

Investment In Electric Energy Infrastructure: Regulatory Issues

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Morgan Lewis

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Investment In Electric Energy Infrastructure: Regulatory Issues

Thursday, May 23, 2013, 1:00 pm Eastern
Panelists: Floyd L. Norton, IV and Levi McAllister



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Overview

- Purpose
 - Investments in electric energy infrastructure raise federal regulatory issues
 - What is the investment?
- Relevant Definitions
 - FERC jurisdiction
 - Public utility and holding company
- Investments through holding companies
 - Federal Power Act (“FPA”) and Public Utility Holding Company Act (“PUHCA”) regulation
 - Limiting regulation
- Investments in brick and mortar
 - FPA regulation
 - Limiting regulation
- Conclusion/Questions

Purpose

- Investments in electric energy assets or in securities of entities that own electric energy assets raise numerous federal regulatory issues.
 - Examples include:
 - Public utility status
 - Holding company classification and related obligations
 - Requisite federal regulatory approval for investments
 - Notification obligations of the energy asset
- The degree of regulation applicable to any particular investment turns on what is being purchased or invested in.
 - Brick and mortar facilities
 - Entities that own brick and mortar facilities

Definitions

- The FPA grants FERC jurisdiction over the “**transmission** of electric energy in interstate commerce and ... the **sale of electric energy at wholesale** in interstate commerce”.
 - **Transmission** of electric energy
 - **Wholesale sales** of electric energy
- FERC Has **No (or Very Limited) Jurisdiction** Over:
 - Facilities used for **local distribution** and intrastate transmission of electricity
 - Transmission or generation facilities in **ERCOT**

Definitions

- Public utility
 - A public utility is any person that owns or operates facilities subject to FERC's jurisdiction.
 - Under the FPA, an asset that makes wholesale sales of energy, transmits energy in interstate commerce, or has agreements and/or rate schedules on file with FERC is subject to FERC's jurisdiction.
 - Examples include:
 - Small power production qualifying facilities ("QFs") that exceed 30 MW.
 - Exempt wholesale generators ("EWGs")
 - Interstate transmission providers
 - Vertically integrated utilities

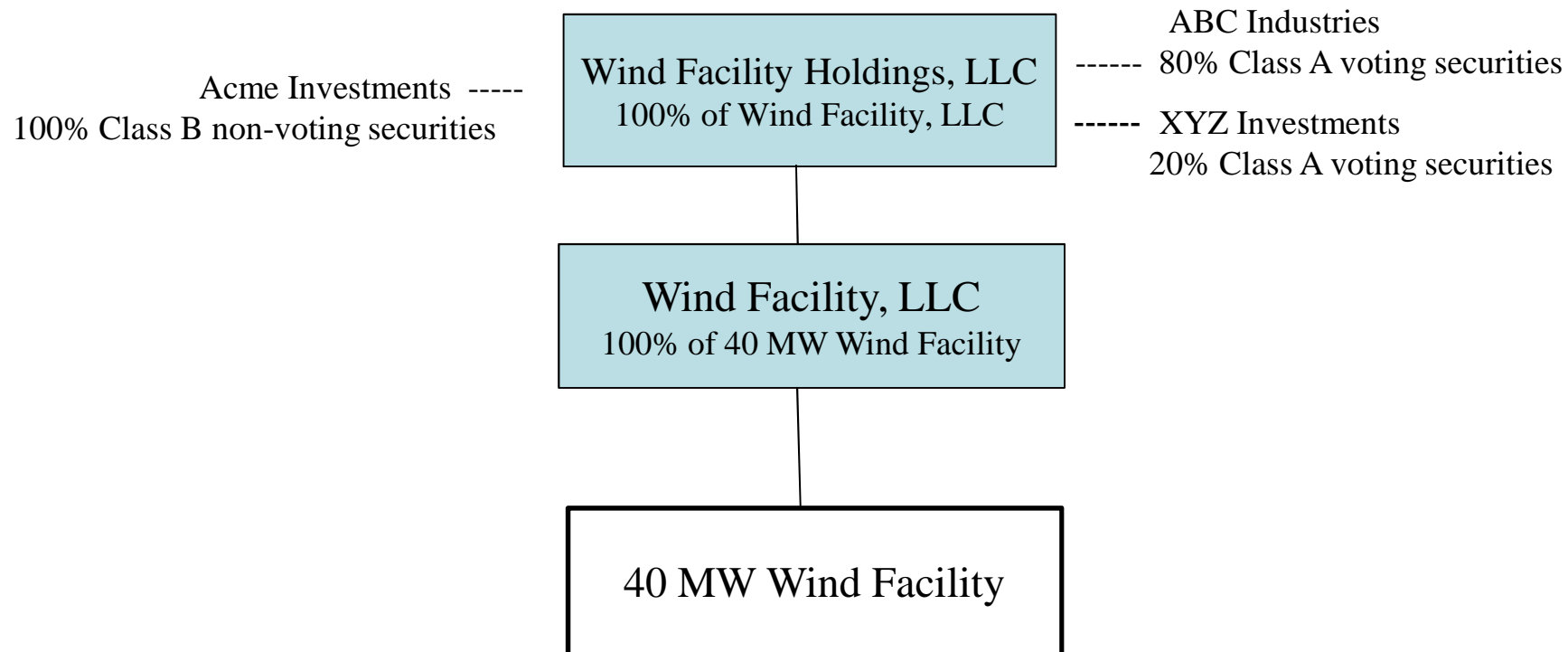
Definitions

- Holding company
 - A holding company is any company that directly or indirectly owns, controls, or holds, with the power to vote, 10 percent or more of the outstanding voting securities of a public-utility company or of a holding company of any public-utility company.
 - Public utility vs. public-utility company: A public-utility company is an electric utility company or a gas utility company.
 - An electric utility company is any company that owns or operates facilities used for the generation, transmission, or distribution of electric energy for sale whether or not those facilities are public utilities, under the FPA

Investments in Public Utility Companies or Holding Companies

- Investments in a public-utility company or a holding company can subject the investor to characterization as a holding company under the Public Utility Holding Company Act of 2005 and FERC's regulations.
 - An entity will be a holding company if its investment equals 10% or more of the voting securities of a public-utility company or a holding company in a system that includes a public-utility company.
 - Partners in a partnership can be considered holding companies if they possess control or veto rights over how the partnership operates.
 - A parent company of a FERC-regulated holding company that is incorporated in a foreign country also falls within FERC's holding company definition.
 - Thus, a foreign incorporated parent company of a FERC-regulated holding company is subject to the regulatory obligations applicable to holding companies.
 - However, FERC has traditionally inquired into the foreign entity's compliance with holding company regulations only if the foreign entity possesses books and records relating to the U.S.-based holding company or public utility company.

Investments in Public Utility Companies or Holding Companies



- Wind Facility, LLC is a public-utility company and a public utility (discussed later)
- Wind Facility Holdings, LLC is a holding company
- ABC Industries and XYZ Investments are holding companies
- Acme Investments would be a passive investor

Avoiding Characterization as A Holding Company

- Ownership of less than 10% of the voting securities of a public utility or ownership of nonvoting securities should avoid characterization as a holding company.
- FERC's regulations also exclude a governmental entity from the holding company definition.
 - A governmental entity is:
 - The United States
 - A state or political subdivision of a state
 - Any foreign governmental authority not operating in the United States
 - Any agency, authority, or instrumentality of any entity referred to above
 - Any officer, agent, or employee of any entity referred to above
 - FERC has not addressed how widely the governmental entity exemption extends for holding companies.
 - If you are a governmental entity, you are not subject to regulation under Section 203 of the FPA or PUHCA (discussed further on the following slides).

FPA Regulation of Holding Companies

- Section 203 of the FPA governs the acquisition and disposition of electric energy assets and securities.
- Section 203(a)(2) requires holding companies to receive prior FERC approval before acquiring certain security interests.
 - A holding company must obtain FERC approval before it:
 - Purchases, acquires, or takes any security with a value in excess of \$10 million of a transmitting utility, an electric utility company, or a holding company in a holding company system; or
 - Merge or consolidate with a transmitting utility, an electric utility company, or a holding company in a holding company system.
- Section 203 of the FPA does not require a holding company to seek prior FERC approval before disposing of assets or security interests.
 - However, the transaction, depending on what is disposed of and who acquires it, may separately require prior FERC approval if it is a public utility (discussed on later slides).

PUHCA Regulation of Holding Companies

- PUHCA imposes certain books and record requirements as well as record retention obligations on holding companies.
 - Part 366 of FERC's regulations requires a holding company to maintain its "books, accounts, memoranda, and other records" of all transactions in sufficient detail that FERC could audit and verify the financial statements of the holding company.
 - The purpose of this is to protect the customers of the public utility subsidiary from inappropriately cross-subsidizing other holding company subsidiaries.
 - Part 368 of FERC's regulations requires a holding company to comply with the record retention requirements in FERC's regulations. These regulations explain how long various types of company records must be maintained.

Minimizing (or Avoiding) Regulation as A Holding Company

- A holding company may avoid regulation under PUHCA (*e.g.* books and records regulation) if it qualifies as an “exempt holding company.” A holding company may be exempt if it:
 - Only owns QFs, EWGs, or foreign utility companies
 - Is a passive investor, so long as its ownership of a public utility remains passive
 - *i.e.* mutual funds, bank-managed investment vehicles, entities that buy and sell public utility securities in the ordinary course of business as a broker/dealer or fiduciary
 - Owns utilities that do not have captive customers and do not have affiliates with captive customers
 - Is an electric power cooperative
 - Certifies on behalf of itself and subsidiaries that it will not charge to the public utility any costs or expenses and will not engage in financing transactions with the public utility
 - Is a single-state holding company
- But, an exempt holding company is still included in the definition of “holding company.” It remains subject to regulation under the FPA.

Minimizing (or Avoiding) Regulation as A Holding Company

- Even though subject to regulation under the FPA, FERC's regulations provide blanket authorizations that allow holding companies to avoid Section 203 review in some instances.
- A holding company may acquire the following without seeking prior FERC approval:
 - If an entity is a holding company solely with respect to QFs, EWGs, and FUCOs, it is granted a blanket authorization to acquire security interests in other QFs, EWGs, or FUCOs.
 - QFs will be discussed in more detail later.
 - An EWG is a generator of energy for sale exclusively to competing wholesale customers, and who is exempt from some requirements of the Public Utilities Holding Company Act of 1935.
 - A FUCO is a foreign utility company.

Minimizing (or Avoiding) Regulation as A Holding Company

- Even though subject to regulation under the FPA, FERC's regulations provide blanket authorizations that allow holding companies to avoid Section 203 review in some instances.
- A holding company may acquire the following without seeking prior FERC approval:
 - Any nonvoting security (that does not convey sufficient veto rights over management actions so as to convey control) in 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
 - Any voting security in 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 if, after the acquisition, the holding company will own less than 10% of the outstanding voting securities
 - Any security of a subsidiary company within the holding company system

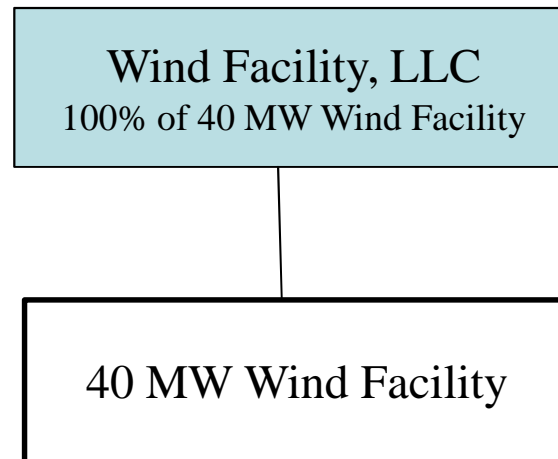
Minimizing (or Avoiding) Regulation as A Holding Company

- Blanket authorizations also allow holding companies to acquire:
 - Any security of a transmitting utility or company that owns, operates, or controls only facilities used solely for transmission in **intrastate** commerce and/or sales of electric energy in intrastate commerce
 - Any security of a transmitting utility or company that owns, operates, or controls only **facilities used solely for local distribution** and/or sales of electric energy at retail regulated by a state commission
 - Any security of an electric utility company that owns generating facilities that total 100 MW or less and are fundamentally **used for its own individual load** or for sales to affiliated end users

Investments in Brick and Mortar Facilities

- Investments in brick and mortar facilities can subject the investor to characterization as a public utility under the FPA and FERC's regulations.
 - An entity will be a public utility as a result of the investment because direct ownership of brick and mortar facilities that make wholesale sales of energy or transmit energy in interstate commerce means that the entity owns facilities subject to FERC's jurisdiction.

Investments into Bricks and Mortar



- Wind Facility, LLC is a public-utility company and a public utility

Regulation of Public Utilities

- Public utilities are subject to numerous regulatory obligations under the FPA and FERC's regulations.
 - FPA Section 203 – Acquisition, dispositions, and mergers
 - Requires prior FERC approval when a public utility seeks to: (i) sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of FERC, or any part thereof of a value in excess of \$10 million; (ii) merge or consolidate, directly or indirectly, such facilities or any part thereof with those of any other person, by any means whatsoever; or (iii) purchase, acquire, or take any security with a value in excess of \$10 million of any other public utility
 - FPA Section 204 – Issuance of securities
 - Requires prior FERC approval in order to issue securities or assume liabilities as guarantor, indorser, surety, or otherwise.
 - FPA Section 205 and 206 – Ratemaking
 - Requirement to file just and reasonable rates and terms of service
 - Requirement to comply with FERC's Uniform System of Accounts
 - Book and recordkeeping obligations

Regulation of Public Utilities

- Public utilities are also required to adhere to periodic reporting obligations:
 - FERC Form No. 561 – Interlocking officers and directors
 - FERC Form No. 566 – Twenty largest retail purchasers
 - FERC Form No. 580 – Fuel and energy purchase practices
 - FERC Form Nos. 1 and 3Q – Financial statements and operating reports
 - FERC Electric Quarterly Reports – market-based rate contracts and transactions
 - FERC triennial market power updates (in some instances)
 - EIA-860 – Information about generating facilities that exceed 1 MW

Minimizing Regulation as A Public Utility

- FERC's regulations provide blanket authorizations that allow public utilities to avoid Section 203 review in some instances.
- A public utility may undertake the following without seeking prior FERC approval:
 - Purchase, acquire, or take any security of a public utility in connection with an intra-system cash management program
 - Transfer a wholesale market-based rate contract to any other public utility affiliate that has the same ultimate upstream ownership
 - Transfer outstanding voting securities to a holding company if the holding company is subject to a blanket authorization for Section 203 approval
 - Transfer contracts as part of an intra-corporate reorganizations

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Minimizing Regulation as A Public Utility for QFs

- QFs may also avoid a majority of FPA regulation in certain instances.
- QFs may either be **small power production facilities** or **cogeneration facilities**.
 - A **small power production facility** is a generating facility of 80 MW or less whose primary energy source is renewable, biomass, waste, or geothermal resources.
 - In order to be considered a qualifying small power production facility, a facility must meet all of the requirements of Part 292 of FERC's regulations
 - A **cogeneration facility** is a generating facility that sequentially produces electricity and another form of useful thermal energy (such as heat or steam) in a way that is more efficient than the separate production of both forms of energy. For example, large cogeneration facilities might provide steam for industrial uses in facilities such as paper mills, refineries, or factories, or for HVAC applications in commercial or residential buildings.

Minimizing Regulation as A Public Utility for QFs

- The 30/20 Rule
 - Small power production facilities that do not exceed 30 MW and all qualifying cogeneration facilities are exempt from most regulation under the FPA.
 - Those facilities are not exempt from:
 - Sections 205 and 206;
 - Provisions relating to reliability;
 - Requirements to receive approval of and report interlocking directors; and
 - Requirement to report 20 largest retail purchasers.
 - But, small power production facilities and cogeneration facilities that are 20 MW or less are not subject to Sections 205 and 206 of the FPA.

Avoiding Regulation as A Public Utility for QFs

- To avoid regulation as a public utility under the FPA:
 1. Limit direct ownership of FERC-jurisdictional facilities to passive investments;
 2. Limit direct ownership of FERC-jurisdictional facilities to QFs no larger than 20 MW; and
 3. Invest indirectly – do not own bricks and mortar facilities; instead own the company that owns the facilities. However . . .

Final Thoughts

- In summary, there are practical ways to avoid FERC regulation:
 - Avoid direct ownership of utility facilities;
 - Limit control of public utilities, by limiting voting interests to less than 10%, or through passive ownership; and
 - If your control of public utilities exceeds 10%, limit ownership to QFs and EWGs.
 - However, the EWG and the QF (if it is a small power production facility that exceeds 30 MW) will be subject to the FPA.

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Questions / Comments

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Floyd L. Norton, IV
(202) 739-5620
fnorton@morganlewis.com



Levi McAllister
(202) 739-5837
lmcallister@morganlewis.com