

120 FERC ¶ 61,061  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

18 CFR Part 35

(Docket No. RM07-15-000)

Cross-Subsidization Restrictions on Affiliate Transactions

(July 20, 2007)

AGENCY: Federal Energy Regulatory Commission.

ACTION: Notice of Proposed Rulemaking.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is proposing to amend its regulations pursuant to sections 205 and 206 of the Federal Power Act to codify restrictions on affiliate transactions between franchised public utilities with captive customers and their market-regulated power sales affiliates or non-utility affiliates. The Commission seeks public comment on the rules and amended regulations proposed herein.

COMMENT DATE: Comments are due [insert date that is 30 days after publication in the **FEDERAL REGISTER**].

ADDRESSES: You may submit comments identified in Docket No. RM07-15-000, by one of the following methods:

- Agency Web Site: <http://www.ferc.gov>. Follow the instructions for submitting comments via the eFiling link found in the Comment Procedures section of the preamble.

- Mail: Commenters unable to file comments electronically must mail or hand deliver an original and 14 copies of their comments to the Federal Energy Regulatory Commission, Secretary of the Commission, 888 First Street, N.E., Washington, D.C. 20426. Please refer to the Comment Procedures section of the preamble for additional information on how to file paper comments.

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SUPPLEMENTARY INFORMATION:

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Cross-Subsidization Restrictions on  
Affiliate Transactions

Docket No. RM07-15-000

NOTICE OF PROPOSED RULEMAKING

(July 20, 2007)

**I. Introduction**

1. Pursuant to sections 205 and 206 of the Federal Power Act (FPA),<sup>1</sup> the Commission is proposing to amend its regulations to revise Part 35 of Title 18 of the Code of Federal Regulations (CFR) 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.<sup>2</sup> The Commission's goal in proposing these prophylactic

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<sup>1</sup> 16 U.S.C. 824d, 824e.

<sup>2</sup> For purposes of this Notice of Proposed Rulemaking, a "market-regulated" power sales affiliate means any power sales affiliate, other than a franchised public utility, whose power sales are regulated in whole or in part on a market basis. This would include, e.g., a power marketer, exempt wholesale generator, qualifying facility or other power seller affiliate permitted to make some or all of its power sales at market-based rates. A "non-utility" affiliate would include an affiliate that is not in the power sales or transmission business, e.g., a coal mining company, construction company, real estate company, energy-related technology company, communications systems company, among others. While the Commission, in previous documents, has referred to both categories of affiliates as "non-regulated," consistent with the discussion on cross-subsidization issues in our recent Market-Based Rate Final Rule, we believe the term "market-regulated" more accurately describes power sellers with market-based rates since they remain subject to regulation. Market-Based Rates For Wholesale Sales Of

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restrictions is to protect against inappropriate cross-subsidization of market-regulated and unregulated activities by the captive customers of public utilities. The proposed restrictions are based upon those already imposed by the Commission in the context of certain FPA section 203<sup>3</sup> and 205 approvals, but expand the transactions and entities to which they apply.<sup>4</sup> The Commission seeks public comment on the proposed rules.

## **II. Background**

2. The Commission requires public utilities to implement codes of conduct with regard to affiliate transactions where an entity seeks market-based rate authorization.

The Commission also imposes codes of conduct on entities seeking merger authorization

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Electric Energy, Capacity And Ancillary Services By Public Utilities, Order No. 697, 72 FR 39903 (July 20, 2007), FERC Stats. & Regs. ¶ 31,252, at P 490 (2007) (Market-Based Rate Final Rule). Accordingly, we have modified our terminology in this Notice of Proposed Rulemaking.

<sup>3</sup> 16 U.S.C. 824b, amended by Energy Policy Act of 2005, Pub. L. No. 109-58, 1289, 119 Stat. 594, 982-83 (2005) (EPAAct 2005).

<sup>4</sup> This Notice of Proposed Rulemaking is one of three actions being taken based on the Commission's experience implementing amended FPA section 203 and the Public Utility Holding Company Act of 2005, EPAAct 2005, Pub. L. No. 109-58, 1261, et seq., 119 Stat. 594, 972-78 (2005) (PUHCA 2005), as well as the record from the Commission's December 7, 2006 and March 8, 2007 technical conferences regarding Section 203 and PUHCA 2005. In addition, in separate orders, the Commission is concurrently issuing a section 203 Supplemental Policy Statement, FPA Section 203 Supplemental Policy Statement, 120 FERC ¶ 61,060 (2007) (issued in Docket No. PL07-1-000), and a Notice of Proposed Rulemaking proposing to grant a limited blanket authorization for certain dispositions of jurisdictional facilities under FPA section 203(a)(1), Blanket Authorization Under FPA Section 203, 120 FERC ¶ 61,062 (2007) (issued in Docket No. RM07-21-000).

under section 203 of the FPA. The discussion below summarizes the Commission's existing practices in these two areas.

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

**1. Historical Approach**

3. The Commission began considering proposals for market-based pricing of wholesale power sales and attendant cross-subsidy issues in 1988. At that time, 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 whether there was evidence of affiliate abuse or reciprocal dealing involving the seller or its affiliates.<sup>5</sup> 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

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<sup>5</sup> 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)).

The other three “prongs” of the Commission’s “four-prong” analysis include: (1) whether the seller and its affiliates lack, or have adequately mitigated, market power in generation; (2) whether the seller and its affiliates lack, or have adequately mitigated, market power in transmission; and (3) whether the seller or its affiliates can erect other barriers to entry. See Market-Based Rate Final Rule, FERC Stats. & Regs. ¶ 31,252 at P 7. These additional “prongs” are not directly at issue in this proceeding.

exercise market power through its affiliate dealings.”<sup>6</sup> 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.<sup>7</sup> 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 undue profit to the affiliated entity at the expense of the franchised public utility’s captive customers.<sup>8</sup> In determining whether to allow power sales affiliate transactions, the

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<sup>6</sup> 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.”).

<sup>7</sup> See, e.g., Heartland, 68 FERC at 62,062.

<sup>8</sup> The Commission has found that a transaction between two non-traditional utility affiliates (such as power marketers, exempt wholesale generators, or qualifying facilities) 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

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Commission, over time, has adopted several methods, all of which have focused on ensuring that captive customers are adequately protected against affiliate abuse.

4. 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.<sup>9</sup> The same concerns about giving undue profits to affiliated “unregulated” entities and shareholders, discussed above with respect to power sales, also apply with respect to non-power goods and services transactions.

5. Accordingly, the Commission’s policy for many years has 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 between regulated and non-regulated affiliated power sellers. The Commission has also required that applicants include a provision in their market-based rate tariffs prohibiting power sales between

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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).

<sup>9</sup> See, e.g., Potomac Electric Power Company, 93 FERC ¶ 61,240, at 61,782 (2000); Heartland, 68 FERC at 62,062-63.

regulated and non-regulated affiliated power sellers without first receiving authorization of the transaction under section 205 of the FPA.<sup>10</sup>

6. The purpose of the market-based rate code of conduct is 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.<sup>11</sup> In such cases, however, the Commission directed the utilities to notify the Commission should they acquire captive customers in the future and expressly reserved the right to reimpose the market-based rate code of conduct requirement.

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<sup>10</sup> Aquila, Inc., 101 FERC ¶ 61,331, at P 12 (2002).

<sup>11</sup> 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 (1999) (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).



## **2. The Market-Based Rate Final Rule**

7. In the Commission's recent Market-Based Rate Final Rule, 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.<sup>12</sup> 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.

### **B. Affiliate Transactions Under Section 203**

#### **1. Before EPCRA 2005**

8. The Commission has also addressed cross-subsidization issues in the context of section 203 merger applications. Prior to EPCRA 2005, the Commission's policy was to condition its approval of certain section 203 mergers on the applicants' agreement to

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<sup>12</sup> Market-Based Rate Final Rule, FERC Stats. & Regs. ¶ 31,252 at P 23.

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 the Public Utility Holding Company Act of 1935<sup>13</sup> in order to find that the merger would not adversely affect federal regulation.<sup>14</sup> 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.<sup>15</sup> Under Ohio Power, if the SEC approved an affiliate contract involving special purpose subsidiary goods or services at cost, the Commission had to 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.<sup>16</sup> For over a decade following the Ohio Power

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<sup>13</sup> 16 U.S.C. 79a *et seq.* (PUHCA 1935). EPAAct 2005 repealed PUHCA 1935. EPAAct 2005, Pub. L. No. 109-58, 1263.

<sup>14</sup> See, e.g., Niagara Mohawk Holdings, Inc., 95 FERC ¶ 61,381, at 62,414, order on reh'g, 96 FERC ¶ 61,144 (2001).

<sup>15</sup> 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).

<sup>16</sup> 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

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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.<sup>17</sup>

## 2. After EAct 2005

9. 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 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

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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).

<sup>17</sup> Public Service Company of Colorado, 75 FERC ¶ 61,325, at 62,046 (1996); 1996 Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,124-25.

context of a section 205-206 rate proceeding.<sup>18</sup> 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.

10. In the Order No. 669 rulemaking proceedings,<sup>19</sup> 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.<sup>20</sup> However, the Commission made two additional clarifications.

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<sup>18</sup> 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.

<sup>19</sup> 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).

<sup>20</sup> Amended section 203(a)(4) does add 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.

11. First, in its implementation of regulations pursuant to PUHCA 2005,<sup>21</sup> the Commission discussed one exception to the traditional standards articulated in the 1996 Merger Policy Statement. In the Order No. 667 rulemaking proceeding,<sup>22</sup> 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, the 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

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<sup>21</sup> 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.

<sup>22</sup> 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.”<sup>23</sup> 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 and created a rebuttable presumption that costs incurred under at-cost pricing for such services are reasonable.<sup>24</sup> 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 supply company or a construction company, the Commission continued with its prior practice.<sup>25</sup>

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<sup>23</sup> Order No. 667, FERC Stats. & Regs. ¶ 31,197 at P 168.

<sup>24</sup> Id. P 169.

<sup>25</sup> Order No. 667 states, in relevant part:

First, with respect to sales from a public utility to a non-regulated, affiliated special-purpose company, we agree ... that 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. 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. The non-regulated, affiliated special-purpose company may not sell to its public utility affiliate at a price above the market

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12. 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,<sup>26</sup> 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 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

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price. We believe 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.

<sup>26</sup> 117 FERC ¶ 61,080 (2006) (National Grid).

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.<sup>27</sup>

13. 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.

### **III. Discussion**

14. Historically, section 205 rate review has been the primary mechanism by which the Commission disallowed as imprudent or unjust and unreasonable the costs incurred by a franchised public utility in purchasing power or non-power goods and services from a non-utility or power sales affiliate when the utility could have purchased such power or non-power goods and services from a non-affiliated entity. However, as discussed above, the Commission's policy over the years has been to develop prophylactic affiliate cross-subsidy restrictions in the context of blanket market-based rate authorizations under FPA

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<sup>27</sup> Id. P 66 (internal citations removed).



section 205 and merger proceedings under section 203. We believe prophylactic restrictions setting forth the standards under which affiliates may transact are superior to relying exclusively on after-the-fact rate reviews of costs already incurred. Further, it would be virtually impossible for the Commission to individually pre-approve every power and non-power goods and services transaction given the volume of transactions that occur on a daily basis. The affiliate restrictions the Commission has previously imposed in individual cases involving market-based rate applicants and merger applicants allow public utilities to know up-front the standards under which they may transact with affiliates; and, if they do not follow those standards, they are at risk for full refunds plus interest, or other remedial action.

15. Accordingly, to provide better assurance against inappropriate cross-subsidization, we believe it is appropriate to continue imposing affiliate restrictions, to expand the coverage of those restrictions, and to codify them in our regulations. As noted above, there is a gap in coverage of the restrictions as they are currently imposed. Specifically, the restrictions imposed on section 205 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 only on the market-based rate applicants. Additionally, while the restrictions imposed on section 203 applicants cover transactions between a franchised public utility and market-regulated power sales affiliates as well as non-utility affiliates, they apply only to merger

applicants; they do not apply to other section 203 applicants and do not apply to public utilities that do not require any section 203 authorization.<sup>28</sup> Finally, while the preamble to Order No. 667 discussed the Commission's pricing policy on affiliate non-power goods and services transactions, including pricing of non-power goods and services provided by centralized service companies, the pricing policy (which technically is a ratemaking policy rather than a PUHCA 2005 issue) was not codified in the regulations.

16. To address this gap in coverage, the uniform affiliate restrictions that the Commission proposes to implement would be applicable to all franchised public utilities with captive customers and their market-regulated and non-utility affiliates and would address both power and non-power goods and services transactions between the utility and its affiliates. Specifically, they would: (1) require the Commission's approval of all power sales by a franchised utility with captive customers to a market-regulated power sales affiliate; (2) require a franchised public utility with captive customers to provide non-power goods and services to a market-regulated power sales affiliate or a non-utility affiliate at a price that is the higher of cost or market price; (3) prohibit a franchised public utility with captive customers from purchasing non-power goods or services from a market-regulated power sales affiliate or a non-utility affiliate at a price above market price (with the exception of (4)); and (4) prohibit a franchised public utility with captive customers from receiving non-power services from a centralized service company at a

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<sup>28</sup> See supra P 12.

price above cost. These restrictions will 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 us 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 transactions.

17. We note that there is overlap in the affiliate restrictions proposed herein and those that were recently adopted in the Market-Based Rate Final Rule. However, as discussed above, those restrictions apply only to market-based rate applicants and only to transactions between power sales affiliates. The restrictions herein are consistent with, and in some instances mirror, those imposed in the Market-Based Rate Final Rule. We believe any overlap is appropriate and necessary to ensure that all franchised public utilities with captive customers have the same restrictions imposed on them. We also note that we are proposing one additional restriction that is not covered in the Market-Based Rate Final Rule, but which has been imposed on section 203 merger applicants. That restriction would prohibit a centralized service company from providing non-power goods and services to a franchised public utility with captive customers at a price above cost. This implements the findings made in Order No. 667 and, by codifying it in the regulations along with the other affiliate restrictions, will eliminate any gaps in coverage and ensure uniformity in the restrictions being applied.

18. The Commission seeks comments on these proposed affiliate cross-subsidy restrictions. We also seek comment on whether the Commission should impose any

after-the-fact reporting requirements on transactions covered by the restrictions and, if so, what they should be. In this regard, we note that the Commission already receives reporting of public utility affiliate power sales transactions through Electric Quarterly Reports and we see no need to duplicate existing power sales reporting. However, we are particularly interested in: whether any reporting requirements regarding affiliate non-power goods and services transactions should be imposed; whether such reporting, if it were to be required, should be on a yearly basis or within some other time frame, and what specific information should be reported; whether states already require such reporting; and the burdens that any reporting requirements would impose. Although the Commission has authority to review such transactions through auditing and in individual section 205 rate proceedings, we seek comment on the general usefulness of additional reporting requirements.

#### **IV. Information Collection Statement**

19. The Office of Management and Budget's (OMB) regulations require that OMB approve information collection requirements imposed by agency rules.<sup>29</sup> The Commission is proposing amendments to the Commission's regulations to codify restrictions on affiliate transactions between franchised public utilities with captive customers and their market-regulated power sales affiliates or non-utility affiliates. The Commission is not imposing an information collection requirement upon the public.

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<sup>29</sup> 5 CFR 1320.

However, the Commission will submit for informational purposes only a copy of this rulemaking to OMB.

## **V. Environmental Analysis**

20. 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.<sup>30</sup> The Commission has categorically excluded certain actions from this requirement as not having a significant effect on the human environment.<sup>31</sup> The proposed regulations are categorically excluded as they address rate filings submitted under sections 205 and 206 of the FPA.<sup>32</sup> Accordingly, no environmental assessment is necessary and none has been prepared in this NOPR.

## **VI. Regulatory Flexibility Act Certification**

21. The Regulatory Flexibility Act of 1980 (RFA)<sup>33</sup> requires agencies to prepare certain statements, descriptions, and analyses of proposed rules that will have significant

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<sup>30</sup> 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).

<sup>31</sup> 18 CFR 380.4.

<sup>32</sup> See 18 CFR 380.4(a)(15).

<sup>33</sup> 5 U.S.C. 601-12.

economic impact on a substantial number of small entities.<sup>34</sup> Agencies are not required to make such an analysis if a rule would not have such an effect.

22. The proposed rule will be applicable to franchised public utilities with captive customers. Most such companies regulated by the Commission do not fall within the RFA's definition of small entity.<sup>35</sup> Therefore, the Commission certifies the proposed rule will not have a significant economic impact on a substantial number of small entities. As a result, no regulatory flexibility analysis is required.

## **VII. Comment Procedures**

23. The Commission invites interested persons to submit comments on the matters and issues proposed in this notice, including any related matters or alternative proposals that commenters may wish to discuss. Comments are due [insert date 30 days from publication in the **FEDERAL REGISTER**]. Comments must refer to Docket No. RM07-15-000, and must include the commenter's name, the organization they represent,

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<sup>34</sup> 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 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.

<sup>35</sup> 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.

if applicable, and their address in their comments. Comments may be filed either in electronic or paper format.

24. Comments may be filed electronically via the eFiling link on the Commission's web site at <http://www.ferc.gov>. The Commission accepts most standard word processing formats, but requests commenters to submit comments in a text-searchable format rather than a scanned image format. Commenters filing electronically do not need to make a paper filing. Commenters that are not able to file comments electronically must send an original and 14 copies of their comments to: Federal Energy Regulatory Commission, Secretary of the Commission, 888 First Street, N.E., Washington, D.C., 20426.

25. All comments will be placed in the Commission's public files and may be viewed, printed, or downloaded remotely as described in the Document Availability section below. Commenters on this proposal are not required to serve copies of their comments on other commenters.

### **VIII. Document Availability**

26. 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 the Commission's Home Page (<http://www.ferc.gov>) and in the Commission'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.

27. From the Commission's Home Page on the Internet, this information is available in the Commission's document management system, eLibrary. The full text of this document is available on eLibrary in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number (excluding the last three digits of the docket number), in the docket number field.

28. User assistance is available for eLibrary and the Commission's website during normal business hours. For assistance, please contact FERC Online Support at (202) 502-6652 (toll-free at 1-866-208-3676) or e-mail at [ferconlinesupport@ferc.gov](mailto: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](mailto:public.referenceroom@ferc.gov).

List of subjects in 18 CFR Part 35

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

By direction of the Commission.

Kimberly D. Bose,  
Secretary.



In consideration of the foregoing, the Commission proposes to amend Part 35, Chapter I, Title 18, Code of Federal Regulations, 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) Captive customers means any wholesale or retail electric energy customers served under cost-based regulation.

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

(3) 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.

(4) Non-utility affiliate means any affiliate that is not in the power sales or transmission business.

(b) The provisions of this subpart apply to all franchised public utilities with captive customers.

§ 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 with captive customers, 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 subsection (b)(3), a franchised public utility with captive customers 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 with captive customers may not purchase or receive non-power goods and services from a centralized service company at a price above cost.