

122 FERC ¶ 61,155
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

18 CFR Part 35

[Docket No. RM07-15-000; Order No. 707]

Cross-Subsidization Restrictions on Affiliate Transactions

(Issued February 21, 2008)

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final Rule.

SUMMARY: In this Final Rule, pursuant to sections 205 and 206 of the Federal Power Act, the Federal Energy Regulatory Commission (Commission) is amending its regulations to codify restrictions on affiliate transactions between franchised public utilities that have captive customers or that own or provide transmission service over jurisdictional transmission facilities, and their market-regulated power sales affiliates or non-utility affiliates. These restrictions will supplement other restrictions the Commission has in place to protect captive customers of franchised public utilities or transmission customers of franchised public utilities that own or provide transmission service over jurisdictional transmission facilities from inappropriate cross-subsidization of affiliates.

EFFECTIVE DATE: This Final Rule will become effective [Insert_Date days after publication in the **FEDERAL REGISTER**].

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SUPPLEMENTARY INFORMATION:

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FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Sudeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Cross-Subsidization Restrictions on Affiliate
Transactions

Docket No. RM07-15-000

ORDER NO. 707

FINAL RULE

(Issued February 21, 2008)

1. On July 20, 2007, the Commission issued a Notice of Proposed Rulemaking to codify affiliate restrictions that would be applicable to all 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.¹ After receiving comments in response to the Affiliate Transactions NOPR, the Commission amends Part 35 of its regulations, pursuant to sections 205 and 206 of the Federal Power Act (FPA), to adopt such restrictions.²

¹ Cross-Subsidization Restrictions on Affiliate Transactions, Notice of Proposed Rulemaking, 72 FR 41644 (July 31, 2007), FERC Stats. & Regs. ¶ 32,618 (2007) (Affiliate Transactions NOPR).

² 16 U.S.C. 824d, 824e.

2. Finalization of this rulemaking is one of a number of steps the Commission has taken following the repeal of the Public Utility Holding Company Act of 1935³ to ensure that customers of franchised public utilities do not inappropriately cross-subsidize the activities of “non-regulated” affiliates, and are not otherwise financially harmed as a result of affiliate transactions and activities. The restrictions in this Final Rule will provide certainty to public utilities and customers with respect to the pricing standard that must be applied to certain affiliate transactions. While the Commission already has in place affiliate rules that apply to public utilities with market-based rates and to public utilities seeking merger approvals, the restrictions in this rule will supplement existing restrictions and will apply to all franchised public utilities that have captive customers or that own or provide transmission service over jurisdictional transmission facilities. Thus, they will strengthen the Commission’s ability to ensure that customers are protected against affiliate abuse and that rates remain just and reasonable.

I. Background

3. Under sections 205 and 206 of the FPA, the Commission must ensure that the rates, terms and conditions of jurisdictional service are just, reasonable and not unduly discriminatory or preferential. As part of the Commission’s obligation in administering this FPA standard, it ensures that wholesale customers’ rates do not reflect costs that are the result of undue preferences granted to affiliates or that are imprudent or unreasonable

³ 16 U.S.C. 79a et seq. (PUHCA 1935).

as a result of affiliate transactions. The Commission has a long history of scrutinizing affiliate transactions for potential cross-subsidization and in recent rulemakings and orders it has codified and expanded affiliate restrictions, both under its FPA section 205-206 rate authority (in the context of market-based rates) and under its FPA section 203 merger authority. As discussed infra, pursuant to its FPA section 205-206 authority, in this Final Rule the Commission will extend similar restrictions to all franchised public utilities that have captive customers or that own or provide transmission service over jurisdictional transmission facilities. As historical backdrop, however, we first discuss our past and existing practices with respect to affiliate transactions in the context of market-based rates and mergers.

A. Affiliate Transactions in the Context of Market-Based Rate Authorizations

1. Historical Approach

4. The Commission began considering proposals for market-based pricing of wholesale power sales and attendant cross-subsidy issues in 1988. The Commission acted on market-based rate proposals filed by various wholesale suppliers on a case-by-case basis. In doing so, the Commission considered, among other things, whether there

was evidence of affiliate abuse or reciprocal dealing involving the seller or its affiliates.⁴ As the Commission explained, “[t]he Commission’s concern with the potential for affiliate abuse is that a utility with a monopoly franchise may have an economic incentive to exercise market power through its affiliate dealings.”⁵ The Commission also stated its concern that a franchised public utility and an affiliate may be able to transact in ways that transfer benefits from the captive customers of the franchised public utility to the affiliate and its shareholders.⁶ Where a franchised public utility makes a power sale to an affiliate, the Commission is concerned that such a sale could be made at a rate that is too low, in effect, transferring the difference between the market price and the lower rate from captive customers to the market-regulated affiliated entity. Where a power seller with market-based rates makes power sales to an affiliated franchised public utility, the concern is that such sales could be made at a rate that is too high, which would give an

⁴ See Heartland Energy Services Inc., 68 FERC ¶ 61,223, at 62,062 (1994) (Heartland) (discussing the potential for abuse in the case of affiliated power marketers); Commonwealth Atlantic Limited Partnership, 51 FERC ¶ 61,368, at 62,245 (1990) (discussing potential for reciprocal dealing if a buyer agrees to pay more for power from a seller in return for that seller (or its affiliates) paying more for power from that buyer (or its affiliates)).

⁵ Boston Edison Company Re: Edgar Electric Energy Co., 55 FERC ¶ 61,382, at 62,137 n.56 (1991) (Edgar). See also TECO Power Services Corp., 52 FERC ¶ 61,191, at 61,697 n.41, order on reh’g, 53 FERC ¶ 61,202 (1990) (“The Commission has determined that self dealing may arise in transactions between affiliates because affiliates have incentives to offer terms to one another which are more favorable than those available to other market participants.”).

⁶ See, e.g., Heartland, 68 FERC at 62,062.

undue profit to the affiliated entity at the expense of the franchised public utility's captive customers.⁷ In determining whether to allow power sales affiliate transactions, the Commission, over time, has adopted several methods, all of which have focused on ensuring that captive customers are adequately protected against affiliate abuse.

5. Just as the Commission has expressed concern about the potential for affiliate abuse in connection with power sales between affiliates, it also has recognized that there may be a potential for affiliate abuse through other means, such as the pricing of non-power goods and services or the sharing of market information between affiliates.⁸ The same concerns about giving undue profits to affiliated market-regulated entities and their shareholders, discussed above with respect to power sales, also apply with respect to these interactions.

⁷ The Commission has found that a transaction between two non-traditional utility affiliates (such as power marketers, exempt wholesale generators (EWGs), or qualifying facilities (QFs)) does not raise the same concern about cross-subsidization because neither has a franchised service territory and therefore has no captive customers. As the Commission has explained, no matter how sales are conducted between non-traditional affiliates, profits or losses ultimately affect only the shareholders. FirstEnergy Generation Corporation, 94 FERC ¶ 61,177, at 61,613 (2001); USGen Power Services, L.P., 73 FERC ¶ 61,302, at 61,846 (1995). With respect to affiliate power sales, the Commission has also developed guidelines on how to determine whether a transaction is above suspicion and captive customers are protected, as well as guidelines for competitive solicitation processes. See Edgar, 55 FERC at 62,167-69; Allegheny Energy Supply Company, LLC, 108 FERC ¶ 61,082, at 61,417 (2004).

⁸ See, e.g., Potomac Electric Power Company, 93 FERC ¶ 61,240, at 61,782 (2000) (Potomac); Heartland, 68 FERC at 62,062-63.

6. Accordingly, the Commission's policy for many years had been to require that, as a condition of market-based rate authorization, applicants adopt a code of conduct applicable to non-power goods and services transactions and information sharing between regulated and non-regulated (market-regulated) affiliated power sellers. The Commission has also required that applicants include a provision in their market-based rate tariffs prohibiting power sales between regulated and non-regulated affiliated power sellers without first receiving authorization of the transaction under section 205 of the FPA.⁹

7. The purpose of the market-based rate code of conduct was to safeguard against affiliate abuse by protecting against the possible diversion of benefits or profits from franchised public utilities (i.e., traditional public utilities with captive ratepayers) to an affiliated entity for the benefit of shareholders. The Commission has waived the market-based rate code of conduct requirement in cases where there are no captive customers, and thus no potential for affiliate abuse, or where the Commission finds that such customers are adequately protected against affiliate abuse.¹⁰ In such cases, however, the Commission directed the utilities to notify the Commission should they acquire captive

⁹ Aquila, Inc., 101 FERC ¶ 61,331, at P 12 (2002).

¹⁰ See, e.g., CMS Marketing, Services and Trading Co., 95 FERC ¶ 61,308, at 62,051 (2001) (granting request for cancellation of code of conduct where wholesale contracts, as amended, "cannot be used as a vehicle for cross-subsidization of affiliate power sales or sales of non-power goods and services"); Alcoa Inc., 88 FERC ¶ 61,045, at 61,119 (waiving code of conduct requirement where there were no captive customers); Green Power Partners I LLC, 88 FERC ¶ 61,005, at 61,010-11 (1999) (waiving code of conduct requirement where there are no captive wholesale customers and retail customers may choose alternative power suppliers under retail access program).

customers in the future and expressly reserved the right to reimpose the market-based rate code of conduct requirement.

2. The Market-Based Rate Final Rule

8. In the Commission's recent Market-Based Rate Final Rule,¹¹ among other things, the Commission codified in the regulations at 18 CFR part 35, subpart H, an explicit requirement that any seller with market-based rate authority must comply with the affiliate power sales restrictions and other affiliate restrictions. Compliance on an ongoing basis is a condition of retaining market-based rate authority. The Market-Based Rate Final Rule retains the policy that wholesale sales of power between a franchised public utility and any of its market-regulated power sales affiliates must be pre-approved by the Commission. It also adopts uniform affiliate restrictions governing power sales, sales of non-power goods and services, separation of functions, and information sharing between franchised public utilities with captive customers and their market-regulated power sales affiliates.¹² The power and non-power goods and services restrictions, however, apply only to transactions involving two power sellers. They do not apply to transactions between a franchised public utility and a non-utility affiliate.

¹¹ Market-Based Rates For Wholesale Sales Of Electric Energy, Capacity and Ancillary Services by Public Utilities, Order No. 697, 72 FR 39904 (July 20, 2007), FERC Stats. & Regs. ¶ 31,252 (2007) (Market-Based Rate Final Rule).

¹² Id. P 23.

B. Affiliate Transactions Under Section 203

1. Before the Energy Policy Act of 2005

9. The Commission has also addressed cross-subsidization issues in the context of section 203 merger applications. Prior to the Energy Policy Act of 2005,¹³ the Commission's policy was to condition its approval of certain section 203 mergers on the applicants' agreement to abide by certain restrictions on non-power goods and services transactions between a merged company's utility and non-utility or market-regulated subsidiaries. The condition was imposed on those mergers involving registered holding companies under PUHCA 1935¹⁴ in order to find that the merger would not adversely affect federal regulation.¹⁵ That requirement grew out of judicial determinations that, when a merger would create or involve a registered holding company, the actions of the Securities and Exchange Commission (SEC) may preclude the Commission from asserting jurisdiction over the non-power transactions between subsidiaries of that holding company.¹⁶ Under Ohio Power, if the SEC approved an affiliate contract involving special purpose subsidiary goods or services at cost, the Commission had to

¹³ Energy Policy Act of 2005, Pub. L. No. 109-58, 1289, 119 Stat. 594, 982-83 (2005) (EPAAct 2005).

¹⁴ EPAAct 2005 repealed PUHCA 1935. EPAAct 2005, Pub. L. No. 109-58, 1263.

¹⁵ See, e.g., Niagara Mohawk Holdings, Inc., 95 FERC ¶ 61,381, at 62,414, order on reh'g, 96 FERC ¶ 61,144 (2001).

¹⁶ See Ohio Power Co. v. FERC, 954 F.2d 779, 782-86 (D.C. Cir.), cert. denied sub nom., Arcadia v. Ohio Power Co., 506 U.S. 981 (1992) (Ohio Power).

allow pass-through of the costs in jurisdictional rates even if the public utility purchasing the goods or services could have obtained them at a lower market price from a non-affiliate.¹⁷ For over a decade following the Ohio Power decision, the Commission required that, to gain section 203 approval of a proposed merger without a hearing, if the transaction would create a registered holding company under the PUHCA 1935, applicants must agree to waive the Ohio Power immunity and abide by the Commission's policy on intra-system transactions for non-power goods and services.¹⁸

2. After EAct 2005

10. Because EAct 2005 repealed PUHCA 1935, certain activities of previously-registered holding companies that were previously subject to SEC regulation, including intra-system affiliate transactions, are no longer exempt from this Commission's full regulatory review. In particular, the Commission's conditions and policies under FPA

¹⁷ The Commission's policy since the mid-1990s has been that where the regulated public utility has provided non-power goods or services to the non-regulated affiliate, the public utility provides the goods or services at the higher of cost or market. A non-regulated affiliate that sells non-power goods or services to an affiliate with captive customers may not sell at higher than market price. This is often referred to as the "market" standard. These standards were articulated in the Commission's 1996 Merger Policy Statement. Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592, 61 FR 68595 (Dec. 30, 1996), FERC Stats. & Regs. ¶ 31,044, at 30,124-25 (1996) (1996 Merger Policy Statement), reconsideration denied, Order No. 592-A, 62 FR 33341 (June 19, 1997), 79 FERC ¶ 61,321 (1997).

¹⁸ Public Service Company of Colorado, 75 FERC ¶ 61,325, at 62,046 (1996) (PSC Colorado); 1996 Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,124-25.

sections 205 and 206 with respect to non-power goods and services transactions between holding company affiliates may now be applied to all public utilities that are members of holding companies, whether in the context of a section 203 merger proceeding or the context of a section 205-206 rate proceeding.¹⁹ In addition, the Commission has authority to review allocation of service company costs among members of holding companies that have public utilities with captive customers.

11. In the Order No. 669 rulemaking proceedings,²⁰ which revised the Commission's regulations pursuant to amended section 203, the Commission continued its past approach with respect to affiliate abuse restrictions involving power and non-power goods and services transactions, in the context of section 203 applications.²¹ However, the Commission made two additional clarifications.

¹⁹ The provisions of PUHCA 1935 that formed the basis for Ohio Power are no longer in effect, thus removing the Ohio Power limitation on our oversight of non-power transactions. Further, FPA section 318, which provided for SEC preemption in certain circumstances where there was a conflict between SEC PUHCA 1935 regulation and Commission regulation, was repealed.

²⁰ Transactions Subject to FPA Section 203, Order No. 669, 71 FR 1348 (Jan. 6, 2006), FERC Stats. & Regs. ¶ 31,200 (2005), order on reh'g, Order No. 669-A, 71 FR 28422 (May 16, 2006), FERC Stats. & Regs. ¶ 31,214, order on reh'g, Order No. 669-B, 71 FR 42579 (July 27, 2006), FERC Stats. & Regs. ¶ 31,225 (2006).

²¹ Amended section 203(a)(4) adds to the Commission's merger analysis the explicit requirement that the Commission find that any proposed transaction will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless that cross-subsidization, pledge, or encumbrance will be consistent with the public interest.

12. First, in its implementation of regulations pursuant to PUHCA 2005,²² the Commission discussed one exception to the traditional standards articulated in the 1996 Merger Policy Statement. In the Order No. 667 rulemaking proceeding,²³ the Commission explained that there are two circumstances in which the at-cost or market standards may arise in the context of the Commission's jurisdictional responsibilities: (1) the Commission's review of the costs of non-power goods and services provided by a traditional, centralized service company to public utilities within the holding company system; and (2) when a service company that is a special-purpose company within a holding company provides non-power goods or services to one or more public utilities in the same holding company system. Under both scenarios, similar concerns regarding affiliate abuse arise: "[w]hether the public utility's costs incurred in purchasing from the affiliate are prudently incurred and just and reasonable, and whether non-regulated affiliates purchasing non-power goods and services from the same special-purpose

²² PUHCA 2005 is primarily a books and records access statute and does not give the Commission any new substantive authorities, other than the requirement that the Commission review and authorize certain non-power goods and services cost allocations among holding company members upon request. EAct 2005, Pub. L. No. 109-58, 1275.

²³ 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 FR 75592 (Dec. 20, 2005), FERC Stats. & Regs. ¶ 31,197 (2005), order on reh'g, Order No. 667-A, 71 FR 28446 (May 16, 2006), FERC Stats. & Regs. ¶ 31,213, order on reh'g, Order No. 667-B, 71 FR 42750 (July 28, 2006), FERC Stats. & Regs. ¶ 31,224 (2006), order on reh'g, 72 FR 8277 (Feb. 26, 2007), 118 FERC ¶ 61,133 (2007).

company are receiving preferential treatment vis-à-vis the public utility.”²⁴ In Order No. 667, the Commission exempted traditional, centralized service companies, which at that time were using the SEC’s “at-cost” standard, from complying with the Commission’s market standard for their sales of non-power goods and services to regulated affiliates.²⁵ In determining that the at-cost standard was appropriate for traditional, centralized service companies, the Commission noted that centralized provision of the services provided by such companies (such as accounting, human resources, legal, tax, and other such services) benefits ratepayers through increased efficiency and economies of scale. Moreover, the Commission recognized that it is frequently difficult to define the market value of the specialized services provided by centralized service companies. On this basis, the Commission stated it would apply a rebuttable presumption that costs incurred under at-cost pricing of such services are reasonable.²⁶ However, with respect to non-power goods and services transactions between holding company affiliates other than traditional, centralized service companies, i.e., service companies that are non-regulated, special-purpose affiliates, such as a fuel

²⁴ Order No. 667, FERC Stats. & Regs. ¶ 31,197 at P 168.

²⁵ Id. P 169.

²⁶ Id. The Commission stated, however, that it would entertain complaints that at-cost pricing for such services exceeds the market price, but complainants would have the burden of demonstrating that that is the case.

supply company or a construction company, the Commission continued with its prior practice.²⁷

13. Second, in recent section 203 merger proceedings, the Commission has extended the applicability of the code of conduct restrictions previously applied only to registered holding companies. In National Grid plc,²⁸ the Commission announced that it would require all merging parties to abide by a code of conduct containing specific provisions regarding power and non-power goods and services transactions between the utility subsidiaries and their affiliates:

Implementation of the Code of Conduct for all utility subsidiaries of the merged company, as required by our decision here, will address both power and non-power goods and services transactions between the utility subsidiaries and their affiliates. The Code of Conduct to be implemented by the merged company shall (1) require our approval of all power sales by a utility to an affiliate, (2) require a utility with captive customers to provide non-power goods or

²⁷ In Order No. 667, the Commission stated that, with respect to sales from a public utility to a non-regulated, affiliated special-purpose company, the price should be no less than cost, *i.e.*, the higher of cost or market; otherwise, a public utility could attempt to game the system and forego profits it could otherwise obtain by selling to a non-affiliate, to the benefit of its non-regulated affiliate who receives a good or service at a below-market price. The Commission also stated that, when the situation is reversed, *i.e.*, the non-regulated, affiliated special-purpose company is providing non-power goods and services to the public utility affiliate, the Commission will continue to apply its market standard. Accordingly, the non-regulated, affiliated special-purpose company may not sell to its public utility affiliate at a price above the market price. The Commission found that such transactions involving such non-regulated, affiliated special-purpose companies pose a greater risk of inappropriate cross-subsidization and adverse effects on jurisdictional rates. *Id.* P 171.

²⁸ 117 FERC ¶ 61,080 (2006) (National Grid).

services to a non-utility or “non-regulated utility” affiliate at a price that is the higher of cost or market price, (3) prohibit a non-utility or non-regulated utility affiliate from providing non-power goods or services to a utility affiliate with captive customers at a price above market price, and (4) prohibit a centralized service company from providing non-power services to a utility affiliate with captive customers at a price above cost. These requirements protect a utility’s captive customers against inappropriate cross-subsidization of non-utility or non-regulated utility affiliates by ensuring that the utility with captive customers neither recovers too little for goods and services that the utility provides to an affiliate nor pays too much for goods and services that the utility receives from an affiliate. Implementation of these requirements provides a prophylactic mechanism to ensure that the merger will not result in cross-subsidization of non-utility or non-regulated utility companies in the same holding company system and therefore meets the requirement of section 203(a)(4) that a merger not result in inappropriate cross-subsidization of a non-utility associate company.²⁹

14. While these affiliate restrictions are broad in terms of transactions covered (covering transactions between power sales affiliates as well as transactions between power sales affiliates and non-utility affiliates) and have been extended within the context of section 203 approvals, they do not apply to public utilities that do not need to seek section 203 merger approval.

II. Affiliate Transactions NOPR

15. In the Affiliate Transactions NOPR, the Commission proposed to implement uniform affiliate restrictions that would be applicable to all franchised public utilities with captive customers and their market-regulated and non-utility affiliates and would

²⁹ Id. P 66 (internal citations removed).

address both power and non-power goods and services transactions between the utility and its affiliates.³⁰ The Commission's goal in proposing these prophylactic restrictions is to protect against inappropriate cross-subsidization of market-regulated and unregulated activities by the captive customers of franchised public utilities. The proposed restrictions are based upon those already imposed by the Commission in the context of certain section 203 and 205 approvals, but expand the transactions and entities to which they apply.

16. Specifically, the proposed regulations would: (1) require the Commission's approval of all wholesale sales between a franchised public utility with captive customers and 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

³⁰ On July 20, 2007, the Commission took three actions based on the Commission's experience implementing amended FPA section 203 and PUHCA 2005, as well as the record from the Commission's December 7, 2006 and March 8, 2007 technical conferences regarding section 203 and PUCHA 2005. In this docket, the Commission issued the Affiliate Transactions NOPR. In addition, in separate orders, the Commission issued a section 203 Supplemental Policy Statement, and a Notice of Proposed Rulemaking proposing additional blanket authorizations under section 203 of the FPA. FPA Section 203 Supplemental Policy Statement, 72 FR 42277 (Aug. 2, 2007), FERC Stats. & Regs. ¶ 31,253 (2007) (Supplemental Policy Statement), order on clarification and reconsideration, 122 FERC ¶ 61,157 (2008); Blanket Authorization Under FPA Section 203, Notice of Proposed Rulemaking, 72 FR 41640 (July 31, 2007), FERC Stats. & Regs. ¶ 32,619 (2007) (Blanket Authorization NOPR); see Blanket Authorization Under FPA Section 203, Order No.708, 122 FERC ¶ 61,156 (2008) (Blanket Authorization Final Rule).

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 goods and services from a centralized service company at a price above cost. The Commission stated that these restrictions would help the Commission meet the requirement of amended section 203(a)(4) that a transaction not result in the inappropriate cross-subsidization of a non-utility associate company and, moreover, help the Commission assure just and reasonable rates and the protection of captive customers for all public utilities pursuant to sections 205 and 206 of the FPA, irrespective of whether they need approval of a section 203 transaction.

III. Procedural Matters

17. The Affiliate Transactions NOPR invited comments on the proposed regulations. Comments on the Affiliate Transactions NOPR were filed by: American Public Power Association and National Rural Electric Cooperative Association (APPA/NRECA); Edison Electric Institute (EEI); Entergy Services, Inc. (Entergy); Interstate Gas Supply, Inc. (IGS); National Grid USA (National Grid); New York State Public Service Commission (New York Commission); NiSource Inc. (NiSource); Occidental Power Marketing, L.P. (Occidental); Oklahoma Corporation Commission (Oklahoma Commission); Pacific Gas and Electric Company (PG&E); the Pinnacle West Companies

(Pinnacle West)³¹; and San Diego Gas & Electric Company and Southern California Gas Company (Sempra).³²

IV. Discussion

18. This Final Rule explains the Commission's authority and jurisdiction under sections 205 and 206 of the FPA to regulate affiliate transactions to ensure that public utility rates are just, reasonable, and not unduly discriminatory or preferential. This Final Rule implements affiliate restrictions applicable to power sales and transactions for non-power goods and services between franchised public utilities that have captive customers or that own or provide transmission service over jurisdictional transmission facilities, and their market-regulated and non-utility affiliates.

A. General Matters

1. The Need for the Proposed Regulations

a. Comments

19. EEI argues that the Commission has not demonstrated a need for the proposed regulations. While EEI agrees that the Commission has been applying affiliate

³¹ For purposes of their filing, the Pinnacle West Companies include: Pinnacle West Marketing & Trading Co., LLC; Arizona Public Service Company; and APS Energy Services Company, Inc.

³² Although unnecessary to preserve their rights to participate in a rulemaking proceeding, Allegheny Power and Allegheny Energy Supply Company, LLC filed a motion to intervene without comments.

transactions restrictions in the context of section 203 and market-based rates,³³ EEI argues that the Affiliate Transactions NOPR goes too far. EEI argues that the Commission does not provide any examples of the problems that the Commission has discovered in the pricing of utility-affiliate transactions that would warrant the expanded new regulations. EEI also argues that there is sufficient regulatory oversight by the Commission and state commissions, so this extension of policy is not warranted.

20. Moreover, EEI argues that the Commission's authority to regulate utility-affiliate transactions under sections 205 and 206 is limited to determining whether jurisdictional rates are just and reasonable. EEI argues that the Commission has not demonstrated why the proposed regulations are necessary to achieve a just and reasonable result. EEI also argues that the Affiliate Transactions NOPR indirectly proposes to regulate entities over which the Commission has no jurisdiction – EWGs, QFs, and non-utilities – by imposing constraints on the prices that utilities may pay these companies for non-power goods and services and the companies in turn must pay the utilities for such goods and services.³⁴

³³ EEI asserts that the Affiliate Transactions NOPR states that the Commission currently waives market-based rate code of conduct requirements and allows transactions in cases where there are no captive customers or customers are protected against affiliate transactions, but that exception is not reflected in the Market-Based Rate Final Rule.

³⁴ EEI Comments at 6-7 (citing Sunray Mid-Continental Co. v. FPC, 364 U.S. 137, 142 (1960); Altamont Gas Transmission Co. v. FERC, 92 F.3d 1239 (D.C. Cir. 1996); National Fuel Gas Supply Corp. v. FERC, 909 F.2d 1519 (D.C. Cir. 1990)).

21. EEI also argues that the Commission's adoption of the rules as a "prophylactic" measure ignores the wording of the Commission's cross-subsidy authority under section 203 by failing to recognize that certain transactions may be in the public interest.

b. Commission Determination

22. We disagree with EEI regarding the need for the proposed regulations or the Commission's authority to enact them. Sections 205 and 206 of the FPA require the Commission to ensure that public utility rates are just, reasonable and not unduly discriminatory or preferential. A rate is not just and reasonable if it includes costs which the Commission finds are imprudently incurred or which require a customer to bear costs that are unreasonable. Further, the Commission must ensure that no public utility makes or grants an undue preference with respect to any transmission or sale subject to the Commission's jurisdiction.³⁵ The Commission has the authority to address these types of rate issues not only in individual cases, but also to set standards by rulemaking with respect to what costs will or will not be considered just and reasonable. The Commission's experience makes clear the need for these types of restrictions and we believe they are particularly warranted in light of the repeal of PUHCA 1935 and our need to be vigilant with respect to holding companies and affiliate transactions.

³⁵ Although section 203 of the FPA requires the Commission to recognize that certain cross-subsidization or pledges or encumbrances of utility assets can be in the public interest, the proposed regulations are set forth pursuant to the Commission's authority under sections 205 and 206 of the FPA.

23. As discussed above, the Commission has a long history of requiring public utilities to comply with affiliate restrictions where an entity seeks market-based rate authorization and in the context of seeking merger authorization under section 203 of the FPA.

However, limiting affiliate restrictions to these two contexts leaves a regulatory gap. As the Affiliate Transactions NOPR explained, (1) restrictions on market-based rate applicants do not cover non-power goods and services transactions between a franchised public utility and non-utilities; they cover only transactions between power sales affiliates and are imposed on only the market-based rate applicants; (2) restrictions imposed on section 203 applicants only apply to merger applicants; (3) the pricing policy set forth in Order No. 667 regarding non-power goods and services provided by centralized service companies was not codified in the regulations; and (4) not all states regulate these types of transactions.³⁶ The purpose of the proposed regulations therefore is to supplement existing affiliate restrictions to cover transactions between all franchised public utilities with captive customers and their non-utility affiliates. Just as the Commission has adopted regulations designed to prevent captive customers of franchised public utilities from inappropriately cross-subsidizing the activities of market-regulated affiliates (such as affiliated power marketers), so too the Commission wants to ensure that captive customers of franchised public utilities do not inappropriately cross-subsidize the activities of non-utility affiliates (such as an affiliated construction services firm, real

³⁶ Affiliate Transactions NOPR, FERC Stats. & Regs. ¶ 32,618 at P 15.

estate company, legal services companies, fuel supply companies, or other non-utility affiliates). For example, where a franchised public utility with captive customers transacts with an affiliated non-utility construction services firm, the Commission is concerned that the franchised public utility with captive customers not pay an above-market price for construction services provided by the affiliated construction firm. Otherwise, the public utility's customers would be inappropriately cross-subsidizing the activities of the affiliate. Indeed, non-utility affiliates such as real estate companies, legal services companies, fuel supply companies or other companies selling non-power goods and services could provide similar opportunities for affiliate abuse and improper cross-subsidization.

24. Finally, we disagree with EEI that the Affiliate Transactions NOPR indirectly proposes to regulate entities over which the Commission "has no jurisdiction" – EWGs, QFs, and non-utilities. As an initial matter, the Commission does, in fact, have certain jurisdiction over QFs, and most EWGs are jurisdictional public utilities. More importantly, however, the pricing rules we adopt here are rooted in our authority to impose pricing rules with respect to certain sales and purchases by public utilities (including EWGs) over whom we have rate jurisdiction under the FPA. These restrictions are tied directly to the reasonableness of public utility rates and the Commission has the statutory responsibility to protect captive customers from unjust and unreasonable rates.

2. The Scope of the Proposed Regulations

a. Comments

25. Several commenters filed comments concerning the scope of the proposed regulations. APPA/NRECA ask that the Commission 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.

26. The Oklahoma Commission notes that the Commission stated that it would require all merging parties to abide by a code of conduct that has specific provisions regarding power and non-power goods and services transactions between the utility subsidiaries and their affiliates. The Oklahoma Commission urges to the Commission to continue to do so. The Oklahoma Commission also asks that the Commission add language that states that section 203 does not preempt applicable state law concerning reporting requirements, which would further protect the interest and authority of state commissions.

27. IGS agrees with the Commission's proposal to codify affiliate restrictions but suggests that the intent of the code of conduct requirement also includes preventing a utility or its affiliate from gaining unfair advantages in a market, thus impeding the development of a competitive market. IGS agrees that a code of conduct should be codified and expanded to apply to non-power goods and services, and that a code of conduct and related rules should also apply outside the context of merger situations. IGS also agrees that, even outside of the context of a merger, it is important that

utility/affiliate code of conduct and related rules apply. IGS further agrees that it is appropriate for the code of conduct and related rules to apply to transactions involving non-power goods and services because, among other things, consumers may not be able to differentiate easily between affiliates and traditional regulated utility and where affiliates are provided preferential access and opportunities, competition is stifled. In addition, IGS argues that the same opportunity for abuse exists in the natural gas industry. It maintains that the same affiliate restriction concepts should be extended to natural gas utilities, and should be considered whenever the utility has an economic interest in the sale of the commodity or non-commodity goods or services.

28. Occidental argues that the proposed regulations permit a utility to circumvent the affiliate transactions restrictions by simply conducting all of its market-based rate activities within its franchised public utility. Occidental asks that the Commission explicitly require that the functional attributes, rather than the arbitrary structure, of a utility be considered in determining compliance with the rule's affiliate abuse restrictions.

b. Commission Determination

29. We agree with APPA/NRECA that the pricing rules that we adopt 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.

30. Regarding the Oklahoma Commission's request that we continue to require all merging parties to abide by a code of conduct that has specific provisions regarding power and non-power goods and services transactions between the utility subsidiaries and

their affiliates, although this rulemaking is not under section 203, as discussed supra, as a condition of section 203 authorization for mergers, we have already stated in the context of section 203 proceedings that we will continue to impose affiliate restrictions on entities seeking merger authorization under section 203 of the FPA. Further, we clarify that neither the rules we adopt here, nor the cross-subsidization restrictions imposed under section 203 of the FPA, preempt applicable state law concerning reporting requirements.

31. We deny IGS' request to expand the proposed regulations to include preventing a utility or its affiliate from gaining unfair advantage in a market. The scope of the proposed regulations is to protect against inappropriate cross-subsidization of affiliates by franchised public utilities with captive customers. We note, however, the cross-subsidy protections go a long way to preventing such unfair advantages since market-regulated or non-regulated companies may have an unfair competitive advantage in the marketplace if others bear some of their costs of doing business.

32. We also deny IGS' request to expand the scope of the proposed regulations to include the natural gas industry. As discussed above, the focus of this rulemaking is public utilities – specifically, franchised public utilities that have captive customers or that own or provide transmission service over jurisdictional transmission facilities. We find that there is an insufficient record to warrant including LDCs and interstate pipelines within the scope of the regulations at this time.

33. Finally, we decline to revise the scope of the proposed regulations to address Occidental's concern that the proposed regulations permit a utility to circumvent the affiliate transactions restrictions by simply conducting all of its market-based rate activities within its franchised public utility. We note that Occidental has raised this concern in its request for rehearing of the Market-Based Rate Final Rule. We find that this concern is more appropriately addressed on rehearing of that order.

B. Specific Issues

1. Definitions

a. Captive Customers

i. Comments

34. Commenters seek a number of clarifications concerning the definition of "captive customers."

35. EEI and Pinnacle West ask the Commission to clarify that wholesale customers with fixed price contracts are not "captive customers" even if the contracts are cost-based, because there is no risk of harm to such customers from utility-affiliate transactions.

36. Occidental argues that the Commission should revise the definition of "captive customer" to not include wholesale customers. Occidental argues that the Commission clarified in the Market-Based Rate Final Rule that retail customers that have retail choice are not captive customers. Occidental maintains that wholesale customers, whether cost-based or market-based, have alternatives and therefore, are not captive. Accordingly,

Occidental argues that the definition of “captive customer” should be limited to retail customers served under cost-based regulation who do not have retail choice available, and should not include wholesale customers which have choices.

37. EEI, National Grid, and Pinnacle West ask the Commission to clarify its definition of “captive customers” consistent with its use of the term in the preamble of the Market-Based Rate Final Rule. In this regard, they ask that the Commission clarify that retail customers in states with retail competition are not “captive customers” for purposes of the affiliate restrictions. Pinnacle West also states that the Commission clarified in Order No. 697 that, for companies the Commission has acknowledged in prior orders as not having captive customers, the affiliate transaction restrictions can be waived. It asks the Commission to provide the same clarification and exemptions in this proceeding.

38. IGS, on the other hand, argues that the restrictions proposed in the Affiliate Transactions NOPR should not be waived for utilities simply because those utilities implement a retail choice program. IGS argues that the ability of a customer to purchase commodities from an alternative power supplier under a retail access program does not mean that these customers are not captive for purposes of receiving their distribution service under cost-based legislation. IGS also states that the restrictions should apply even if the retail customer has a competitive alternative available. It further argues that, as long as a utility is in the business of providing commodity service, there is an opportunity for abuse.

39. EEI and National Grid also ask that the Commission clarify that “captive customers” do not include transmission customers, consistent with the Market-Based Rate Final Rule. By contrast, APPA/NRECA ask that the definition of “captive customers” be expanded to expressly include transmission customers. APPA/NRECA state that the Commission recognized in both the Order No. 669 series and the Order No. 667 series that transmission customers must be protected against cross-subsidization along with captive wholesale and retail customers. They note that the Commission adopted regulatory language in Order No. 669-A “to cover public utilities that own or provide transmission service over Commission-jurisdictional transmission facilities,” and ask that the Commission clarify the regulatory text in the Final Rule to ensure that the new generic cross-subsidization regulation explicitly protects transmission customers.

40. APPA/NRECA also ask that the Commission confirm, consistent with the Market-Based Rate Final Rule, that the affiliate transactions rules do not apply to electric cooperatives.

ii. Commission Determination

41. The term “captive customers” is used in a number of recently adopted Commission rules, including Order No. 667, Order No. 669, and the Market-Based Rate Final Rule. The Commission for many years had used this term in its orders without definition, but in both the Order No. 669 series and the Market-Based Rate Final Rule, the Commission included in the regulatory text a definition or description of “captive customers” as: “any wholesale or retail electric energy customers served under cost-

based regulation.”³⁷ Based on the comments received, we recognize that there may be some ambiguity as to what types of customers are considered to be under “cost-based regulation” and we provide additional clarifications below. We also modify the definition to make clear that it is intended to refer to customers of franchised public utilities. First, however, we believe it is important to discuss the purpose of our definition and its focus on “cost-based regulation.”

42. The Commission’s fundamental goal in categorizing certain customers as “captive” is to protect customers served by franchised public utilities from inappropriately subsidizing the market-regulated or non-utility affiliates of the franchised public utility or otherwise being financially harmed as a result of affiliate transactions and activities. In other words, we are concerned about the potential for the inappropriate transfer of benefits from such customers to the shareholders of the franchised public utility or its holding company.³⁸ Where customers are served under market-based

³⁷ Order No. 669-A, FERC Stats. & Regs. ¶ 31,214 at P 147; Market-Based Rate Final Rule, FERC Stats. & Regs. ¶ 31,252 at P 23; see also Order No. 667-A, FERC Stats. & Regs. ¶ 31,213 at n.35.

³⁸ For example, if a market-regulated seller sells power to its affiliated franchised public utility at an above market price, the customers of the franchised public utility pay more than they need to for power and the affiliate makes a higher profit for the holding company’s shareholders. Similarly, if a franchised public utility sells temporarily excess fuel to its market-regulated power seller affiliate at a price below its cost, the customers of the franchised utility end up subsidizing the affiliate’s operating costs, to the benefit of shareholders and the detriment of the customers of the franchised utility. In other contexts, an extreme example would be a holding company that siphons funds from a franchised public utility to support its failing non-regulated affiliate company; again, this results in financial benefit to shareholders at the expense of customers.

regulation as opposed to cost-based regulation, it is presumed that the seller has no market power over a customer and that the customer has a choice of suppliers; thus, there is less opportunity for a customer to involuntarily be in a situation in which its rates subsidize or support another entity.

43. Under a regime of cost-based regulation, however, we cannot make these same assumptions. If a franchised public utility is selling at a wholesale cost-based rate under the FPA, the franchised utility seller may be in the position of potentially trying to flow through its cost-based rates costs that should instead be borne by its affiliates, i.e., potentially subsidizing the “non-regulated” activities of its market-regulated and non-utility affiliates to the detriment of the franchised public utility’s customer(s). While there is some merit to Occidental’s assertion that wholesale customers, by definition, have alternatives and that there is no obligation for a wholesale seller to sell to any buyer, nor for a buyer to buy from any particular seller, for the customer protection reasons stated above, we believe it is important to err on the side of a broad definition of captive customers.

44. Although we are erring on the side of a broad definition of captive customers, we recognize that there may well be circumstances in which customers fall within our definition but nevertheless there are sufficient protections in place to protect such customers against any risk of harm from transactions between the franchised public utility and its affiliates. For example, it is possible, as advocated by EEI and Pinnacle West, that wholesale customers with fixed rate contracts would be adequately protected

and that the affiliate restrictions of this rule should not apply to utilities whose customers all have fixed rate contracts with no fuel adjustment clause.³⁹ We are not prepared at this time to generically exclude such customers from the definition of captive customers but instead will allow franchised public utilities, on a case-by-case basis, to seek a waiver of the affiliate restrictions. This will allow the Commission to closely examine the facts related to each franchised public utility. There may be circumstances other than fixed rate contracts in which we may be willing to waive the affiliate restrictions of this rule, but a public utility will need to demonstrate that there is no opportunity for wholesale customers of the franchised public utility to be harmed as a result of affiliate transactions.

45. With respect to requested clarifications regarding retail customers in states with retail competition, consistent with our Market-Based Rate Final Rule, we clarify that customers with retail choice are not considered to be customers served under “cost-based regulation” and therefore are not considered captive customers. These customers have retail choice, i.e., by virtue of state law they can purchase at market-based rates from retail suppliers other than a franchised public utility.⁴⁰ As the Commission explained in

³⁹ The Commission would need to be assured that all wholesale customers of a franchised public utility have adequate fixed rate contracts, not just a sub-set of the customers. Further, because such contracts may have different expiration dates, the Commission might need to place temporal conditions on such a waiver.

⁴⁰ As further discussed in the Market-Based Rate Final Rule, the role of this Commission is not to evaluate the success or failure of a state’s retail choice program including whether sufficient choices are available for customers inclined to choose a different supplier. In this regard the states are best equipped to make such a determination and, if necessary, modify or otherwise revise their retail access programs

(continued)

the Market-Based Rate Final Rule, in a regulatory regime in which retail customers have no ability to choose a supplier, they are considered captive because they must purchase from the local utility pursuant to rates set by a state or local regulatory authority.

However, retail customers in retail choice states who choose to buy power from their local utility at cost-based rates as part of that utility's provider-of-last resort obligation are not considered captive customers because, although they may choose not to do so, they have the ability to take service from a different supplier whose rates are set by the

as they deem appropriate. Further, to the extent a retail customer in a retail choice state elects to be served by its local utility under provider-of-last resort obligations, the state or local rate setting authority, in determining just and reasonable cost-based retail rates, would in most circumstances be able to review the prudence of affiliate purchased power costs and disallow pass-through of costs incurred as a result of an affiliate undue preference. Market-Based Rate Final Rule, FERC Stats. & Regs. ¶ 31,252 at P 481. Also, we note that some states have chosen to impose their own affiliate restrictions in such circumstances.

marketplace.⁴¹ We clarify, however, that if a state regulatory authority in a retail choice state does not believe retail customers are sufficiently protected and that our affiliate restrictions should apply to the local franchised public utility, it may file a petition for declaratory order to deem its retail customers to be captive customers for purposes of applying the affiliate restrictions.⁴²

46. As a general matter, we also clarify that the definition of captive customers, and our interpretations of the term, are intended to be applied uniformly in implementing all of our rules. In connection with the affiliate restrictions adopted in the Market-Based Rate Final Rule, we clarified that those affiliate restrictions will not apply where a seller demonstrates, and the Commission agrees, that the seller has no captive customers.⁴³ We also clarified that any sellers that have previously demonstrated and been found not to have captive customers, and therefore have received a waiver of the market-based rate code of conduct requirement in whole or in part, will not be required to request another waiver of the associated affiliate restrictions.⁴⁴ We will adopt a similar approach with

⁴¹ Id. If the retail choice program is not available to all customers in the state, those customers that do not have retail choice would be considered captive customers of the franchised public utility that serves them, and our affiliate restrictions would apply to the franchised public utility.

⁴² Under the Commission's regulations, states are exempt from filing fees for petitions for declaratory order. 18 CFR 381.108.

⁴³ Market-Based Rate Final Rule, FERC Stats. & Regs. ¶ 31,252 at P 552.

⁴⁴ Id. P 551.

regard to the cross-subsidization affiliate restrictions that we adopt in this Final Rule. If a utility makes a showing that it has no captive customers, and the Commission agrees, the affiliate cross-subsidization restrictions will not apply. If a public utility has received a finding that it has no captive customers for purposes of meeting the market-based rate affiliate restrictions, such filing will be deemed sufficient here. However, the utility must make an informational filing with the Commission stating that the affiliate restrictions we adopt in this Final Rule do not apply.

47. Further, in considering the comments in this docket and in the Market-Based Rate Final Rule (pending rehearing), and in reviewing the use of the definition of captive customers in our other rules, we believe it appropriate to modify the definition of captive customers to make explicit what was only implicit in our earlier rules – that the definition is intended to apply to customers served by a franchised public utility under cost-based regulation. Accordingly, we will modify the term to mean: “any wholesale or retail electric energy customers served by a franchised public utility under cost-based regulation.”⁴⁵

48. In response to clarification requests by APPA/NRECA that we modify our proposed regulatory text so that the affiliate restrictions apply not only to franchised

⁴⁵ We recognize that this amended definition will result in redundancy in certain of our regulations since some regulations refer to “franchised public utilities with captive customers” and other regulations simply refer to “captive customers” without elaboration. However, we believe the amendment will eliminate possible confusion in future interpretations.

public utilities that have captive customers but also to public utilities that own Commission-jurisdictional transmission facilities or provide Commission-jurisdictional transmission service, we will grant the request. Thus, the affiliate restrictions will apply where a franchised public utility has captive customers or owns or provides transmission service over Commission-jurisdictional transmission facilities. While some franchised public utilities have captive customers, others do not, although they own or provide transmission service over Commission-jurisdictional transmission facilities.⁴⁶ The customers of these franchised public utilities also should not inappropriately be required to subsidize “non-regulated” activities of the affiliates of such utilities.⁴⁷

49. Finally, we clarify that, consistent with the Market-Based Rate Final Rule, we will continue to treat electric cooperatives as not subject to the Commission’s affiliate abuse restrictions.⁴⁸

⁴⁶ A public utility that has no captive power customers but that owns or provides transmission service over Commission-jurisdictional facilities may seek a waiver of the affiliate restrictions if it can demonstrate that transmission customers are adequately protected against inappropriate cross-subsidization.

⁴⁷ For example, if a franchised public utility owns transmission facilities and also owns a non-utility construction services firm, the public utility’s customers should not pay an above market price for construction services to upgrade transmission facilities.

⁴⁸ Market-Based Rate Final Rule, FERC Stats. & Regs. ¶ 31,252 at P 526.

b. Non-Utility Affiliate

i. Definition of “Affiliate”

(a) Comments

50. PG&E asks the Commission to clarify the definition of “affiliate,” as used in the definition of non-utility affiliate.⁴⁹ PG&E states that the Commission should clarify whether the proposed regulations use the definition of affiliate set forth in the PUHCA 2005 regulations or some other definition.

(b) Commission Determination

51. In response to PG&E’s request for clarification concerning the definition of affiliate in the proposed regulations, we have considered the use of the term affiliate in the context of the Affiliate Transactions NOPR, the Commission’s Standards of Conduct for Transmission Providers, and other precedent.⁵⁰ We have also reviewed the affiliate definitions contained in both the PUHCA 1935 and PUHCA 2005 and have considered the fact that, with respect to certain affiliate preferences or advantages involving EWG rates and charges, we are specifically required by FPA section 214⁵¹ to use the definition contained in PUHCA 1935. After taking into account these differing definitions of affiliate (or, in some cases, no definition at all, as in the context raised by PG&E), and

⁴⁹ As defined in the proposed regulations, “non-utility affiliate” means “any affiliate that is not in the power sales or transmission business.”

⁵⁰ See, e.g., Morgan Stanley Capital Group, Inc., 72 FERC ¶ 61,082, at 61,436-37 (1995) (Morgan Stanley).

⁵¹ 16 U.S.C. 824m.

recognizing the need to provide greater clarity and consistency in our rules, we believe it is important to try to adopt a more consistent definition in our various rules and also one that is sufficiently broad to allow us to adequately protect customers.⁵²

52. Our goal is to have a more consistent definition of affiliate for purposes of both EWGs and non-EWGs to the extent possible, as well as to strengthen the Commission's ability to ensure that customers are protected against affiliate abuse. Accordingly, having studied the clarity and scope of various definitions, we believe it appropriate to modify the definition proposed in the Affiliate Transactions NOPR to explicitly incorporate the PUHCA 1935 definition of affiliate for EWGs (rather than incorporate it by reference as previously has been done). We will also adopt the PUHCA 1935 definition of affiliate for non-EWGs, but with adjustments to reflect our previously-used 10 percent voting interest threshold for non-EWGs and to eliminate certain language not applicable or necessary in the context of the FPA. This is discussed more fully below.

53. In the case of non-EWG public utilities, our past approach has been that a voting interest of 10 percent creates a rebuttable presumption of control for purposes of determining the existence of an affiliate relationship.⁵³ For EWGs, on the other hand, section 214 of the FPA specifies that the term affiliate shall have the same meaning as provided in section 2(a) of PUHCA 1935 (which, *inter alia*, contains a five percent voting

⁵² For example, we adopt this definition of affiliate for purposes of section 203 of the FPA in the concurrent Blanket Authorization Final Rule.

⁵³ See Morgan Stanley, 72 FERC at 61,436-37; 18 CFR 358.3(b) and (c).

interest test) for purposes of determining whether an electric utility is an affiliate of an EWG for purposes of evaluating EWG rates. Although PUHCA 2005 also contains a definition of affiliate, which has been incorporated in § 366.1 of our regulations, that definition is not the same as the definition contained in PUHCA 1935. Indeed, it is narrower than the definition contained in PUHCA 1935.⁵⁴

54. In particular, the PUHCA 2005 definition defines affiliate of a company to mean “any company, 5 percent or more of the outstanding voting securities of which are owned, controlled, or held with power to vote, directly or indirectly, by such company.” The PUHCA 1935 definition, on the other hand, also defines as an affiliate of a specified company “any person that directly or indirectly owns, controls, or holds with power to vote, 5 per centum or more of the outstanding voting securities of such specified company” and “any individual who is an officer or director of such specified company, or of any company which is an affiliate thereof” In addition, the PUHCA 1935 definition also includes in the definition of affiliate “any person or class of persons that the Commission determines, after appropriate notice and opportunity for hearing, to stand in such relation to such specified company that there is liable to be such an absence of arm’s-length bargaining in transactions between them as to make it necessary or

⁵⁴ It is not clear whether some of the language from PUHCA 1935 was inadvertently omitted from the PUHCA 2005 definition or whether Congress thought a more narrow definition was appropriate with respect to a “books and records” access statute. In either case, the PUHCA 1935 definition provides a more “bright line” approach while still reserving the agency’s ability to deem an entity an affiliate based on specific circumstances, thus better ensuring the ability to protect customers.

appropriate in the public interest or for the protection of investors or consumers that such person . . .” be treated as an affiliate.

55. Because FPA section 214 directs the Commission to use the definition of affiliate that appears in PUHCA 1935 with respect to certain affiliate preferences affecting rates or charges of EWGs, we will revise the definition proposed in the Affiliate Transactions NOPR to be consistent with the PUHCA 1935 definition.⁵⁵

56. We also will revise the definition of “affiliate” for purposes of non-EWGs utilities to be consistent with the definition of “affiliate” for EWGs, except to the extent we believe it may leave a gap in coverage or contains language not applicable to the FPA. The definition we adopt for non-EWGs essentially parallels the EWG definition (with certain exceptions that we discuss below), while retaining the 10 percent voting interest threshold contained in the current regulations. Use of the PUHCA 1935 definition for non-EWGs may capture under the definition of “affiliate” entities that otherwise would not have been treated as affiliates under the definition currently in place in the Commission’s regulations. We believe it is appropriate to adopt a broader definition, one that is largely consistent with the definition for EWGs, because it will strengthen the Commission’s ability to ensure that customers are protected against affiliate abuse. For example, the revised affiliate definition for non-EWGs will give the Commission the

⁵⁵ Section 214 provides that no rate or charge of an EWG shall be lawful if, after notice and opportunity for hearing, the Commission finds that it resulted from any undue preference or advantage received from an electric utility that is an associate or affiliate of the EWG.

ability to treat an entity as an affiliate of a company if, after notice and opportunity for hearing, the Commission finds that “there is liable to be such an absence of arm’s-length bargaining in transactions between them as to make it necessary or appropriate in the public interest or for the protection of investors or consumers” that such entity be treated as an affiliate. It also is consistent with other recent orders and rules (e.g., the Supplemental Policy Statement) in which we have provided greater clarity as to what is considered “control” of an entity.

57. While the affiliate definition we adopt for non-EWGs essentially parallels the EWG definition, there are a number of exceptions. One exception is that the non-EWG definition also defines an affiliate of a specified company to include “any person that is under common control with such specified company.” This language is included in the definition of non-EWG affiliate that currently is in the Commission’s regulations and identifies an additional instance in which an entity will be deemed to be an affiliate of a specified company. On this basis, we believe it appropriate to include this language as part of the non-EWG definition. Because the “under common control with” language is not part of the PUCHA 1935 definition, however, we cannot also include it as part of the definition of affiliate for purposes of EWGs. We also include as part of the non-EWG affiliate definition a provision making clear that where a person owns, controls, or holds with power to vote less than 10 percent of the outstanding voting securities of a specified company, this creates a rebuttable presumption of lack of control. Although the PUHCA 1935 definition does not contain a parallel provision with regard to the five percent

threshold in the case of EWGs, we nevertheless believe that it is appropriate to include this rebuttable presumption as part of the non-EWG definition because it provides greater clarity concerning the circumstances in which an entity will be presumed not to be an affiliate.

58. Another exception concerns the provision in the PUHCA 1935 definition that includes as an affiliate of a specified company “any individual who is an officer or director of such specified company, or of any company which is an affiliate thereof” We do not believe it necessary to include that language as part of the affiliate definition for non-EWGs because we already are including in the definition, a provision giving the Commission the ability to treat an entity as an affiliate if, after notice and opportunity for hearing, the Commission finds that there is liable to be an absence of arm’s-length bargaining in transactions between two entities.⁵⁶

59. In sum, we believe that the definition of affiliate that we adopt in this Final Rule will provide greater clarity to public utilities and customers with respect to identifying which entities are considered to be affiliates for purposes of the regulations that we adopt in this Final Rule.

⁵⁶ With respect to this provision, we note that we are omitting language referencing the duties, obligations and liabilities imposed by PUHCA 1935 since those are no longer applicable in light of repeal of PUHCA 1935.

ii. **Definition of “Non-Utility Affiliate”**

(a) **Comments**

60. NiSource argues that the Commission should revise the definition of non-utility affiliate because it could inadvertently include state-regulated local distribution companies (LDCs) and Commission-regulated interstate pipelines because they are not in the power sales or transmission business. NiSource notes that the regulatory text strongly suggests that the Commission intended the definition of non-utility affiliate to apply only to “unregulated” entities. NiSource argues that this is important because any franchised public utility with captive customers would have to price sales of non-power goods and services to any non-utility affiliate at the higher of cost or market. NiSource argues that imposing this pricing requirement on LDCs and Commission-regulated interstate pipelines (as non-utility affiliates): (1) is inconsistent with the intent of the regulations, which is to prevent cross-subsidization of a “non-utility associate company” as derived from PUHCA 1935 and PUHCA 2005, (2) could conflict with state requirements, and (3) is unnecessary because the Commission and the states have ample authority to review such transactions.

(b) **Commission Determination**

61. We agree with NiSource and clarify that the definition of non-utility affiliate does not apply to utility affiliates that sell or transport natural gas, such as LDCs, or Commission-regulated interstate pipelines. However, we will not foreclose the expansion

of the definition of non-utility affiliate to include LDCs and/or interstate pipelines if circumstances warrant it in the future.

2. Pricing Non-Power Affiliate Transactions

62. In the Affiliate Transactions NOPR, the Commission proposed to implement affiliate restrictions that would be applicable to transactions for non-power goods and services between franchised public utilities with captive customers and their market-regulated and non-utility affiliates. Specifically, the Commission proposed that: (1) a franchised public utility with captive customers that provides non-power goods and services to a market-regulated power sales affiliate or a non-utility affiliate should charge a price that is the higher of cost or market price; (2) a franchised public utility with captive customers should be prohibited from purchasing non-power goods and services at a price above market price from market-regulated power sales affiliates and non-utility affiliates, with the exception of centralized service companies;⁵⁷ and (3) a franchised public utility with captive customers should be prohibited from buying non-power goods and services from a centralized service company at a price above cost.⁵⁸ The Affiliate

⁵⁷ Order No. 667 defines centralized service companies as performing generally corporate administration functions, such as accounting, human resources, legal and tax services, while special-purpose non-utility affiliates provide generally a single input to utility operations, such as fuel supply, construction or real estate. Order No. 667, FERC Stats. & Regs. ¶ 31,197 at P 171 n.178.

⁵⁸ Affiliate Transactions NOPR, FERC Stats. & Regs. ¶ 32,618 at P 16.

Transactions NOPR indicated that each of the proposed restrictions was consistent with restrictions previously imposed in the 203-merger context.⁵⁹

a. Comments

63. Several commenters suggest that the Commission's proposal will raise prices within holding company systems by creating inefficiencies. Specifically, EEI, Entergy, NiSource and PG&E argue that the Commission should require at-cost pricing for all transactions within a holding company system regardless of whether the services are provided for or by the franchised public utility. They contend that an at-cost standard creates savings through economies of scale that apply whether the employee providing the non-power good or service is located in a centralized service company, a utility or another affiliate. In addition, they note that it is difficult to find a market price for affiliate transactions for such goods and services.

64. EEI and PG&E further argue that requiring a utility to charge an affiliate the "higher of cost or market" would likely increase costs to both the utility and the affiliate by discouraging the efficient sharing of services. As a substitute for the "higher of cost or market" requirement for sales by a franchised public utility to an affiliate, they state that the Commission should allow the fully loaded cost to be a proxy for the market price for sales of non-power services by a utility to its affiliates.

⁵⁹ See, e.g., National Grid, 117 FERC ¶ 61,080 at P 66.

65. National Grid argues that at-cost pricing for sales of non-power goods and services provided by a franchised public utility to a centralized service company would be consistent with the Commission's rationale for allowing at-cost pricing for sales in the opposite direction. It states that the Commission established at-cost pricing in Order No. 667 to encourage centralization of certain services that provide economies of scale that benefit customers, and that these benefits occur whether a franchised public utility is buying or selling non-power goods or services to or from its centralized service company. It argues that requiring at-cost pricing for transactions from a centralized service company to a franchised public utility on the one hand, while requiring at-the-higher-of-cost-or-market pricing for transactions from a franchised public utility to a centralized service company on the other hand, creates a bifurcated-pricing structure that undermines efficient pricing within a holding company. It further argues that tracking which transactions are "at market" and which transactions are "at cost" adds a level of complexity to the accounting within holding companies, and identifying the market prices for certain non-power goods and services that may be sold by franchised public utilities to centralized service companies is difficult.

66. In contrast, the New York Commission focuses on whether the Commission's proposed pricing standards adequately protect captive customers from cross-subsidization. Specifically, it challenges the Commission's proposal to prohibit a franchised public utility with captive customers from purchasing non-power goods and services at a price above market price from market-regulated power sales affiliates and

non-utility affiliates, with the exception of centralized service companies. It asserts that this standard would allow utilities to purchase non-power goods or services from an affiliated entity at market prices and may allow holding companies to structure affiliate transactions so that utilities with captive customers would pay above-cost charges. It states that where an affiliate makes central purchases on behalf of several utilities, the affiliate will likely obtain discounts in the prices it pays due to the combined volume of purchases. The New York Commission contends, however, that the Commission's proposal would allow the central purchasing affiliate to charge each utility up to the prevailing market price which otherwise would be incurred if the utilities made their own separate purchases, and the result would provide a source of affiliate cross-subsidization in an amount equivalent to the incremental purchase quantity discount.

67. As an alternative, the New York Commission proposes that the Commission require utilities to record purchases of covered items from their affiliates at the lower of actual cost or market prices. It contends that this standard would protect captive utility customers against paying affiliates more than the affiliate's actual costs.

68. Commenters also made recommendations on the appropriate relationship between state and Commission affiliate-pricing standards. In particular, EEI, National Grid and Pinnacle West argue that, at the very least, the Commission should avoid unnecessary duplication or conflict with state provisions. In particular, EEI encourages the Commission to adopt deference to states in the cross-subsidy context, unless a state or holding company asks the Commission to apply uniform rules to avoid inconsistent

standards that would trap legitimate costs. EEI suggests that the Commission adopt a procedure similar to the one it adopted in Order No. 667, in which a holding company system can apply to the Commission to impose consistent requirements that would eliminate the possibility of trapped costs. National Grid contends that inconsistencies between federal and state rules make implementation of both sets of rules impossible, particularly with respect to the day-to-day press of business within a utility holding company. It argues that deference to the states would minimize disruption of existing holding company accounting and reporting systems, cost-allocation manuals, and interaffiliate-transaction procedures built around state regulation. Pinnacle West states that, because state regulations typically address affiliate transactions, the Commission's regulations could upset states' efforts to ring fence utilities.

b. Commission Determination

69. The Commission will adopt the pricing restrictions on transactions for non-power goods and services proposed in the Affiliate Transactions NOPR, with the exception of a modification to the restriction applicable to transactions with centralized service companies, to conform those restrictions to the language in our Order No. 667 regulations. These are explained below.

70. First, as proposed, a franchised public utility with captive customers that provides non-power goods and services to a market-regulated power sales affiliate or a non-utility affiliate will be required to sell at a price that is the higher of cost or market price. We will not adopt an at-cost pricing structure for these types of non-power transactions (as

suggested by National Grid, EEI, NiSource, Entergy and PG&E) because it would require a franchised public utility to sell to an affiliate at cost even when market prices are higher, thereby foregoing profits that the utility otherwise could have obtained by selling to a non-affiliate at a market price. In such a scenario, the benefit would go to the market-regulated affiliate or non-utility affiliate who receives a good or service at a below-market price. We believe the benefits that captive customers will receive under this “higher of cost or market price” standard outweigh any savings that may (or may not) occur through the use of a uniform at-cost standard.

71. Next, we will adopt the proposal in the Affiliate Transactions NOPR to 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 transactions from centralized service companies, which are discussed below). In doing so, we deny the New York Commission’s request for a “lower of cost or market” standard for these types of transactions. As discussed above, the New York Commission argued that the “at a price above market price” standard would allow holding companies to structure affiliate transactions so that captive customers would pay above-cost charges. But captive customers are not harmed by the franchised public utility paying above-cost charges if those charges are no higher than what they would pay non-affiliates for the same non-power goods and services. Moreover, nothing in the standard requiring that these purchases not be above market prevents the franchised public utility from paying less

than the market price. The New York Commission, or any other state commission, can require a stricter standard for these transactions so long as the standards do not result in trapped costs in situations involving multi-state holding companies. If the state commission's pricing standards for a franchised public utility's purchases from an affiliate are stricter than the Commission's (e.g., the state standard is lower of cost or market as opposed to market), then the stricter pricing standard would apply, as long as there is no conflict in complying with both the state's pricing standard and this Commission's pricing standard.⁶⁰

72. Finally, with regard to centralized service companies, the Affiliate Transactions NOPR proposed that a franchised public utility with captive customers should be prohibited from purchasing or receiving non-power goods and services from a centralized service company at a price above cost. We will conform this standard to the language in Order No. 667, which is to require that such transactions occur "at cost." While this is a change from the Affiliate Transactions NOPR, which proposed to prohibit such sales from centralized service companies at a price above cost, our intent in the Affiliate Transactions NOPR was to be consistent with Order No. 667,⁶¹ as well as the SEC's at-cost standard used prior to the repeal of PUHCA 1935. As we have previously stated, the at-cost pricing standard for transactions for non-power goods and services from

⁶⁰ See 18 CFR 366.5.

⁶¹ Order No. 667, FERC Stats. & Regs. ¶ 31,197 at P 169.

centralized service companies to franchised public utilities with captive customers benefits ratepayers through economies of scale, and eliminates the speculative task of defining a market price in these instances.⁶²

73. We recognize that one of the risks of at-cost pricing is the potential for prices to be imposed that are substantially higher than the market price. As we stated in Order No. 667, the Commission will entertain complaints that at-cost pricing exceeds the market price. Complainants would continue to have the burden of demonstrating the at-cost price exceeded market price and, furthermore, any change in the price as a result of the complaint would be prospective.

74. With regard to comments that the Commission's affiliate-pricing standards may conflict with similar pricing rules at the state level, we are not convinced that the Commission should establish a general policy of deference to existing state rules. For many years, we have required restrictions on certain affiliate transactions for non-power goods and services in the context of both market-base rate authorizations and merger approval under section 203.⁶³ As stated above, to the extent a state has affiliate-pricing standards that are "stricter" than the Commission's then the stricter standard applies, as long as there is no conflict in complying with both the state's pricing standard and this Commission's pricing standard.

⁶² Id.

⁶³ See, e.g., Potomac, 93 FERC at 61,782; Heartland, 68 FERC at 62,062-63; PSC Colorado, 75 FERC at 62,046.

3. Reporting Requirements

75. In the Affiliate Transactions NOPR, the Commission asked whether it should adopt any after-the-fact reporting requirements for transactions covered by the proposed regulations.

a. Comments

76. Most commenters, including EEI, Entergy, PG&E, Pinnacle West and Sempra, argue that the Commission should not require after-the-fact reporting requirements.

77. EEI argues that such reporting would be onerous given the number of transactions at issue, the fact that further reporting could include sensitive information and the Commission already collects large volumes of information from utilities and service companies. EEI also argues that if the Commission does adopt these regulations, it should clarify that utilities no longer need to include language that duplicates the regulations in their code of conduct as part of their individual tariffs.

78. Pinnacle West and Sempra argue that additional reporting is not required because many states already require reporting of affiliate transactions (including the states in which they conduct business) and the Commission already collects affiliate power sales information through EQRs and market-based rate requirements. Sempra states that it does not object to additional reporting requirements provided that the entities subject to the requirements are authorized to submit the same information in the same format and in the same time period as is required under existing state requirements.

79. PG&E encourages the Commission not to require additional reporting requirements for single-state holding companies. PG&E argues that such a requirement would be extraordinarily onerous. PG&E also argues that such a requirement would be duplicative because of Commission reporting requirements (EQRs and Form No. 3-Qs) and state requirements (where there is adequate state regulation of cross-subsidy issues).

80. APPA/NRECA and the state commissions support after-the-fact reporting requirements. APPA/NRECA ask that the Commission adopt additional after-the-fact reporting requirements. APPA/NRECA state that the Commission should require the filing of affiliate agreements governing non-power goods and services and the filing of periodic reports of all affiliate transactions within holding company systems regardless of whether they involve a centralized service company, a single-purpose service company, a market-regulated power sales affiliate or a non-utility affiliate. APPA/NRECA assert that there is no question of the Commission's statutory authority to require such reporting (citing the Commission's analysis in Order No. 667). APPA/NRECA also note that, in Order No. 667, the Commission only requires traditional, centralized service companies in holding company systems to file annual reports containing certain information relating to affiliate transactions, but the Commission does not require any reporting for single-purpose service companies or other associate companies in holding company systems. While APPA/NRECA acknowledge that a one-size-fits-all reporting scheme may not be appropriate, they believe additional reporting is required. As a suggestion, they offer that the Commission require each covered public utility to file a one-time compliance filing

which would inform the Commission of its then-existing affiliate relationships and any exemptions from annual reporting requirements. APPA/NRECA admit that that sort of reporting regime is general, and ask that the Commission consider a further technical conference on this question.

81. The Oklahoma Commission also recommends after-the-fact reporting, noting that its rules regarding affiliate information have been effective. The Oklahoma Commission suggests that the Commission allow state commissions the opportunity to review and comment on any post occurrence reporting (suggesting a 90-day review and comment period).

82. The New York Commission also recommends reporting on affiliate transactions. The New York Commission recommends revisions to Form No. 1 and Form No. 2 to require utilities to describe, quantify, and provide the basis used to record each type of transaction with its affiliates. It argues that these reporting requirements are similar to those the Commission included in Form No. 60 for centralized service companies.

b. Commission Determination

83. We believe that the current reporting regulations are adequate to ensure compliance with the proposed restrictions on affiliate transactions between franchised public utilities that have captive customers or that own or provide transmission service over jurisdictional transmission facilities and their market-regulated power sales affiliates or non-utility affiliates. In addition to the information gathered through Form No. 1, the Commission already collects affiliate power sales information from franchised public

utilities through EQRs and market-based requirements. With regard to non-power goods and services, franchised public utilities that have captive customers or that own or provide transmission service over jurisdictional transmission facilities are covered by the existing record retention requirements in Parts 125 and 225 of the Commission's regulations. Accordingly, there is no need to impose additional reporting requirements to ensure compliance with the proposed regulations. However, if the Commission finds that the existing requirements are inadequate, we will consider holding a technical conference to discuss what additional reporting requirements may be warranted.

4. Effective Date

a. Comments

84. EEI and Entergy recommend that the application of any adopted regulations be prospective in nature and not affect any existing contracts. In its comments, EEI asserts that it would be "unjust and detrimental to the financial integrity" of holding companies for the Commission to retroactively void pricing arrangements to provide energy or non-power goods and services.⁶⁴

b. Commission Determination

85. In response to EEI's request for clarification, we clarify that the pricing rules adopted herein are prospective and will apply to any contracts, agreements or arrangements entered into on or after the effective date of this Final Rule. To the extent

⁶⁴ EEI Comments at 13.

different pricing was in effect for any contract, agreement or arrangement entered into prior to the effective date of this Final Rule, such pricing may remain in effect; however, the Commission on its own motion, or upon complaint, may on a case-by-case basis institute a section 206 proceeding to determine whether the costs incurred by a public utility under such pre-existing contracts, agreements or arrangements are just, reasonable and not unduly discriminatory or preferential. We also note that many public utilities already have the same pricing restrictions in effect as a result of Commission orders approving mergers or market-based rates; these restrictions remain in place.

V. Information Collection Statement

86. The Office of Management and Budget's (OMB's) regulations require that OMB approve certain information collection requirements imposed by agency rule.⁶⁵ This Final Rule does not impose any additional information collection requirements. Therefore, the information collection regulations do not apply to this Final Rule. The Commission received 12 comments on the Affiliate Transactions NOPR and no entity specifically addressed the Commission's information collection statement. The Commission will submit for informational purposes only a copy of this rulemaking to OMB.

⁶⁵ 5 CFR 1320.12.

VI. Environmental Analysis

87. The Commission is required to prepare an Environmental Assessment or an Environmental Impact Statement for any action that may have a significant adverse effect on the human environment.⁶⁶ The Commission has categorically excluded certain actions from this requirement as not having a significant effect on the human environment.⁶⁷ The final rule is categorically excluded as it addresses rate filings submitted under sections 205 and 206 of the FPA.⁶⁸ Accordingly, no environmental assessment is necessary and none has been prepared in this final rule.

VII. Regulatory Flexibility Act

88. The Regulatory Flexibility Act of 1980 (RFA)⁶⁹ generally requires a description and analysis of final rules that will have significant economic impact on a substantial number of small entities.⁷⁰ Agencies are not required to make such an analysis if a rule would not have such an effect.

⁶⁶ Regulations Implementing the National Environmental Policy Act, Order No. 486, 52 FR 47897 (Dec. 17, 1987), FERC Stats. & Regs., Regulations Preambles 1986-1990 ¶ 30,783 (1987).

⁶⁷ 18 CFR 380.4.

⁶⁸ See 18 CFR 380.4(a)(15).

⁶⁹ 5 U.S.C. 601-12.

⁷⁰ The RFA definition of “small entity” refers to the definition provided in the Small Business Act, which defines a “small business concern” as a business that is independently owned and operated and that is not dominant in its field of operation. 15 U.S.C. 632. The Small Business Size Standards component of the North American

(continued)

89. The Final Rule is applicable to franchised public utilities that have captive customers or that own or provide transmission service over jurisdictional transmission facilities. Most such companies regulated by the Commission do not fall within the RFA's definition of small entity.⁷¹ Therefore, the Commission certifies the Final Rule will not have a significant economic impact on a substantial number of small entities. As a result, no regulatory flexibility analysis is required.

VIII. Document Availability

90. In addition to publishing the full text of this document in the Federal Register, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page (<http://www.ferc.gov>) and in FERC's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, N.E., Room 2A, Washington D.C. 20426.

91. From FERC's Home Page on the Internet, this information is available on eLibrary. The full text of this document is available on eLibrary in PDF and Microsoft

Industry Classification System defines a small electric utility as one that, including its affiliates, is primarily engaged in the generation, transmission, and/or distribution of electric energy for sale and whose total electric output for the preceding fiscal year did not exceed 4 million MWh. 13 CFR 121.201.

⁷¹ 5 U.S.C. 601(3), citing to section 3 of the Small Business Act, 15 U.S.C. 632. Section 3 of the Small Business Act defines a "small-business concern" as a business which is independently owned and operated and which is not dominant in its field of operation.

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92. User assistance is available for eLibrary and the FERC's website during normal business hours from FERC Online Support at 202-502-6652 (toll free at 1-866-208-3676) or email at ferconlinesupport@ferc.gov, or the Public Reference Room at (202) 502-8371, TTY (202)502-8659. E-mail the Public Reference Room at public.referenceroom@ferc.gov.

IX. Effective Date and Congressional Notification

93. These regulations are effective [insert date 30 days from publication in **FEDERAL REGISTER**]. The Commission has determined, with the concurrence of the Administrator of the Office of Information and Regulatory Affairs of OMB, that this rule is not a "major rule" as defined in section 351 of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of subjects in 18 CFR Part 35

Electric power rates, Electric utilities, Reporting and recordkeeping requirements.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

In consideration of the foregoing, the Commission amends part 35, Chapter I, Title 18, Code of Federal Regulations, to read as follows:

PART 35 – FILING OF RATE SCHEDULES AND TARIFFS.

1. The authority citation for part 35 continues to read as follows:

Authority: 16 U.S.C. 791a-825r, 2601-2645; 31 U.S.C. 9701; 42 U.S.C. 7101-7352.

2. Subpart I is added to read as follows:

Subpart I – Cross-Subsidization Restrictions on Affiliate Transactions

Sec.

35.43

Generally.

35.44

Protections against affiliate cross-subsidization.

§ 35.43

Generally.

- (a) For purposes of this subpart:

- (1) Affiliate of a specified company means:

- (i) For any person other than an exempt wholesale generator:

- (A) Any person that directly or indirectly owns, controls, or holds with power to vote, 10 percent or more of the outstanding voting securities of the specified company;

- (B) Any company 10 percent or more of whose outstanding voting securities are owned, controlled, or held with power to vote, directly or indirectly, by the specified company;

(C) Any person or class of persons that the Commission determines, after appropriate notice and opportunity for hearing, to stand in such relation to the specified company that there is liable to be an absence of arm's-length bargaining in transactions between them as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that the person be treated as an affiliate; and

(D) Any person that is under common control with the specified company.

(E) For purposes of paragraph (a)(1)(i), owning, controlling or holding with power to vote, less than 10 percent of the outstanding voting securities of a specified company creates a rebuttable presumption of lack of control.

(ii) For any exempt wholesale generator (as defined under § 366.1 of this chapter), consistent with section 214 of the Federal Power Act (16 U.S.C. 824m), which provides that "affiliate" will have the same meaning as provided in section 2(a) of the Public Utility Holding Company Act of 1935 (15 U.S.C. 79b(a)(11)):

(A) Any person that directly or indirectly owns, controls, or holds with power to vote, 5 percent or more of the outstanding voting securities of the specified company;

(B) Any company 5 percent or more of whose outstanding voting securities are owned, controlled, or held with power to vote, directly or indirectly, by the specified company;

(C) Any individual who is an officer or director of the specified company, or of any company which is an affiliate thereof under paragraph (a)(1)(ii)(A); and

(D) Any person or class of persons that the Commission determines, after appropriate notice and opportunity for hearing, to stand in such relation to the specified company that there is liable to be an absence of arm's-length bargaining in transactions between them as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that the person be treated as an affiliate.

(2) Captive customers means any wholesale or retail electric energy customers served by a franchised public utility under cost-based regulation.

(3) Franchised public utility means a public utility with a franchised service obligation under state law.

(4) Market-regulated power sales affiliate means any power seller affiliate other than a franchised public utility, including a power marketer, exempt wholesale generator, qualifying facility or other power seller affiliate, whose power sales are regulated in whole or in part on a market-rate basis.

(5) Non-utility affiliate means any affiliate that is not in the power sales or transmission business, other than a local gas distribution company or an interstate natural gas pipeline.

(b) The provisions of this subpart apply to all franchised public utilities that have captive customers or that own or provide transmission service over jurisdictional transmission facilities.

§ 35.44 Protections against affiliate cross-subsidization.

(a) Restriction on affiliate sales of electric energy. No wholesale sale of electric energy may be made between a franchised public utility with captive customers and a market-regulated power sales affiliate without first receiving Commission authorization for the transaction under section 205 of the Federal Power Act.

(b) Non-power goods or services.

(1) Unless otherwise permitted by Commission rule or order, sales of any non-power goods or services by a franchised public utility that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, including sales made to or through its affiliated exempt wholesale generators or qualifying facilities, to a market-regulated power sales affiliate or non-utility affiliate must be at the higher of cost or market price.

(2) Unless otherwise permitted by Commission rule or order, and except as permitted by paragraph (b)(3), a franchised public utility that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, may not purchase or receive non-power goods and services from a market-regulated power sales affiliate or a non-utility affiliate at a price above market.

(3) A franchised public utility that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, may only purchase or receive non-power goods and services from a centralized service company at cost.