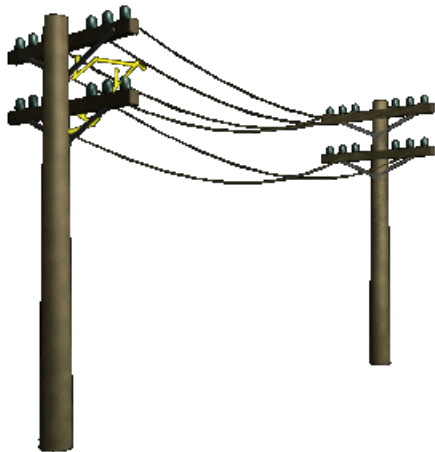


# PROPOSED MODIFICATIONS TO THE "INDEPENDENT OPERATION" REQUIREMENT OF THE STANDARDS OF CONDUCT

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# Performance of Executive Functions: The Regulations

- The Standards of Conduct permit transmission providers to share with their Marketing and Energy Affiliates senior officers and directors who are not Transmission Employees. (18 C.F.R. § 358.4(a)(5).)
- Transmission function employees are persons who direct, organize or carry out transmission-related operations. (18 C.F.R. § 358.3(j).)
- Definition of “transmission function employee” includes not only the person who carries out the transmission function but also includes the person who supervises that person, even if both persons are senior officers or directors (Order 2004-B, P 57.)

# Performance of Executive Functions: The Problem

- The Commission has held that even occasional performance of transmission functions makes a person a transmission employee. (Order No. 2004-A, P 131.)
- The Commission also has held that a person who executes a power sales contract is a marketing employee. *Cinergy Services*, 111 FERC ¶ 61,512, P 34 (2005).
- Many utilities require officers or directors to execute large contracts. They consider this function to be critical to the performance of their fiduciary duties as officers of the corporation.

## Performance of Executive Functions: The Problem continued

- If a corporate officer executes a power sales contract, not only he but his superior officer is a marketing employee and cannot be a shared officer.
- While the FERC has stated that it does not intend the Standards to restrict corporate governance functions (Order No. 2004-A, P 139), the prohibition against contract execution does in fact interfere with corporate governance.
- The problem is particularly acute for mid-sized and small utilities that do not have multiple levels of management. In some instances, there is only one position between the manager of power sales and the CEO of the Utility. If the Manager executes a contract, the only permissible shared officer above him is the CEO. If the Vice President signs the contract, the CEO cannot be a shared officer.

# Performance of Executive Functions: Contract Approval

- The Commission has never clarified whether the review and approval of a contract, but not its actual execution, causes the approving officer to be a Marketing employee; Order No. 2004-A, P 131, indicates that an approving officer may be a Marketing employee.
- If the shared officer cannot approve a contract, it places an even greater restriction on corporate governance. Simply informing a shared officer about a contract without allowing him to approve it or disapprove it prevents the officer from performing his functions.
- If a shared officer may approve contracts, the reason for a distinction between approval and execution is not clear.

# Performance of Executive Functions: Approval of Capital and Operating Expenses

- The Commission has held that a CEO or CFO may approve major capital expenses without becoming a Transmission Employee. (Order No. 2004-A P 141.)
- An informal inquiry to Staff as to whether a shared officer could approve major operating expenses resulted in a response that it would depend on the circumstances.
- It is not clear why a shared officer's approval of capital expenses is acceptable but approval of operating expenses may not be acceptable.
- It also is not clear why a shared officer may approve a capital expense for transmission or generation but may not approve an power purchase or sales contract.

# Performance of Executive Functions: The Solution

- The Commission should hold that contract negotiation is a transmission or merchant function; but that the execution or approval of a contract can be performed by a shared officer, even if the shared officer is the immediate supervisor of the person who negotiated it.
- The Commission also should permit shared officers to approve capital expenditures and operating expenditures for generation and transmission, provided that they do not engage in transmission operations functions or marketing, sales or brokering.
- This preserves the distinction between operating functions and executive functions and also preserves utilities' corporate governance functions.

## Performance of Executive Functions: The Solution continued

- The prohibition against the provision of transmission information and customer information of to the Marketing or Energy Affiliate and the “no conduit rule” will prevent shared officers from misusing their access to transmission information to benefit Marketing and Energy Affiliates.

# Cost of Service and Rate Design: The Problem

- Order No. 2004-C, P 30-31, states that whether tariff administration and rate design are Transmission Employee Functions will be determined on a case-by-case basis.
- The Frequently Asked Questions posting states that transmission administration and rate design is a transmission employee function. (FAQ #21.)
- In many utilities, the cost of service personnel who develop a utility's transmission revenue requirement or power sales revenue requirement are service employees who are not involved in marketing energy or administering transmission tariffs.

# Cost of Service and Rate Design: The Problem

- In smaller utilities, the number of persons who have the capability to develop revenue requirements is limited. Frequently they develop revenue requirements and rate design for retail customers as well.
- Requiring transmission providers to treat cost of service and rate design personnel as transmission employees or marketing employees requires them to employ additional people.

# Cost of Service and Rate Design: The Solution

- The Commission should classify personnel who develop utility revenue requirements and perform rate design as support personnel, provided that they do not engage in transmission or marketing, sales or brokering.
- The development of revenue requirements is primarily based on publicly available Form 1 data, and rates are always publicly filed and subject to challenge.
- Rate design also provides little opportunity to discriminate or to provide preferential treatment since the design of FERC-filed rates involves virtually no discretion.
- The “no conduit rule” prevents cost of service and rate design personnel from providing transmission and customer information to Marketing and Energy Affiliate personnel.