



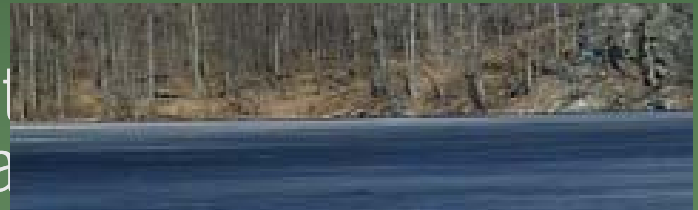
The New Focus of the Federal Energy Regulatory Commission

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Overview

- The FERC is in the process of transforming itself from a rate regulatory commission to a commission that is focused on the regulation of conduct.
- In the process, the FERC is significantly expanding the scope of its jurisdiction to include matters that have not been regulated.
- or a beast?



Federal v. State Jurisdiction – Retail Transmission

- FERC traditionally took a “hands-off” approach to transmission service in connection with retail sales.
- In 1996, FERC asserted that it has jurisdiction over unbundled retail transmission service to ensure that service is not unjust, unreasonable or unduly discriminatory.
- The Supreme Court held in *New York v. FERC* (2002) that:
 - The Federal Power Act does not limit FERC’s jurisdiction over transmission to transmission of wholesale energy.
 - FERC regulation of unbundled retail transmission is within the scope of its jurisdiction.
 - FERC may choose whether to assert jurisdiction over bundled retail transmission.

Federal v. State Jurisdiction – Retail Transmission continued

- The reason for FERC's order was not a desire to regulate rates, per se – it has not required the filing of retail transmission rates at FERC. It issued the order to stop unduly discriminatory conduct.
- The Virginia legislature twice considered legislation that would terminate retail choice in order to ensure that FERC does not have jurisdiction over retail transmission.

Federal v. State Jurisdiction – Distribution Service

- In a proceeding involving the Midwest Independent Transmission System Operator, FERC held that in a retail choice environment, only facilities used exclusively for retail distribution service are not subject to its jurisdiction. It asserted jurisdiction over rates for distribution service to retail customers because the facilities also ? wholesale customers.
- The Court of Appeals held that FERC had confused its jurisdiction over transactions with jurisdiction over facilities, and reversed the Commission.

Federal v. State Jurisdiction – RTO Membership

- In Order 2000, FERC held that RTO membership is voluntary.
- FERC threatened to overrule the Kentucky and Virginia Commissions, who were delaying AEP's attempts to join PJM. AEP was allowed to join PJM.
- In another proceeding, the Court of Appeals held that FERC's attempt to assert control over withdrawal from an RTO under Section 203 of the FPA exceeded FERC's jurisdiction and remanded the case to the FERC.
- FERC responded, saying it hadn't explained itself clearly and reasserted its original opinion.

Federal v. State Jurisdiction – RTO Membership continued

- The Court granted enforcement of its prior order. It held that FERC did not have the right to re-argue the Court's decision and directed FERC to vacate and not reinstate its requirement of approval of withdrawals from RTOs.
- In a settlement, the FERC's control over withdrawal pursuant to Section 203 was deleted. Instead, withdrawal from an RTO constitutes a modification of the Transmission Owners Agreement, which must be approved by FERC under Section 205 of the FPA.

Federal v. State Jurisdiction – Affiliate Transactions

- FERC has jurisdiction over all wholesale sales, including affiliate sales. Many states also regulate affiliate transactions.
- The Virginia SCC required Dominion Virginia Power to include in a FERC-filed service agreement with its affiliate a provision stating that the SCC has supervisory authority over the transaction and can order DVP to terminate it.
 - FERC rejected the provision on preemption grounds.
 - DVP withdrew the service agreement.
- FERC also rejected a provision of a service agreement of Progress Energy Carolinas that provided for state review of an affiliate power sales agreement.

FERC's New Role as the "Conduct Police"

- In each of the decisions discussed so far, there is an element of FERC's review of the conduct of the utility.
- FERC is increasingly moving toward the regulation of conduct; in some ways, rate regulation has become a secondary feature of its regulation.
- Chairman Kelliher is viewed by many as Chief of the Conduct Police. He has made it very clear that he will take action against entities and persons who violate the FERC's conduct rules.

Standards of Conduct

- The FERC regulates the relationship between the transmission function and marketing/energy affiliate function.
- Transmission and merchant operations must be kept separate to the maximum extent practicable.
- Transmission personnel must not provide non-public transmission or customer information to their marketing/energy affiliate personnel.
- The compliance process has involved a huge expenditure of utility resources, and FERC's audit oversight has resulted in very substantial refunds, penalties and compliance obligations.

Code of Conduct

- FERC requires utilities to operate separately from their marketing affiliates to the maximum extent practicable.
- Utility and marketing affiliates personnel may exchange market information only if it is disclosed simultaneously to the public.
- There are rules on inter-affiliate sales of non-power goods and services.
- FERC audit oversight has resulted in significant refunds and penalties.

Market Behavior Rules

- Post-Enron, FERC adopted rules relating to unit operation, market manipulation, accuracy of communications and the reporting of transactions to price index publishers.
- The Energy Policy Act of 2005 includes prohibitions on market manipulation that are based on § 10b-5 of the Securities and Exchange Act.
- FERC has issued a Notice of Proposed Rulemaking to implement the statute and has proposed to eliminate the Market Behavior Rules when the new regulations take effect.

Interlocking Directorates

- FERC has long had the obligation to approve interlocks of officers and directors of two or more utilities and interlocks between a utility and certain banks or suppliers of electrical equipment.
- Recently FERC has taken several steps to tighten up oversight of interlocks.
 - It will refuse interlock applications that are filed late.
 - Automatic approval of interlocks within holding companies is granted only if an information filing is made prior to assuming the position.
 - FERC has denied some interlock applications and has hinted that it would take enforcement action against those who violate the interlock rules.

Other Conduct Regulation

- Electric reliability: FERC will oversee the Electric Reliability Organization, including its establishment of reliability standards and assessment of penalties.
- Transmission service by “unregulated transmitting utilities”: FERC may issue rules or orders requiring transmission service by most non-jurisdictional entities to be provided at rates, terms and conditions that are comparable to the service they provide themselves.

FERC Enforcement Tools

- The Energy Policy Act of 2005 gave FERC additional capability to enforce compliance with conduct rules.
 - FERC complaint and investigatory authority is expanded.
 - Civil penalties have been increased from \$10,000 per day to \$1 million per day.
 - Criminal penalties have been increased from \$5,000/2 years to \$1,000,000/5 years for violation of the statute and \$25,000 for violation of a regulation.
 - The effective date for refunds is now as early as the date of filing of a complaint.

FERC Enforcement Tools continued

- FERC has adopted a policy statement establishing guidelines for enforcement actions that will go a long way toward reassuring the industry that it will act reasonably.
- FERC also issued a NOPR proposing to codify its procedures for challenges to staff audit findings and remedies.

How Will FERC's "Extreme Makeover" Come Out?

- As FERC expands its oversight of utility conduct, it is increasingly addressing issues that traditionally were subject to state regulation. In most respects the states are losing or will lose these battles.
- FERC is somewhat belatedly moving from purely discretionary enforcement action to a "rule of law" approach to conduct regulation.
- At the same time, the FERC Chairman appears to be taking a fairly strict view of its role as "Conduct Police".
- We are likely to see both expanded FERC oversight and increasing emphasis on penalties and remedies to obtain compliance.

Will this new FERC be a beauty or a beast?

- Perhaps it depends on your perspective.

