UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Transactions Subject To FPA Section 203 * Docket No. RM05-34-000

COMMENTS OF THE NATIONAL ASSOCIATION OF
STATE UTILITY CONSUMER ADVOCATES

I. Introduction

On October 3, 2005, pursuant to section 1289 on Title XII of the Energy Policy Act of 2005 ("EPAct 2005"), the Commission issued a Notice of Proposed Rulemaking ("NOPR") for rules and amendments to the Commission's regulations to implement amended section 203 of the Federal Power Act ("FPA").[1] The NOPR describes the changes to section 203 as follows:

> Amended section 203 also: (1) increases (from $50,000 to $10 million) the value threshold for certain transactions subject to section 203; (2) extends the scope of section 203 to included transactions involving certain transfers of generation facilities and certain holding companies' acquisitions with a value in excess of $10 million; (3) limits the Commission's review of a public utility's acquisition of securities of another public utility to transactions greater than $10 million; and (4) requires that the Commission, when reviewing a proposed section 203 transaction, examine cross-subsidization and pledges or encumbrances of utility assets.

The National Association of State Utility Consumer Advocates ("NASUCA") is an association representing 44 state utility consumer advocate offices in 41 states and the District of Columbia. Each of these offices is authorized by the laws of their respective jurisdictions to represent the interests of utility consumers in matters before state or federal regulators and courts. NASUCA offers the following comments on the NOPR.

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[1] 16 U.S.C. section 824b (2000).

II. Comments

A. Definition Of "Value"

The Commission notes that the issue of how to determine the value of assets involved in an acquisition will be more important under amended section 203 because the threshold for Commission review is $10 million instead of $50,000.[2] The Commission makes a number of proposals for how to determine "value" for purposes of section 203.

As a general matter, the Commission should adopt a broad interpretation of the statutory "value" levels to reduce the possibility of transactions that harm the public interest escaping review. The Commission's duty under the FPA is to ensure just and reasonable rates. Included in that is a charge to ensure that sales made at market rates are done in a competitive environment. Corporate mergers and sales of generating assets naturally tend to increase market concentration and thwart effective competition. This is of particular concern where portions of the grid are congested.

Preventing or conditioning transactions that result in structurally flawed, competition-limiting markets before-the-fact is preferable to after-the-fact attempts to monitor and detect problems. Also, the Commission has instituted aggressive provisions for expedited review of certain transactions. Therefore, a broad interpretation of the term "value" would not unduly burden market participants whose transactions would otherwise not be reviewed. Therefore, to avoid preventing review of transaction that affect the public interest as a result of a narrow interpretation of "value," the Commission should adopt a broad interpretation of "value" to ensure review of transactions that could harm the public interest.

[2] NOPR at P. 27.

1. Physical Jurisdictional Facilities

The Commission identifies the issue of determining the value of an asset for section 203 purposes as a choice between using a "market value" or "original/accounting cost value."[3] The Commission states a general preference for a market value approach.

In order to assure that transactions that potentially harm the public interest do not evade review, the Commission should use the greater of undepreciated original cost or market value to determine value for section 203 purposes. This approach would simplify the implementation of section 203 and greatly reduce the possibility that a Commission choice of approaches based on abstract concepts has the unintended consequence of preventing review of transactions that potentially harm the public interest.

In its discussion of the original cost and market value approach to determining value for section 203, the Commission uses an example of two generating units that have similar market values but different original construction costs because one is new and one is old.[4] The Commission points out that an accounting approach to value could lead to one being jurisdictional and not the other, yet the effect on competition from their acquisition could be the same.[5]

Consideration of another example demonstrates that using only a market value approach to determining value would be too restrictive. Consider a generating unit with a high accounting cost value but a low market value. For instance, just a few years ago utilities were claiming that large nuclear generating units had a very low market value but a high book cost (thus they claimed stranded costs). This situation could also occur with generating units subject to limitation from environmental regulations. Acquisition of

[3] *Id*. at P. 28.
[4] *Id*. at P. 30.
[5] *Id*. at P. 30.

such a plant could escape review under a market-value-only approach, yet ownership of such a plant could have implications on the competitiveness of markets and protection of the public interest would require review of the transaction.

The Commission notes that in a transfer of assets between affiliates, there should not be an assumption that the transaction price is the market value.[6] The Commission provides a possible alternative measure of value as the "original cost undepreciated" in an affiliate transaction.[7] NASUCA shares the Commission's concern with relying on the transaction price in an affiliate transaction. Using the higher of market or original cost undepreciated would work for both transactions between affiliated and non-affiliated companies and eliminate the need for a different approach for transactions between affiliated companies.

To the extent that the Commission uses market value to implement section 203, the market value must also include any debt from the selling company to be absorbed by the buying company as part of the acquisition transaction. Unless this is made explicit, there could be a substantial loophole created.

2. Contracts

The Commission proposes to use "total expected contract revenues over the remaining life of the contract." NASUCA supports this definition. Attempting to determine the profits on a contract would be speculative and complicated. Such an approach could prevent review of transactions that potentially harm consumers.

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[6] *Id.*
[7] *Id.*

3. Securities

The Commission seeks comments on how to value transactions involving securities that are not widely traded, particularly between affiliated entities.[8] The Commission seeks comment on "whether we should give particular weight to evidence of non-affiliate transactions involving either non-affiliated buyers or sellers of securities of similarly situated utilities or assets."[9] NASUCA cautions that while this information may be indicative of value, it should not be considered dispositive. The Commission should not afford any kind of presumption of value based on this type of evidence.

The Commission should certainly give *some* weight to prices paid in similar transactions, but the Commission's determination of how to value transactions must take into account *all* evidence of value and weigh those valuations according to what is appropriate to the facts of the case before them. By construction of the question, "transactions involving securities that are not widely traded, particularly between affiliated entities" must not engender the same level of "free market" confidence that such valuations might appropriately engender when transactions are completed in the free market environs of 1) infinite buyers and sellers, 2) full information, and 3) truly unpreserved trades. *None* of these three required conditions are met when limited trades are made with affiliated companies in closed environs, and such trades must be independently suspect on each of the three bases.

As an illustration of valuation bias at work, a holding company may direct or authorize the sale of securities between its affiliates, from a high-risk, unregulated affiliate to a low-risk, rate regulated utility, at rates below-market rates that are within an

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[8] *Id*. at P. 33.
[9] *Id.*

observed variance of ostensibly similar transactions between unaffiliated companies. While defensible on a statistical basis, such purchases of debt hinder the cash accounts of the low-risk, rate regulated purchaser, while subsidizing the debt-capital requirements (and financial risk) of the seller. Such risk-shifting is not only unethical, it also promotes an unhealthy capital ease in the high-risk company that, at bankruptcy, further harms the subsidizing low risk, rate-regulated utility. Obviously, all such harms end up siphoning recovery funds out of the pockets of consumers.

4. Merger Of Two Transmission Companies

The Commission proposes to use the "market value" as reflected in the transaction price as the measure of value in mergers of transmission companies.[10] As discussed above in terms of valuing generation assets, the approach of using the higher of market value or undepreciated original cost for the determination of value for section 203 should be applied here as well. This would allow for a consistent approach and limit the possibility that a merger of transmission companies (i.e., particularly with involving Independent Transmission Companies or "ITCs") that had the potential to harm consumers would escape review based on a definition that only looks at transaction value.

"*A* market price" must never be confused with "*the* market value." Markets are made of a *plethora* of players who vie for goods and services against the other players based upon their own internal drives and resources. In the process, bidding by buyers forces prices up, bidding by sellers forces prices down, and assuming all players are equally informed, market equilibrium can result in a readily identified -- even *singular* -- market price. But introduce limits on the amounts of transactions, or uniqueness in the

[10] *Id.* at P. 34.

goods or services at issue, and no such singular price is possible -- the result being that each transaction proceeds according to the unique characteristics of the thing being traded and the immediately bidding buyer and seller.

With specific regard to transmission assets, to ascribe such transactions as being dispositive of what a broader market would show is to belie the very nature of transmission that compels government regulation: there are limited assets at work in vital areas of public necessity, and by that limited nature, such assets require governance to prevent lost need or abusive prices.[11] The only safe alternative in such a situation, as per the historic utility regulation, is a bottom-up development of asset valuation on a "reproduction cost new less depreciation" (RCNLD) basis. If the Commission is to allow fair and equitable returns from any such investments, with such returns stemming from operations of assets vested with unique and unsubtle claims to public welfare, at rates regulated out of societal necessity, then history and logic both compel recognition of the nature of transmission assets as *not* being in comportment with the use of "market value" stemming from a singular transaction price.

5. <u>Record Keeping And Reporting</u>

The Commission seeks comment on whether its existing record keeping and reporting requirements are sufficient for monitoring compliance with Section 203.[12] "For example, do FERC Form 1s or Order No. 652 market-based rate change in status reports provide sufficient information to monitor compliance with Section 203?"[13] At this time,

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[11] As historically noted, although food is vital, there is more than adequately broad supply to meet the need; no lost customers, no abusive pricing, excepting sports coliseums.
[12] *Id*. at P. 35.
[13] *Id.*

NAUSCA has not identified any additional reporting or record keeping requirements that are required. However, the current record keeping and reporting requirements, including recent enhancements, should be considered the minimum necessary for section 203 purposes. The Commission should not reduce any of the current reporting or record keeping requirements.

B. Definition Of “Existing Generation Facility”

“The Commission proposes to define ‘existing generation facility’ for section 203 purposes as a generation facility that is operational at the time the transaction is consummated.”[14] This definition is insufficient. It leaves open the question of what “operational” means and could allow easy evasion of review.

In the proposed definition, the Commission refers to “the time the transaction is consummated.” This could be interpreted as a particular day or could even reference a particular point in time during a given day. The Commission’s proposed definition also keys on whether the unit is “operational” at that specific point in time. The term “operational” could be interpreted as a generating unit producing electricity. Whether or not a generating unit is producing electricity at the exact time ink is hitting paper on a deal involving the plant is not material to whether review of the transaction is needed to protect consumers.

No plant is producing electricity every minute of every day. All plants go through maintenance cycles during the year. Moreover, many generating units are intended only to operate during certain seasons or even certain hours of the day. Parties should not be able to evade Section 203 review simply by closing the deal in the spring or fall instead

[14] *Id*. at P. 37.

of the summer or in the morning instead of the afternoon. The Commission's proposed definition could even prevent review if parties simply directed that the plant being sold be shut down on the day the transaction is consummated.

The Commission must adopt a definition that includes all plants that could affect markets and market concentrations. The definition should include generating plants that have not yet produced electricity but are the subject of an application to the Commission, a state public service commission, state or federal environmental agency, or regional transmission organization ("RTO") or independent system operator ("ISO") for market-based rate authority, a certificate, a permit, or interconnection rights for the plant. In the particular case where a generation unit has been sold as capacity or as a provider of an ancillary service for a future time period, regardless of where it is in the development process, it is already a participant in the markets and the sale of such a unit should be reviewable by the Commission.

Also, the definition of "existing generation facility" must be broad enough to include any plant that is not producing electricity but is not yet to a point in the process of being converted to an entirely different use, such as an industrial facility or condominiums, that it could not return to producing electricity without going through the entire regulatory process for a completely new facility. In other words, it is not "beyond the point of no return." Therefore, the definition should include any plant that has previously produced electricity and has not been officially shut down, whether by removal from rate base or through the deactivation procedures of an ISO or RTO. Further, any generating unit that still holds market-based rate authority, a state certificate to produce electricity, an environmental permit to produce electricity, or interconnection rights from an RTO or ISO should be included in the definition. Certainly any generating unit that is receiving revenue for capacity or an ancillary service, such as black start service, at the time of the transaction should be considered operational.

C. Definition Of "Non-Utility Associate Company"

Amended section 203(a) (4) requires that the Commission must find that a 203 transaction will not cross-subsidize a "non-utility associate company" or that such cross-subsidization would be in the public interest to approve the transaction.[15] The Commission proposes to define "non-utility associate company" to include not only "unregulated" associated companies in non-energy businesses but also "unregulated" associated companies in energy businesses, particularly affiliated companies that sell electricity at market-based rates. NASUCA supports this interpretation. A narrower definition would frustrate the purpose of protecting captive customers from subsidizing other business endeavors.

D. Contents Of Application – Information Regarding Cross-Subsidization

The Commission seeks comments on what information or proof the applicants should be required to provide with their application on the issue of cross-subsidization of non-utility associate companies.[16] When a utility is incorporated into a different holding company structure, it raises issues of whether there are sufficient procedures in place to prevent cross-subsidization of associated companies. An applicant should be required to

[15] *Id*. at P. 41.
[16] *Id*. at P. 45.

fully describe its procedures for preventing cross-subsidization by the utility in the new holding company structure and submit an independent audit of those procedures.

E. Procedures For Consideration Of Applications

"Amended section 203(a) (5) directs the Commission to adopt procedure for the expeditious consideration of applications for the approval of dispositions, consolidations, or acquisitions under section 203 of the FPA. Section 203(a) (5) also requires the Commission to 'identify classes of transactions, or specify criteria for transactions, that normally meet the standards established in [section 203(a) (4)].'"[17]

The Commission notes its current policy of noticing section 203 applications: a 60-day notice period for applications that require a competitive analysis and a 21-day notice period for all other applications. The Commission also states its intention that applications to "transfer ownership of a generation plant from one affiliate or associate company to another company within the same corporate structure and for other applications that may raise cross-subsidization or pledge or encumbrance issues" will be noticed for a period between 21 days and 60 days.[18]

NASUCA states in a 1996 resolution on merger review that Commission policies should "be adjusted so as to permit meaningful review by interested parties in advance of the deadlines for intervention/protest. This would include additional time for parties to conduct discovery and analyze the merger applications…" The experience of NASUCA's members in merger review cases before the Commission has been that a 60-day notice period without discover rights in a complicated merger proceeding is not

[17] *Id*. at P. 55.
[18] *Id*. at P. 65.

sufficient for intervenors to present a complete and adequate record for Commission review. NASUCA urges the Commission to consider longer notice periods for mergers and acquisition of generation assets that require analysis of the effects on competition.

F. Proposal To Amend Merger Policy Statement

The Commission proposes to remove the current regulation that states that "[w]here the merged entity would be part of a registered public utility holding company, if applicants do not commit in their application to abide by this Commission's policies with regard to affiliate transactions, the Commission will set the issue for a trial-type hearing."[19] The Commission states that this provision is no longer necessary because of repeal of PUHCA 1935 and the fact that intercompany transactions will no longer be exempt from FERC jurisdiction.[20] However, it is important to recognize that this provision established an affirmative burden on companies to comply with the Commission's policies on affiliate transactions. The Commission should ensure that the removal of this provision does not result in a transfer of the burden of proof on theses issues away from the utility.

III. Conclusion

Review of mergers and sales of assets is critical to the Commission's statutory obligations to protect consumers from markets that are not sufficiently competitive and from utility cross-subsidization of affiliates. In adopting regulations to implement amended section 203 of the FPA, the Commission should ensure that it does not adopt

[19] *Id*. at P. 66.
[20] *Id*. at P. 67.

rules that unduly limit its ability to protect consumers. NASUCA respectfully requests that the Commission consider the above comments, which support certain of the proposed regulations and suggest changes to others as necessary to allow the Commission to protect consumers.

Respectfully submitted,

_*/s/ William F. Fields*________
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November 7, 2005

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for the National Association of State Utility Consumer Advocates

November 7, 2005

Honorable Magalie Roman Salas
Office of the Secretary
Federal Energy Regulatory Commission
Dockets Room – Room 1A
888 First Street, N.E.
Washington, DC 20426

Re: Docket Nos. RM05-34

Dear Secretary Salas:

Attached is the Comments of the National Association of State Utility Consumer Advocates for electronic filing in the above-referenced proceeding.

If you have any questions, please do not hesitate to contact me.

Very truly yours,

William F. Fields
Assistant People's Counsel

WFF/mcm
Enclosures
cc: Service List