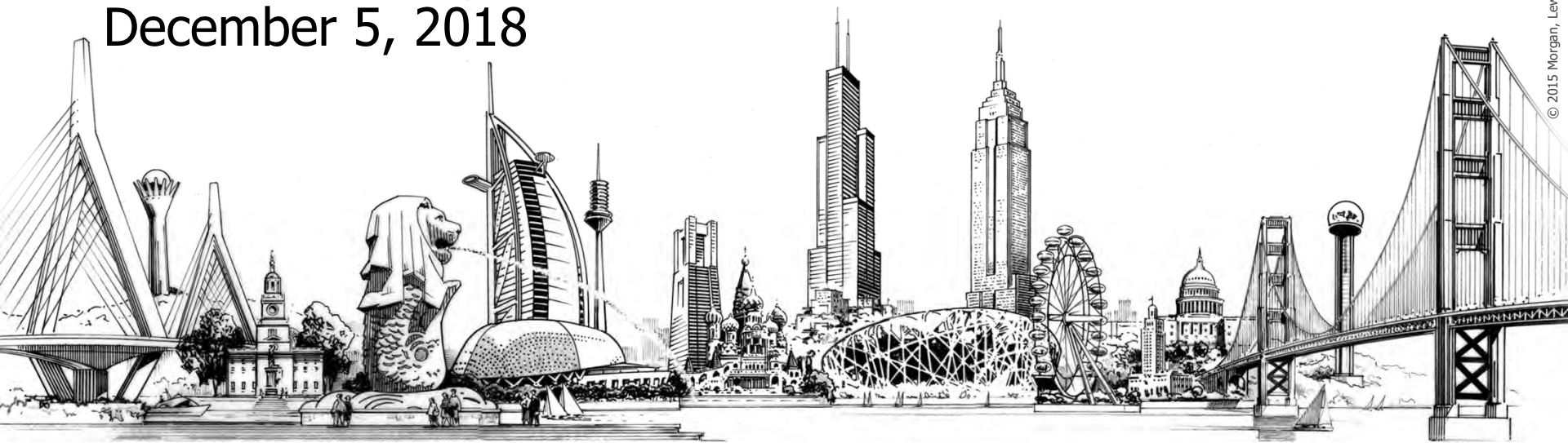
Morgan Lewis

# M&A REGULATORY DEVELOPMENTS AT FERC 2018 ANNUAL REVIEW

Mark C. Williams
J. Daniel Skees
Heather L. Feingold
December 5, 2018



# Agenda

- Section 203 of the Federal Power Act and Its Core Principles
- Immunities, Exemptions, and Passive Investment under Section 203
- Section 203 Activity in 2018
- Current FERC M&A Policy Developments
- 2018 FERC M&A Enforcement Activity
- Potential FERC M&A Policy Developments

# Business Background

M&A, Divestiture, Reorganizations, Changes-In Control

- FERC exercises broad jurisdiction over electric sector mergers, acquisitions, securities transactions and "dispositions"
- Exemptions and "blanket authorizations"
- "Directly or indirectly … by any means whatsoever…"
- There is no bankruptcy exemption
- "Public Utility" includes most U.S. wholesale generation and power marketing businesses and nearly all private sector T&D systems

[Federal Power Act Section 203, 16 U.S.C. § 824b; 18 C.F.R. § 2.26]

# 16 U.S. Code § 824b Disposition of property; consolidations; purchase of securities

**(a) Authorization**

**(1)** No public utility shall, without first having secured an order of the Commission authorizing it to do so—

**(A)** sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of the Commission, or any part thereof of a value in excess of $10,000,000;

**(B)** merge or consolidate, directly or indirectly, such facilities or any part thereof with those of any other person, by any means whatsoever;

**(C)** purchase, acquire, or take any security with a value in excess of $10,000,000 of any other public utility; or

**(D)** purchase, lease, or otherwise acquire an existing generation facility—

**(i)** that has a value in excess of $10,000,000; and

**(ii)** that is used for interstate wholesale sales and over which the Commission has jurisdiction for ratemaking purposes.

**(2)** No holding company in a holding company system that includes a transmitting utility or an electric utility shall purchase, acquire, or take any security with a value in excess of $10,000,000 of, or, by any means whatsoever, directly or indirectly, merge or consolidate with, a transmitting utility, an electric utility company, or a holding company in a holding company system that includes a transmitting utility, or an electric utility company, with a value in excess of $10,000,000 without first having secured an order of the Commission authorizing it to do so.

**(3)** Upon receipt of an application for such approval the Commission shall give reasonable notice in writing to the Governor and State commission of each of the States in which the physical property affected, or any part thereof, is situated, and to such other persons as it may deem advisable.

**(4)** After notice and opportunity for hearing, the Commission shall approve the proposed disposition, consolidation, acquisition, or change in control, if it finds that the proposed transaction will be consistent with the public interest, and 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 the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest.

**(5)** The Commission shall, by rule, adopt procedures for the expeditious consideration of applications for the approval of dispositions, consolidations, or acquisitions, under this section. Such rules shall identify classes of transactions, or specify criteria for transactions, that normally meet the standards established in paragraph (4). The Commission shall provide expedited review for such transactions. The Commission shall grant or deny any other application for approval of a transaction not later than 180 days after the application is filed. If the Commission does not act within 180 days, such application shall be deemed granted unless the Commission finds, based on good cause, that further consideration is required to determine whether the proposed transaction meets the standards of paragraph (4) and issues an order tolling the time for acting on the application for not more than 180 days, at the end of which additional period the Commission shall grant or deny the application.

**(6)** For purposes of this subsection, the terms "associate company", "holding company", and "holding company system" have the meaning given those terms in the Public Utility Holding Company Act of 2005 [42 U.S.C. 16451 et seq.].

**(b) Orders of Commission**

The Commission may grant any application for an order under this section in whole or in part and upon such terms and conditions as it finds necessary or appropriate to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission. The Commission may from time to time for good cause shown make such orders supplemental to any order made under this section as it may find necessary or appropriate.

# 16 U.S. Code § 824b Disposition of property; consolidations; purchase of securities

- **Amendment of Subsection (a)(1)(B) and Addition of Subsection (a)(7)**
- Pub. L. 115–247, provided that, subsection (a)(1) of this section is amended by striking subparagraph (B) and inserting the following:
- *"(B) merge or consolidate, directly or indirectly, its facilities subject to the jurisdiction of the Commission, or any part thereof, with the facilities of any other person, or any part thereof, that are subject to the jurisdiction of the Commission and have a value in excess of $10,000,000, by any means whatsoever;".*
- 2018-Subsec. (a)(1)(B). Pub. L. 115–247, §1, added subpar. (B) and struck out former subpar. (B) which read as follows: "merge or consolidate, directly or indirectly, such facilities or any part thereof with those of any other person, by any means whatsoever;".
- Subsec. (a)(7). Pub. L. 115–247, §2, added par. (7). "(7) (A) Not later than 180 days after the date of enactment of this paragraph, the Commission shall promulgate a rule requiring any public utility that is seeking to merge or consolidate, directly or indirectly, its facilities subject to the jurisdiction of the Commission, or any part thereof, with those of any other person, to notify the Commission of such transaction not later than 30 days after the date on which the transaction is consummated if—
- "(i) the facilities, or any part thereof, to be acquired are of a value in excess of $1,000,000; and
- "(ii) such public utility is not required to secure an order of the Commission under paragraph (1)(B).
- ***Effective Date: March 27, 2019.***

# Legal Issues

- Competition
  - Often not similar to antitrust/HSR review
- Rates/Tariffs
- Regulation
  - Jurisdictional Impairment
  - Any-Agency Vs. State Commission
- Cross-Subsidization
  - Multiple Ingredients

[18 C.F.R. § 2.26, 18 C.F.R. § 33.2]

# 18 C.F.R. § 2.26 Policies concerning review of applications under section 203

**(a)** The Commission has adopted a Policy Statement on its policies for reviewing transactions subject to section 203. That Policy Statement can be found at 77 FERC ¶61,263 (1996). The Policy Statement is a complete description of the relevant guidelines. Paragraphs (b)-(e) of this section are only a brief summary of the Policy Statement.

**(b)** *Factors Commission will generally consider.* In determining whether a proposed transaction subject to section 203 is consistent with the public interest, the Commission will generally consider the following factors; it may also consider other factors:

**(1)** The effect on competition;

**(2)** The effect on rates; and

**(3)** The effect on regulation.

**(c)** *Effect on competition.* Applicants should provide data adequate to allow analysis under the Department of Justice/Federal Trade Commission Merger Guidelines, as described in the Policy Statement and Appendix A to the Policy Statement.

**(d)** *Effect on rates.* Applicants should propose mechanisms to protect customers from costs due to the merger. If the proposal raises substantial issues of relevant fact, the Commission may set this issue for hearing.

**(e)** *Effect on regulation.*

**(1)** Where the affected state commissions have authority to act on the transaction, the Commission will not set for hearing whether the transaction would impair effective regulation by the state commissions. The application should state whether the state commissions have this authority.

**(2)** Where the affected state commissions do not have authority to act on the transaction, the Commission may set for hearing the issue of whether the transaction would impair effective state regulation.

**(f)** Under section 203(a)(4) of the Federal Power Act (16 U.S.C. 824b), in reviewing a proposed transaction subject to section 203, the Commission will also consider whether the proposed transaction will result in cross-subsidization of a non-utility associate company or 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.

# Legal Issues

- One Section, Two Doorways
  - Section 203(a) includes two different subsections that cause Section 203 jurisdiction to attach to difference classes or persons and transactions – but if a person or transaction is covered by either, the same substantive requirement apply.
- 203(a)(1)
  - Direct or indirect control
  - Substantial majority of filings
  - Public Utility buys existing generator
  - Public Utility buys any interest in another Public Utility
  - PL 115-247 to amend Subsection (a)(1)(B) and add Subsection (a)(7)

# Legal Issues

- 203(a)(2)
  - Applies when buyer is already a "holding company"
  - Some blanket authorizations available
- Standards of review under 203(a)(1) and 203(a)(2) are identical
- 10% and $10M floors (sometimes)

# Immunities and Exemptions

- Lengthy list
  - [18 C.F.R. 292.601(c), 18 C.F.R. § 33.1(c)]
- Internal reorganizations of equity interests
- 203(a)(2) blanket authorization for independent generation acquisitions of independent generation [18 C.F.R. § 33.1(c)(8)]
  - Misleading; many of these transactions are still subject to Section 203(a)(1) filings
- Publicly-traded issuers [18 C.F. R. § 33.1(c)(9),(10),(14),(15); FPA Section 203 Supplemental Policy Statement, 122 FERC ¶ 61,157 p.4 (2008).]
  - Unclear and non-explicit regulatory treatment
  - 20% cap on widely-traded issuances has been stated but does not appear in regulations
  - Buyer eligibility
  - Investor blanket authorization filings
    - Universally valuable?

# Immunities and Exemptions

- QF acquisitions
  - Multiple categories of QF
    - Size, fuel, Small Power QFs vs Cogeneration QFs
- Small Power QFs over 30 mw
  - Internally inconsistent size caps
    - QF status does not equal QF 203 exemption
- QFs with "Market-Based Rate" authority and/or transmission tariffs
  - Prior substantial inconsistencies in FERC 203 treatment of QFs loosely resolved
  - A QF that is otherwise exempt from 203 does not become subject to 203 solely due to the QF holding MBR authority [*Chevron U.S.A. Inc.*, 153 FERC ¶ 61,192 (2015)]

[QF includes both cogeneration and small power Qualifying Facilities; see 18 C.F.R. Part 292]

# Passive Investment

- Multiple classes and proceedings
- Tax Equity and Similar Matters:  FERC's AES Creative / EquiPower standard

  [18 C.F.R. § 33.1(c)(2)(i); *Starwood Energy Group Global, L.L.C.*, 153 FERC ¶ 61,332 (2015); and cases cited therein, including *AES Creative Resources, L.P.*, 120 FERC ¶ 61,239 (2009).]
- Tax Equity interest M&A transactions
  - *Ad Hoc Renewable Financing* declaratory order [161 FERC ¶ 61,010 (2017)]

# Passive Investment

- Purely passive fund investors (LPs), co-investors, fund entities are disregarded for FERC M&A and immediately related purposes
- Fund GPs, managers, advisers are NOT disregarded, and normally control is attributed to these non-passive actors
- *Starwood* precedent cited several times in this year's transactions

[*Starwood Energy Group Global, L.L.C.* (2015)]

# Section 203 by the Numbers

The numbers are slightly down for 2018, but note the legal limitations on number of filings as a barometer for activity –

- Some transactions, even a few larger ones, immune. FERC has conferred "blanket authorization" on over a dozen different classes of entities and transactions.
  [ 18 C.F.R. § 33.1(c)]
  - Example: Transactions involving Small Power QFs 30 MW or smaller, or Cogen QFs, normally would not require FPA 203 filings
- $$-size is not always a gating factor
  [16 U.S.C. § 824b(1)(A),(C),(D)]
- Some surprisingly small transactions not immune, but new legislation will reduce the filing requirements
  [16 U.S.C. § 824b(1)(B)]
- Increasing blanket authorizations and exemptions mean fewer "abundance of caution" 203 filings – actual jurisdictional activity may be up
- Transactions prior to the time when FERC jurisdiction attaches

# The Numbers

- In Gross:
- 2018 FY/YTD: 164 Section 203 Applications
- 2017 FY/YTD: 199 Section 203 Applications
- 2016 FY/YTD: 196 Section 203 Applications
- 2015 FY/DY:  218 Section 203 Applications
- 2014 FY/DY:  150 Section 203 Applications
- 2013 FY/DY:  155 Section 203 Applications
- 2012 FY/DY:  145 Section 203 Applications
- 2011 FY/DY:  119 Section 203 Applications

[Results of search results:
elibrary.ferc.gov/idmws/search/fercadvsearch.asp, Nov. 5, 2018)

# The Numbers

Independent Generation v. Traditional Franchised Utilities

- Substantial majority:  independent generation (solar/wind projects)
- Multiple fleet transactions
- "Passive" ownership issues
- "Abundance of caution" applications declining due to more granular generic guidance on immunities for passive interests (less than 20 abundance of caution filings re passive interests in EC18 dockets)

[Results of search results: elibrary.ferc.gov/idmws/search/fercadvsearch.asp, Nov. 5, 2018)

# Behind The Numbers

- Responding to post-filing Staff inquiries
- Fund changes in control/Yield Cos – continuing decline
- International investment
- Reorganizations and Bankruptcy Code § 1129(a)(6)
- Ongoing reduction in Tax Equity 203 applications, as a result of generic relief (See Notice of Withdrawal in EC18-1)

[Results of search results:
elibrary.ferc.gov/idmws/search/fercadvsearch.asp, Nov. 5, 2018)

# Recent Developments

**Aged Rulemaking Proceedings With No Signs of Movement**

1. Connected Entities Proceeding
   - Dramatically greater quantity, extent of Market-Based Rate disclosures
   - 40-page draft "data dictionary"
   - Substantial impact on section 203 information disclosures

   [*Notice of Proposed Rulemaking*, Docket No. RM16-17-000, *Data Collection for Analytics and Surveillance and Market-Based Rate Purposes*, 156 FERC ¶ 61,045 (July 21, 2016); 81 Fed. Reg. 51,726 (published Aug. 4, 2016).]

2. Section 203 Notice of Inquiry

- Companion to Connected Entity Proceeding
- Dramatically increased statistical screen requirements
- Blanket authorizations potentially at risk

[*Notice of Inquiry*, Docket No. RM16-21-000, *Modifications to Commission Requirements for Review of Transactions under Section 203 of the Federal Power Act and Market-Based Rate Applications under Section 205 of the Federal Power Act,* 156 FERC ¶ 61,214, 81 Fed. Reg. 66,649 (2016).]

# Recent Developments

**H.R. 1109: To amend section 203 of the FPA** (Public Law as of Sept. 28, 2018. PL 115-247)

- Amends the FPA to include a minimum monetary threshold of **$10 million** for the merger or consolidation of FERC-jurisdictional facilities under Section 203(a)(1)(B); thus providing a limited exemption from Section 203 for physical facility consolidation transactions valued at no greater than $10 million.
- The amendment is narrow in nature and addresses one situation that has been commonly encountered in the transmission sector.
- The FPA is also amended so that a public utility seeking to merge or consolidate its facilities with asset values of over **$1 million** must report such transaction to FERC within 30 days of consummation.
- The amendment will likely save FERC-regulated parties from the need to file interconnection turnover applications, a number of which are typically filed each year.
- The amendment is mainly a paperwork-reduction measure.
- FERC has released the implementing rulemaking in Docket No. RM19-4; comments will be due in late December.
- PL 115-247 does not take effect until **March 27, 2019**.

  - Note that EIA's application in **EC19-17** to acquire limited transmission substation facilities at ***no cost*** could have been avoided if the amendment was currently effective.
  - Additionally, at least a handful of **EC18** 203 applications involving small dollar amount transmission facilities would not have been required if the 203(a)(1)(B) amendment was currently in effect.

# Recent Developments

Recent Declaratory Order – Ad Hoc Renewable Energy Financing Group

- When a generating company is subject to FPA Section 203(a)(1), and Tax Equity interest acquisitions are consummated only after the generating company becomes FERC-jurisdictional (such as via MBR effectiveness), some investors insisted on obtaining 203 authorization
- Practices were highly disuniform
- Technically, if the Tax Equity interests confer only passive-investor (veto/consent) rights, **no 203 authorization was ever required**
- Declaratory order confirmed this view in the first single order on the issue in the 12 years that the issue had been before the Commission
- Case cited several times in EC18 dockets and resulted in one 203 application withdrawal (EC18-1)

[*Ad Hoc Renewable Energy Financing Group*, *Order Granting Petition for Declaratory Order*, Docket No. EL17-26-000, 161 FERC ¶ 61,010 (2017)]

# M&A Enforcement Developments

**Section 203, Related Transactional Requirements are a FERC Enforcement Priority**

- During FY 2018, FERC Enforcement Staff undertook numerous M&A and related enforcement actions, including:
- Responses to self-reports
- Post-transaction compliance reviews
- Punitive actions addressing identified violations
- Imposing controls and procedures to ensure that merger-related transaction costs are appropriately accounted for

# M&A Enforcement Developments

Key Enforcement Actions and Matters Included:

- In FY 2018, there was a continued high volume of accounting filings related to asset acquisitions, similar to FY 2017.
- There were over **100** late filings submitted under sections 203 or 205 of the FPA in FY 2018 (a decrease from 150 in FY 2017), each of which was individually reviewed by Enforcement Staff. The Report does not distinguish between 203 and 205 violations, so it is unclear the actual number of 203 violations in FY 2018.
- Formula rate audits in recent years have identified patterns of noncompliance regarding internal merger costs. In these cases, utilities were subject to hold-harmless commitments to exclude merger-related transaction and transition costs from rates unless FERC approves recovery of such costs and were required to have appropriate controls and procedures to ensure that the costs are tracked and excluded from formula rates.
- DAA reviewed **7** merger and divestiture applications and approximately **151** asset acquisition and sales applications from public utilities under section 203 for accounting compliance.

# M&A Enforcement Developments

Adversary Proceeding

- On June 8, 2018, FERC approved the settlement of an investigation of one large utility holding company relating to whether it failed to fully and accurately communicate information to FERC concerning certain transmission studies submitted in support of the application for approval of its merger with a large neighboring utility.
- Under the terms of the settlement, the acquiring holding company stipulated to the facts, but neither admitted nor denied the alleged violations of 18 C.F.R. § 35.41(b).
- The HoldCo agreed to pay a civil penalty of **$3.5 million** and to submit annual compliance monitoring reports for two years.(Docket No. IN15-6-000; Order Approving Stipulation and Consent Agreement, 163 FERC ¶ 61,189.)

# Staying on the Right Side of FERC Enforcement

- Understand the risks
- Noncompliance with Part II of the FPA: fines up to $1,238,271 per violation, per day (*Civil Monetary Penalty Inflation Adjustments*, 162 FERC ¶ 61,010 (2018))
  - Adjusted annually under Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015
  - FERC could unwind a transaction, but has not chosen to do so [*San Diego Gas & Elec. Co. v. Alamito Co.*, 38 FERC ¶ 61,241, at p. 61,779 & n.16 (1987)]
  - Affected parties could seek to have the transaction voided by a court [*PDI Stoneman*, 104 FERC 61,270 at P 25 (2003).
  - Risk of financing default in the event of FERC violation
- Each transaction involving electric utility assets or equity interests must be evaluated, the earlier in the process the better
- When potential noncompliance is identified, develop a plan to minimize the ongoing risk

# Policy Issues Affecting FPA Section 203 Transactions

- PURPA Reform
  - Primary focus:  mandatory purchase obligation and potential regulatory changes
  - QF status is accompanied by certain exemptions from the FPA and from other energy laws.  FERC is required by the PURPA statute to afford regulatory relief to what are often smaller QF projects
  - The continued reduction in PURPA "must buy" requirements could place other features of QF status – particularly regulatory exemptions – at risk
  - If QF regulatory exemptions were to be reduced or eliminated, substantial FERC M&A, financing, and power sales requirements could attach to thousands of project companies that are not now fully regulated
- DOE "Resiliency" NOPR in RM18-1/AD18-7
  - Current status
    - Jan 8, 2018 FERC terminated the RM18-1 proceeding and initiated a new proceeding (AD18-7) to examine the resilience of the bulk power system.
    - FERC issued an Order Granting Rehearing for Further Consideration in RM18-1/AD18-7 on March 8, 2018
  - Open questions include whether the proceeding could affect electric M&A transactions
- Other initiatives under new FERC leadership, which has been in flux

# Concluding Comments

**M&A Regulatory Development at FERC**
December 5, 2018

Mark Williams
(202) 739-5327
mark.williams@morganlewis.com

J. Daniel Skees
(202) 739-5834
daniel.skees@morganlewis.com

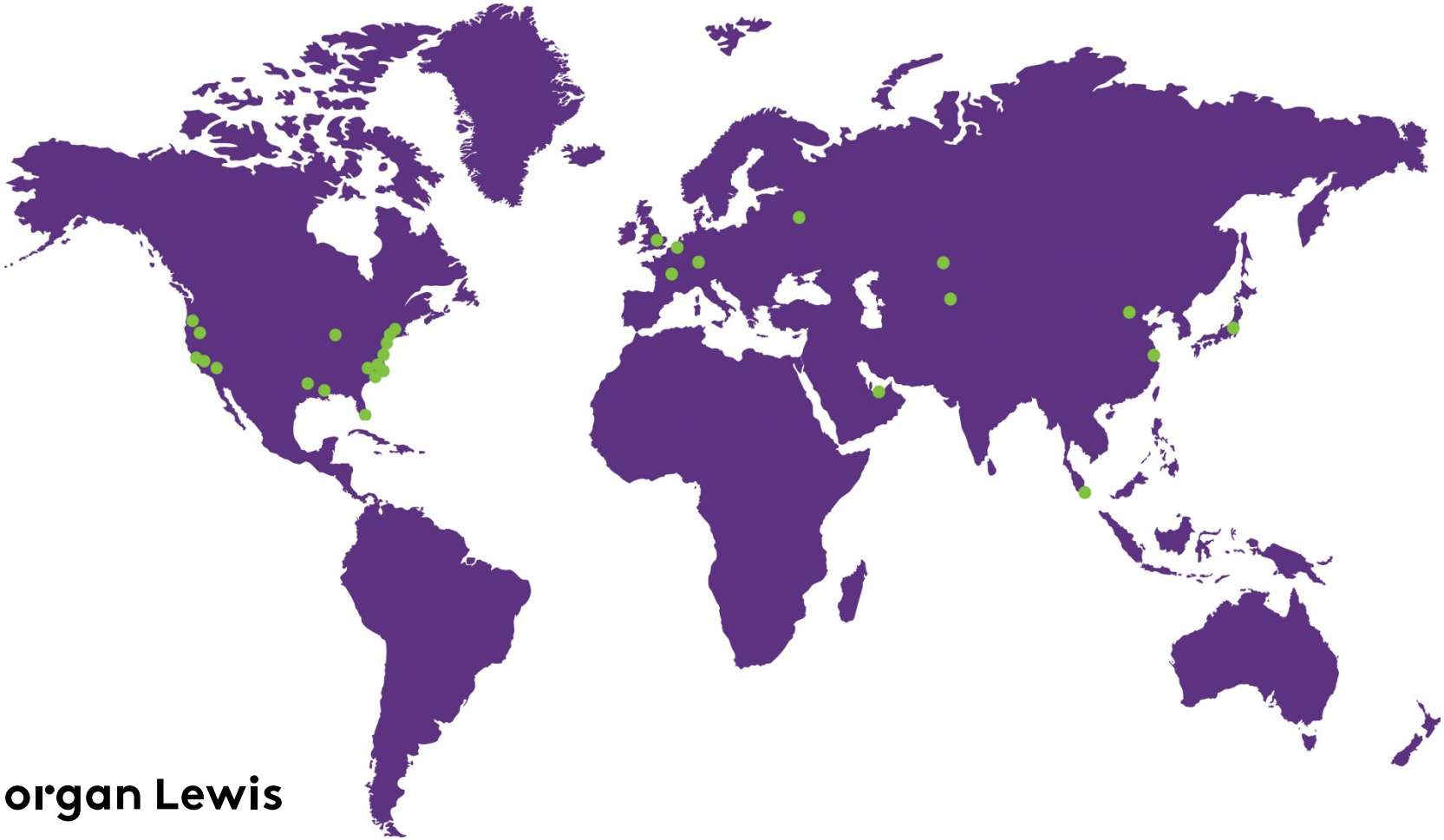
Heather Feingold
(202) 739-5371
heather.feingold@morganlewis.com

## Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

## Our Locations

Almaty
Astana
Beijing
Boston
Brussels
Chicago
Dallas
Dubai
Frankfurt
Hartford
Houston
London
Los Angeles
Miami
Moscow
New York
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Santa Monica
Shanghai
Silicon Valley
Singapore
Tokyo
Washington, DC
Wilmington



Morgan Lewis

# THANK YOU