

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Blanket Authorization Under FPA Section 203

Docket No. RM07-21-000

**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

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 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

¹ 72 Fed. Reg. 41,640 (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.

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

Section 203(a)(1) of the Federal Power Act (FPA) requires Commission approval for a public utility to, *inter alia*, dispose of jurisdictional facilities or merge such facilities with those of any other person.² In the NOPR, the Commission seeks comment on its proposal to amend its regulations to provide for a blanket authorization under section 203(a)(1) for a public utility “to dispose of less than 10 percent of its voting securities to a public utility holding company but only if, after the disposition, the holding company

² 16 U.S.C. § 824b(a)(1).

and any associate company *in aggregate* will own less than 10 percent of that public utility.”³

In response to the instant NOPR, APPA and NRECA submit comments addressing the following points:

1. If the Commission adds this blanket authorization to its regulations, it should by all means include the 10-percent aggregate ownership limitation. As the NOPR observes, this limitation would help to prevent the transfer of control of a public utility without *ex ante* Commission approval, consistent with the statutory requirement and Commission policy.

2. If the Commission provides this blanket authorization, it should also require the public utility to report on all dispositions of its securities undertaken pursuant to the blanket authorization to ensure that the Commission and the public are apprised of all dispositions that might, alone or in aggregate, support a transfer of control.

3. The Commission should not extend the proposal, however, to include a blanket authorization for public utilities to dispose of unlimited amounts of their securities—and potentially transfer control—to persons that are holding companies solely because they own an exempt wholesale generator (EWG), foreign utility company (FUCO), or qualifying facility (QF). Such authorization could allow a holding company to acquire generation market power without Commission approval.

4. Neither should the Commission extend its proposal to include a blanket authorization for public utilities to dispose of unlimited amounts of their securities to non-bank holding companies for the purpose of engaging in “hedging transactions,” even

³ NOPR, P 9 (emphasis original).

on the condition that the holding company may only vote less than 10 percent of the public utility's outstanding voting securities. Such blanket authorization is not "consistent with the public interest," because neither Commission's existing regulations nor the instant NOPR defines "hedging transactions." True, the Commission's existing blanket authorizations under section 203(a)(2) of the FPA⁴ for holding companies to acquire public-utility securities for purposes of engaging in undefined "hedging transactions"⁵ already suffers from this deficiency. But until the existing blanket authorizations are better defined and their effects understood, they should not be extended under section 203(a)(1).

5. Finally, the Commission should not issue a blanket authorization under section 203(a)(1) to public utilities to dispose or acquire jurisdictional contracts—even if neither the disposing nor acquiring public utility has captive customers or owns or provides transmission service over Commission-jurisdictional facilities and the contract does not convey control over the operation of a generation or transmission facility. Many public-power utilities and cooperatives (and doubtless other load-serving entities) rely on jurisdictional power-purchase contracts to provide a reliable power supply for their loads. Many such contracts, especially power supply agreements, are not "cookie cutter" in nature, but are situation specific and unique. Even where those contracts are at market-based rates, so that the Commission deems the buyer not to be a "captive customer," the seller public utility should not be free to assign or transfer the contract to another—

⁴ 16 U.S.C. § 824b(a)(2). This section requires Commission approval for "a holding company in a holding company system that includes a transmitting utility or an electric utility" to, *inter alia*, acquire any security with a value over \$10 million of a transmitting utility, electric utility company, or another such holding company.

⁵ 18 C.F.R. § 33.1(c)(10).

possibly unrelated—public utility without Commission approval. At this critical stage in the evolution of wholesale power markets, the Commission should retain its scrutiny of these transactions. Wholesale power-purchase contracts have not reached the point of being freely transferable commodity products so that their free transfer is necessarily consistent with the public interest.

Comments

A. The Commission should retain the NOPR’s proposed 10% aggregate limitation on ownership.

Section 203(a)(2) of the FPA requires Commission authorization for “a holding company in a holding company system that includes a transmitting utility or an electric utility” to, *inter alia*, acquire any security with a value over \$10 million of a transmitting utility, electric utility company, or another such holding company.⁶ In Order No. 669,⁷ the Commission granted blanket authorization under section 203(a)(2) for such a holding company to acquire any such voting security “if, after the acquisition, the holding company will own less than 10 percent of the outstanding voting securities.”⁸

Section 203(a)(1) of the FPA requires Commission authorization for a public utility to, *inter alia*, dispose of jurisdictional facilities or merge such facilities with those of any other person.⁹ A public utility’s disposition of its voting securities to another person, in an acquisition or merger, may constitute a transfer of control of the public

⁶ 16 U.S.C. § 824b(a)(2).

⁷ Transactions Subject to FPA Section 203, Order No. 669, 71 Fed. Reg. 1,348, P 145 (Jan. 6, 2006), *order on reh’g*, 71 Fed. Reg. 28,421 (May 16, 2006), *order on reh’g*, 71 Fed. Reg. 42,579 (July 27, 2006).

⁸ 18 C.F.R. § 33.1(c)(2)(ii) (2007).

⁹ 16 U.S.C. § 824b(a)(1).

utility's jurisdictional facilities requiring Commission authorization under section 203(a)(1).¹⁰

The Commission proposes in the instant NOPR to grant public utilities a blanket authorization under section 203(a)(1) that “would work in conjunction with the blanket authorization granted to holding companies under section 203(a)(2)”¹¹ The proposed regulation would grant a blanket authorization under FPA section 203(a)(1) for a public utility “to transfer its outstanding voting securities to any holding company granted blanket authorizations in section (c)(2)(ii) of this section [18 C.F.R. § 33.1(c)(2)(ii)] if, after the transfer, the holding company and any of its associate or affiliate companies in aggregate will own less than 10 percent of the outstanding voting interests of such public utility.”¹² The reference in the proposed language is to the blanket authorization for a holding company to acquire such securities if, after the acquisition, the holding company will own less than 10 percent of the outstanding voting securities.

The NOPR states that the proposed section 203(a)(1) blanket authorization “would not entirely ‘parallel’ the section 203(a)(2) authorization,” because the latter “does not contain the ‘in aggregate’ limitation,” but the Commission “believe[s] this limitation would provide better protection against possible transfer of ‘control’ of a public utility” and seeks comment on this limitation.¹³

¹⁰ NOPR, P 8 & n.10.

¹¹ NOPR, P 9.

¹² 18 C.F.R. § 33.1(c)(12) (proposed). An “associate company” of a company is any company in the same holding company system with such company. An “affiliate” of a company is any company, 5% or more of the outstanding voting securities of which are owned, controlled, or held with power to vote, directly, or in directly, by such company. *See* 18 C.F.R. § 33.1(b)(4) (2007) (associate company and affiliate company have the same meaning as under Public Utility Holding Company Act of 2005 (PUHCA 2005)); 18 C.F.R. § 366.1 (2007) (defining affiliate and associate company under PUHCA 2005).

¹³ NOPR, P 9.

The Commission should not promulgate the section 203(a)(1) blanket authorization without the “in aggregate” limitation. Without this limitation, a public utility could transfer less than 10 percent of its outstanding voting shares to each of several affiliates or associate companies. Although each individual transfer would be covered by the blanket authorization under section 203(a)(2), the transfers to several affiliated entities taken together could easily constitute the indirect transfer of control of the public utility’s jurisdictional facilities to a single entity. Similarly, without the “in aggregate” limitation, a public utility could make several successive transfers of less than 10 percent of its outstanding voting shares to the same entity because each transfer individually would be covered by the blanket authorization under section 203(a)(2). However, the transfers in the aggregate could easily convey control of the public utility’s jurisdictional facilities to a single entity. The proposed “in aggregate” limitation would ensure that the Commission is able to review such transfers of control on a case-by-case basis.

A blanket authorization under section 203(a)(1) without the “in aggregate” limitation is not “consistent with the public interest.”¹⁴ Absent a case-by-case review, the Commission has no basis for a finding that an indirect transfer of control of a public utility’s generation or transmission facilities to a single entity or to several affiliated entities will not harm competition, captive customers, or transmission customers.¹⁵ In Order No. 669-A, where the Commission declined to grant a blanket authorization to

¹⁴ 16 U.S.C. § 824b(a)(4) (Commission shall approve proposed transaction if it finds that the proposed transaction, inter alia, “will be consistent with the public interest”).

¹⁵ See NOPR, P 10 (finding that proposed blanket authorization will not harm competition or captive customers); Order No. 669-A, PP 103, 147 (Commission merger policy protects both transmission customers and captive customers).

public utilities under section 203(a)(1) without an “in aggregate” limitation, the Commission explained that “[c]oncerns with control, markets and protection of captive customers or customers receiving transmission service over jurisdictional transmission facilities are closely linked with assets directly controlled by the public utilities.”¹⁶ These concerns remain valid and central to the Commission’s merger policies.

Accordingly, if the Commission grants the proposed blanket authorization under section 203(a)(1), it should include the proposed “in aggregate” limitation.

B. The Commission should require public utilities to report transactions made pursuant to the blanket authorization.

The existing section 203(a)(2) blanket authorization to holding company in 18 C.F.R. § 33.1(c)(2)(ii) is conditional on the holding company providing the Commission copies of any Schedule 13D, Schedule 13G, and Form 13F filed with Securities and Exchange Commission in connection with the securities acquisition.¹⁷ This requires the holding company to notify the SEC, and this Commission, if it acquires more than 5% of the public utility’s voting securities.¹⁸ The NOPR does not propose to require the selling public utility to provide any additional information but seeks comments on whether it should do so.¹⁹

The current requirements for reporting by holding companies to the SEC and this Commission are inadequate to protect the public interest as defined in FPA section 203. The Commission correctly recognizes that the proposed “in aggregate” limitation on the

¹⁶ Order No. 669-A, P 103.

¹⁷ 18 C.F.R. § 33.1(c)(4).

¹⁸ See NOPR, P 11.

¹⁹ *Id.*

blanket authorization is warranted to protect against possible transfers of control. The Commission should require public utilities to provide it information giving assurance of their continued compliance with the “in aggregate” limitation at the time of any transfer made under color of these blanket authorizations. The reporting burden is minimal. But the Commission should not have to piece this information together from multiple schedules and reports by holding companies and other sources. Indeed, it is not clear that the holding-company reporting would be sufficient for this purpose, since it would be entirely possible for a transfer of control to be accomplished by multiple holding-company acquisitions, only some of which would be reported.

Accordingly, the Commission should require public utilities to report all dispositions of their securities undertaken pursuant to this blanket authorization and to certify their continued compliance with the “in aggregate” limitation.

C. The Commission should not grant public utilities blanket authorization under section 203(a)(1) to transfer their securities to holding companies granted a blanket authorization under FPA section 203(a)(2) to acquire the securities of EWGs, FUCOs, or QFs.

Under the Commission’s regulations, a person that is a holding company solely with respect to one or more exempt wholesale generators (EWGs), foreign utility companies (FUCOs), or qualifying facilities (QFs) is granted a blanket authorization under section 203(a)(2) to acquire the securities of additional EWGs, FUCOs, or QFs.²⁰ The NOPR seeks comments on whether its proposed blanket authorization to public utilities under section 203(a)(1) “should be extended” to authorize public utilities to

²⁰ 18 C.F.R. § 33.1(c)(8).

transfer their securities to holding companies granted a blanket authorization under section 203(a)(2) by this regulation.²¹

The Commission should not grant such a blanket authorization under section 203(a)(1). Such an extension of the proposal would preauthorize an EWG or QF that is a public utility to transfer all or any part of its securities to a holding company that has blanket authorization to acquire them. This blanket authorization under section 203(a)(1) would enable a public utility to transfer control of its generation facilities to a holding company that already controls another public utility, without Commission scrutiny of the transaction.

Due to the risk of a direct or indirect transfer of control of jurisdictional facilities to a single entity, such a blanket authorization under section 203(a)(1) would be inconsistent with the requirements of FPA section 203 and established Commission merger policy. It would disable the Commission from ensuring that the transfer of control would not harm competition. The Commission has no basis for finding that such a blanket authorization under section 203(a)(1) would be “consistent with the public interest.”

D. The Commission should not provide blanket authorization for public utilities to transfer their securities to a non-bank holding company or its subsidiary for purposes of engaging in hedging transactions.

The Commission’s regulations grant a blanket authorization under section 203(a)(2) for a holding company or its subsidiary to acquire any security of a public utility or a holding company that includes a public utility “[f]or purposes of engaging in hedging transactions, subject to the condition that its such holdings are 10 percent or more

²¹ NOPR, P 12.

of the voting securities of a given class, the holding company or its subsidiary shall not vote such holdings to the extent that they are 10 percent or more.”²²

The NOPR again seeks comments on whether the Commission should extend its proposed blanket authorization to public utilities under section 203(a)(1) to authorize public utilities to transfer their securities to holding companies granted a blanket authorization under section 203(a)(2) by this regulation.²³

The Commission should not extend a blanket authorization to public utilities to sell their securities to holding companies for purposes of the holding company’s “hedging transactions,” even with the 10% voting limitation. The Commission has no basis for finding that the transactions covered by such a blanket authorization under section 203(a)(1) would be “consistent with the public interest” as required by FPA section 203.

First, the Commission’s existing regulations nowhere define “hedging transactions,” and neither does the instant NOPR. In addition, any holding company or its subsidiary, without limitation, can acquire the securities. There is no requirement that the acquiring company be in some business other than the utility, power, or energy business, and thus no assurance that the hedging transaction is only incidental to the holding company’s main business. Thus, the scope of and the very basis for such a blanket authorization under section 203(a)(1) would be uncertain.²⁴ Without a clear

²² 18 C.F.R. § 33.1(c)(10).

²³ NOPR, P 12.

²⁴ The Commission grants a similar, but narrower, blanket authorization for regulated banking companies to acquire an unlimited amount of the securities of holding companies that include a transmitting utility or an electric utility company “in the normal course of its business” and “[a]s principal for derivatives hedging purposes incidental to the business of banking,” if “it commits not to vote such securities to the extent they exceed 10 percent of the outstanding shares.” 18 C.F.R. § 33.1(c)(9)(ii). This blanket authorization has inherent limits, since bank regulators allow hedging for purposes of bank safety and soundness and thus supervise the allowed hedging transactions. *See* Technical Conference Comments of the Financial Institutions Energy Group, Docket No. AD07-2-000, at 19 (Jan. 26, 2007); Request for Clarification and/or

understanding of the types of hedging transactions that this blanket authorization would facilitate, and the potential impacts of such transactions on the continued financial health of the subject public utility, the Commission should be very wary of allowing such transactions without prior case-by-case review.

It may be said that these problems already exist in the blanket authorization under section 203(a)(2) provided in 18 C.F.R. § 33.1(c)(10)(ii). That is true. But the solution is to fix or else delete the existing blanket authorization, not extend it to public utilities under section 203(a)(1).

The discussion in Order No. 669-A of the existing blanket authorization under section 203(a)(2) does not describe why it is consistent with the public interest, except to conclude that the 10% voting limitation will prevent a transfer of control of the public utility.²⁵ But the same cannot be said for the blanket authorization under section 203(a)(1), for the same reasons that required the “in aggregate” limitation in the NOPR’s proposed blanket authorization. Thus, if the Commission were to grant a further blanket authorization under section 203(a)(1), it should contain a similar “in aggregate” limitation.

E. The Commission should not provide a blanket authorization for the disposition of jurisdictional contracts.

The Commission also seeks comments on whether it should grant “a generic blanket authorization under section 203(a)(1) for the acquisition or disposition of a jurisdictional contract where neither the acquirer nor the transferor has captive customers

Rehearing of Bank of America, N.A. and JPMorgan Chase Bank, N.A., Docket No. RM05-32-001, at 24-25 (Jan. 23, 2006). *See also* Order No. 669-A, P 131. The exemption to non-bank holding companies in 18 C.F.R. § 33.1(c)(10) contains no such built-in limitations.

²⁵ Order No. 669-A, P 132.

and the contract does not convey control over the operation of a generation or transmission facility.”²⁶ The Commission indicates that it has heard arguments for an even broader blanket authorization that would apply so long as the acquirer has no captive customers, but recognizing that such a blanket authorization “may present concerns where the transferor has captive customers,” the NOPR seeks comments on the narrower generic blanket authorization quoted above.²⁷

At the outset, the blanket authorization posited in the NOPR is not narrow enough to be consistent with existing Commission policy under section 203, which protects transmission customers as well as “captive customers.” The Commission’s existing regulations under section 203 exclude transmission customers from the definition of “captive customers.”²⁸ However, the Commission has recognized that transmission customers must be protected against cross-subsidization in the same way that captive wholesale and retail power customers are protected.²⁹ Thus, in Order No. 669-A, the Commission, adopting language proposed by APPA and NRECA, included regulatory language “to cover public utilities that own or provide transmission service over Commission-jurisdictional facilities.”³⁰ This should be no exception. Thus, if the Commission were to adopt the described blanket authorization, to be consistent with existing Commission policy and regulation the authorization would have to be further narrowed so that would be limited to circumstances where “neither the acquirer nor the

²⁶ NOPR, P 13.

²⁷ *Id.*

²⁸ Order No. 669-A, PP 142, 147.

²⁹ *Id.* See also Comments on Notice of Proposed Rulemaking of APPA and NRECA, Docket No. RM07-15-000, at 6-7 (Sept. 6, 2007).

³⁰ Order No. 669-A at P 147. See 18 C.F.R. § 33.1(c)(1)(i), 1(ii), 5(ii)(D), (6) (2007); *id.* § 33.2(j)(ii).

transferor has captive customers or owns or provides transmission service over Commission-jurisdictional facilities....”

But even this narrower generic blanket authorization is inadvisable, however. At this critical juncture in the development of competitive wholesale power markets, the Commission should not exempt this broad class of transactions in jurisdictional power contracts.

The described blanket authorization would enable any public utility without captive customers—such as a power marketer or an independent power producer—to transfer its book of jurisdictional power sales contracts to any other such entity. So a municipal utility or an electric cooperative that signs a power purchase contract with one seller would face the prospect of the transfer of its contract to another entity at any time during the term of the contract without *ex ante* Commission approval. While it is true that many power purchase contracts have assignment language that requires the purchaser’s consent, it is the experience of APPA and NRECA members that contracts with assignment provisions often have boilerplate language that also requires the consent to assignment not be unreasonably withheld. If the Commission grants blanket authorization for such transfers, on the ostensible basis that it would be “consistent with the public interest,” the seller could then argue that it would be unreasonable for the buyer to withhold consent. Consequently, the buyer would be forced to file a complaint under FPA section 206,³¹ and bear the burden of proof and the burden of litigation, just to preserve its contract and prevent its assignment.

³¹ 16 U.S.C. § 824e.

Left out of the calculus is that the buyer under the jurisdictional contract, even though not technically “captive” (as the Commission narrowly defines that term) may be a load-serving entity that depends on the contract for a reliable power supply, or to meet regulatory obligations (e.g., installed capacity requirements) or contractual obligations (e.g., lending covenants). Indeed, the described blanket authorization would appear to allow a contract for the purchase of full requirements, load following “system power” from a vertically integrated utility with market-based rates to be freely assigned to an entity without any “system” whatsoever to back it up.

More generally, a load-serving entity may contract to purchase from a well-established, well-financed marketer or generator, only to find its contract later assigned to another entity that provides much less assurance of its ability to perform. Indeed, a seller might transfer unprofitable jurisdictional contracts to an affiliated entity for “ring fencing” purposes in order to insulate itself from litigation or bankruptcy risk—all without the Commission’s *ex ante* approval.

If such free transfers of contracts were allowed, the power-contract business might come to resemble the mortgage-loan business, with securitization of portfolios of contracts and a secondary market so that your contract is “sold” to another entity for “servicing.” For load-serving entities that rely on wholesale contracts for the physical delivery of power to meet load service obligations, that is a daunting scenario. The Commission should not grant such a blanket authorization for the transfer of jurisdictional contracts.

Conclusion

If the Commission promulgates the proposed regulation, it should retain the proposed “in aggregate” limitation. It should also require public utilities to report on all transactions made under the blanket authorization. The Commission should not grant the additional blanket authorizations as described 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

(202) 467-2910 (fax)

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

Jay A. Morrison

Senior Regulatory Counsel

National Rural Electric Cooperative Association

4301 Wilson Blvd.

Arlington, VA 22203

(703) 907-5811

(703) 907-5517 (fax)

richard.meyer@nreca.coop

/s/ Randolph Lee Elliott

Sean T. Beeny

Randolph Lee Elliott

Miller, Balis & O'Neil, P.C.

1140 Nineteenth Street, N.W.

Suite 700

Washington, D.C. 20036

(202) 296-2960

(202) 296-0166 (fax)

relliott@mbolaw.com

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

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