)(ii) (2007).

[24] Order No. 667-A at P 17. *See* 18 C.F.R. § 366.3(b)(2)(ii) (2007).

Commission reaffirmed a long line of established precedent[25] in finding that the affiliate cross-subsidization rules otherwise applicable to all public utilities with market-based rates were unnecessary for electric cooperatives:

> For electric cooperatives that are public utility sellers and not exempted from public utility regulation by FPA § 201(f), as discussed above, the Commission will continue to treat such electric cooperative as not subject to the Commission's affiliate abuse restrictions, based on a finding that transactions of an electric cooperative with its members do not present dangers of affiliate abuse through self-dealing. Even if an electric cooperative is not statutorily exempted from our regulation under Part II of the FPA, we conclude that a waiver of § 35.39 is appropriate. As the Commission has previously explained, "affiliate abuse takes place when the affiliated public utility and the affiliated power marketer transact in ways that result in a transfer of benefits from the affiliated public utility (and its ratepayers) to the affiliated power marketer (and its shareholders)." However, as the Commission has previously stated in many market-based rate orders over the years, where a cooperative is involved, the cooperative's members are both the ratepayers and the shareholders. Any profits earned by the cooperative will enure to the benefit of the cooperative's ratepayers. Therefore, we have found that there is no potential danger of shifting benefits from the ratepayers to the shareholders.[26]

Since issuing Order No. 697, the Commission has reaffirmed this position in denying rehearing of an order approving a cooperative's market-based rate filing.[27]

The Commission has repeatedly adopted the same analysis in other similar regulatory contexts, exempting cooperatives from the Commission's restrictions under

---

[25] *See, e.g., Deseret Generation & Transmission Elec. Co-op.*, 115 FERC ¶ 61,306, at P 14 (2006) (citing cases), *reh'g denied*, 120 FERC 61,139 (2007).

[26] Order No. 697, P 526 (*quoting Heartland Energy Services, Inc.*, 68 FERC ¶ 61,223 at 62,062 (1994)). *See also Deseret*, 115 FERC ¶ 61,306, at P 14 ("affiliate abuse is not a concern for cooperatives owned by other cooperatives, where the cooperative's ratepayers are its members").

[27] *Deseret Generation & Transmission Co-op.*, 120 FERC ¶ 61,139 at P 16 (2007) ("In Order No. 697, the Commission found that where a cooperative is involved, the cooperative's members are both the ratepayers and the shareholders and any profits earned by the cooperative will enure to the benefit of the cooperative's ratepayers.").

FPA section 204 governing the issuance of securities by public utilities[28] and from the Commission's holding-company regulations under PUHCA 2005.[29]

Consistent with this established policy and multiple precedents, the Commission should confirm in the final rule that the restrictions on affiliate transactions in the promulgated regulations do not apply to electric cooperatives.

3. The Commission should clarify that the regulations adopted in this proceeding do not preclude the Commission from imposing additional cross-subsidization restrictions on affiliate transactions as appropriate on a case-by-case basis.

Codifying the Commission's cross-subsidization restrictions on affiliate transactions in the regulations to eliminate the gaps in the coverage of the Commission's existing restrictions and ensure uniformity in the restrictions being applied, as proposed in the NOPR, is a salutary goal. As the NOPR observes, the proposed generic regulations would assist the Commission in ensuring that rates are just and reasonable and in meeting the requirement of amended FPA section 203 that transactions authorized under that section do not result in the unchecked cross-subsidization of non-utility companies.[30]

Yet the Commission's review of jurisdictional rates under FPA section 205 and section 206,[31] and of applications under FPA section 203, often requires the Commission to make findings and balance considerations that are unique to a particular case.

---

[28] *See Kandiyohi Power Coop.*, 106 FERC ¶ 61,010 at P 16 (2004). The Commission has consistently followed this rule. *See e.g., Platte-Clay Elec. Coop., Inc.*, 112 FERC ¶ 62,188 (2005); *Fla. Keys Elec. Coop.*, 111 FERC ¶ 62,104 (2005); *Wells Rural Elec. Co.*, 109 FERC ¶ 62,093 (2004); *Salmon River Elec. Coop., Inc.*, 108 FERC ¶ 62,021 (2004); *Wabash Valley Power Ass'n*, 108 FERC ¶ 62,001 (2004). The restrictions are contained in *Westar Energy, Inc.*, 102 FERC ¶ 61,186, *clarified*, 104 FERC ¶ 61,018 (2003).

[29] Order No. 667, P 130. *See* 18 C.F.R. § 366.1 ("voting security" does not include "membership interests in electric power cooperatives").

[30] NOPR, P 16.

[31] 16 U.S.C. § 824e.

Accordingly, the Commission should clarify that the final rule in this proceeding will not foreclose the Commission's consideration of supplemental affiliate restrictions, such as ring-fencing measures, on an individual basis in appropriate circumstances.[32] In the policy statement on FPA section 203 transactions issued concurrently with the instant NOPR, the Commission has expressed its intent to consider such supplemental protections on an individual basis in FPA section 203 proceedings.[33] In the final rule in this docket, the Commission should explicitly affirm its intent to consider supplemental restrictions.

C. The Commission should adopt after-the-fact reporting requirements for affiliate transactions.

The NOPR seeks comment on whether the Commission should impose after-the-fact reporting requirements on non-power goods and services transactions covered by the proposed affiliate restrictions and, if so, what form they should take.[34] APPA and NRECA believe the Commission should consider adopting additional after-the-fact reporting requirements.

At the outset, there is no question of the Commission's statutory authority to require such reporting. In the PUHCA 2005 final rule, Order No. 667, the Commission concluded that it has authority under the FPA to require public utilities to file all agreements involving the allocation of the costs of non-power goods and services to public utilities and other members of the holding-company system.[35] It follows that the

---

[32] *See FPA Section 203 Supplemental Policy Statement*, 72 Fed. Reg. at P 22.

[33] FPA Section 203 Supplemental Policy Statement, P 23.

[34] NOPR, P 18.

[35] Order No. 667, P 149.

Commission has the authority to require public utilities to report on the affiliate transactions they undertake pursuant to such agreements.

Nonetheless, in Order No. 667, the Commission did not require the blanket filing of all such agreements governing the allocation of costs under non-power goods and services transactions.[36] The Commission requires traditional, centralized service companies in holding company systems to file annual reports (FERC Form No. 60) containing certain information relating to affiliate transactions.[37] The Commission concluded that it could adequately protect customers by reviewing the information in these annual reports, plus any information it obtains in ordinary rate proceedings and through audits.[38]

The Commission does not, however, require single-purpose service companies or other associate companies in holding-company systems to file any periodic reports of non-power goods and services transactions. These leaves the Commission and wholesale and transmission customers with a significant information gap when it comes to evaluating whether cross-subsidization is in fact occurring. APPA and NRECA continue to believe that the Commission should require the filing of affiliate agreements governing non-power goods and services transactions, and the filing of periodic reports of all affiliate transactions within holding-company systems, whether they involve a traditional centralized service company, a single-purpose service company, a market-regulated power sales affiliate, or a non-utility affiliate.

---

[36] *Id.*, P 151.

[37] *See* 18 C.F.R. § 366.23 (2007).

[38] *Id.*, P 152.

True, a one-size-fits-all reporting regime may not appropriate for all public utilities subject to these rules. But that does not mean that no reporting should be required. Instead, the Commission could require each covered public utility to file a one-time compliance filing informing the Commission of its then-existing affiliate relationships. (To the extent possible, all affiliated companies would be required to make a joint filing.) The Commission would allow covered public utilities to seek exemption from the reporting requirements based on such factors as the structure of the corporate family, the quantity and type of business risks in the corporate family, the magnitude of potential for cross-subsidization, and the geographic reach of the corporate family, and the presence of state regulation and reporting requirements.[39]

If not exempt, public utilities should be required to submit annual statements regarding affiliations and affiliate transactions. The Commission should require "change in status" reports, particularly from public utilities that have complete or partial exemptions from the reporting requirements.

This outline of reporting regime is admittedly general. After receiving comments on the NOPR in this proceeding—and reply comments if useful—the Commission should consider a further technical conference to address this question.

Conclusion

The Commission should adopt the proposed rule as clarified above. The Commission should also require that affiliate agreements involving non-power goods and

---

[39] If any states do require such reporting, the companies in those states could easily provide the same information to the Commission that it is required to report to the state. On the other hand, if any states do not require such reporting, the companies in those states should report to the Commission under the Commission's guidelines.

services transactions be filed with the Commission and require after-the-fact reporting of such affiliate transactions as outlined above.

Respectfully submitted,

AMERICAN PUBLIC POWER ASSOCIATION

/s/ Susan N. Kelly

Susan N. Kelly
Vice President of Policy Analysis
and General Counsel
Allen Mosher
Senior Director of Policy Analysis and Reliability

American Public Power Association
2301 M Street, N.W., Suite 300
Washington, D.C. 20037-1484
(202) 467-2900
Fax: (202) 467-2910
Email: skelly@appanet.org
amosher@appanet.org

NATIONAL RURAL ELECTRIC COOPERATIVE
ASSOCIATION

/s/ Wallace F. Tillman
Wallace F. Tillman
Vice President, Energy Policy and General Counsel
Richard Meyer
Senior Regulatory Counsel

National Rural Electric Cooperative Association
4301 Wilson Blvd.
Arlington, VA 22203
(703) 907-5811
Fax: (703) 907-5517
E-mail: richard.meyer@nreca.coop

/s/ Randolph Lee Elliott ___________________

Randolph Lee Elliott
Bethany Pribila
Miller, Balis & O'Neil, P.C.
1140 Nineteenth Street, N.W.
Suite 700
Washington, D.C. 20036
(202) 296-2960
(202) 296-0166 (fax)

Counsel for American Public Power Association
and National Rural Electric Cooperative
Association

September 6, 2007