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Client Alert Commentary

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FERC Expands Scope of Affiliation Between Investor and Public Utility

More investors in public utilities may now be considered affiliates, thereby significantly increasing compliance obligations and transactions subject to prior FERC approval.

On October 20, 2022, the Federal Energy Regulatory Commission (FERC or the Commission) issued two orders (the Affiliation Orders) significantly broadening the scope of the terms "affiliate" and "change in control" under FERC regulations and precedent pertaining to the Federal Power Act, as amended.[1]

The Commission has established a rebuttable presumption that an investor with an ownership share of less than 10% of the voting securities of a "public utility" subject to FERC's jurisdiction (generally, entities that engage in the wholesale sale or transmission of electric energy in interstate commerce, including entities with market-based rate authority) or holding company of a public utility does not have "control" over such entity and therefore no affiliation exists between the investor and the public utility or holding company.[2] The Commission, however, effectively held in the Affiliation Orders that an investor's right to appoint a board member of a holding company or public utility who is not independent of the investor creates an affiliate and control relationship between the investor and the holding company or public utility, regardless of the size of the investor's ownership share in the holding company or public utility.[3]

The broadened scope of these two terms will have potentially material impacts on investors in FERC-jurisdictional public utilities. For example, affiliation is a central part of the market power analysis required to obtain and maintain authorization to sell power at market-based rates under Section 205 of the Federal Power Act (Section 205).[4] In addition, changes in control of public utilities generally require prior authorization from FERC under Section 203 of the Federal Power Act (Section 203); the broader scope of what constitutes change in control will decrease flexibility in structuring corporate transactions and other actions that do not require such approval.[5] Accordingly, public utilities that were not previously considered affiliated with other public utilities may now be considered affiliated, and more types of transactions and other corporate actions will require prior FERC approval.

Impact on Market-Based Rate Authorizations

Pursuant to Section 205, Congress granted FERC the authority to ensure that wholesale electricity rates are just, reasonable, and not unduly discriminatory or preferential.[6] To ensure the justness and reasonableness of sales of electricity at market-based rates, FERC requires entities to obtain authorization to make such sales. To receive and maintain such authorization, public utilities must

demonstrate that they lack horizontal and vertical market power.[7] This analysis includes the capacity controlled by the public utility and by all affiliates of that public utility in a given region. FERC regulations specify what types of relationships constitute affiliation.[8] While a person that "directly or indirectly owns, controls, or holds with power to vote, 10 percent or more of the outstanding voting securities of the specified company" is an affiliate of that company,[9] "owning, controlling or holding with power to vote, less than 10 percent of the outstanding voting securities of a specified company creates a rebuttable presumption of lack of control."[10]

Until the Evergy Order, entities that held a 10% or greater interest in a company have generally been considered affiliates of that company under Section 205, whereas entities that held a less than 10% interest in a company were typically not considered affiliates of that company.[11] Following the Evergy Order, however, an investor of a company will likely now be considered an affiliate of the company if at least one board member is directly accountable to the investor, regardless of the percentage of shares held by the investor.[12] The Commission reasoned that a board member will provide the investor "those rights, privileges, and access, and thus the authority to influence significant decisions involving the public utility holding company."[13]

Notably, the Commission stressed the importance of the non-independence of a board member as the triggering factor that can rebut the presumption of lack of control in the Evergy Order.[14] The Commission specifically held that Elliott Management Corp. was not an affiliate of Evergy, despite Elliott's power to negotiate for the appointment of board members, because those board members are independent of, and not compensated by, Elliot.[15] In contrast, FERC distinguished this relationship from Evergy's relationship with Bluescape Energy Partners, LLC, in which Bluescape's executive chairman sat on Evergy's board.[16] The Commission found that the non-independence of this board member rebutted the presumption against control.[17]

Because the Commission did not define the terms "independent" or "accountable," it may be difficult to determine whether its ruling applies in cases in which an investor appoints a board member to a company that is not an officer or director of the investor. Notably, the Commission does not indicate whether the definition of "independent" is tied to the definition of an "independent" board member under the New York Stock Exchange rules.

In this case, the Commission determined that the key distinction between Bluescape (which was found to have control) and Elliott (which was found to not have control) was that "Evergy has appointed one of Bluescape's own directors, its Executive Chairman, to the Evergy Board."[18]

Impact on Mergers and Acquisitions

Just as the Commission instituted a change in law regarding affiliation under Section 205 with the Evergy Order, it instituted a corresponding change in law under Section 203 regulations with the TransAlta Order.[19]

Section 203 requires prior authorization from FERC to consummate certain transactions that involve a change in control. Yet, the Commission has established a rebuttable presumption that a change in control does not occur if an investor acquires less than 10% of the outstanding shares of a company.[20]

Under the TransAlta Order, for the purposes of Section 203, when an investor appoints a board member who is one of "an investor's own officer or director, or other appointee accountable to the investor," the transaction will generally require prior Commission approval as a change in control.[21] The Commission has now established a rule that such a board member "functions to rebut the presumption" of a lack of

control,[22] and held that its change in law announced in the TransAlta Order would apply on a "going forward" basis.[23]

Conclusion

The Affiliation Orders reflect an important change in law at FERC, and public utilities and their investors should be aware of these changes when evaluating transactions. While FERC did not provide clear guidance regarding general compliance requirements, FERC-jurisdictional entities and investors therein should re-examine their relationships to determine whether they may be deemed affiliate relationships in light of the Evergy Order.

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Endnotes

[1] *Order on Notice of Change in Status*, 181 FERC ¶ 61,044 (2022) (Evergy Order); *Order Authorizing Disposition of Jurisdictional Facilities and Acquisition of Securities*, 181 FERC ¶ 61,055 (2022) (TransAlta Order).

[2] 18 C.F.R. § 35.36(a)(9) (2022); *Transactions Subject to FPA Section 203*, Order No. 669, 113 FERC ¶ 61,315 (2005), *order on reh'g*, Order No. 669-A, 115 FERC ¶ 61,097, *order on reh'g*, Order No. 669-B, 116 FERC ¶ 61,076 (2006).

[3] Evergy Order at P 45 ("we find that, where an investor's non-independent director, such as its own officer or director, or other appointee accountable to the investor, is appointed to the board of a public utility or public utility holding company, that appointment functions to rebut the presumption of lack of control under section 35.36(a)(9)(v)."); TransAlta Order at P 29 ("We clarify, consistent with our finding in *Evergy*, that the appointment of two board members that are not independent from Investor and its affiliates to TransAlta's Board of Directors does constitute a change of control.").

[4] 16 U.S.C. § 824d (2018); 18 C.F.R. § 35.37 (2022).

[5] 16 U.S.C. § 824b; 18 C.F.R. § 33.2.

[6] 16 U.S.C. § 824d.

[7] 18 C.F.R. §§ 35.36, 35.37.

[8] 18 C.F.R. § 35.36(a)(9).

[9] 18 C.F.R. § 35.36(a)(9)(a)(i).

[10] 18 C.F.R. § 35.36(a)(9)(v).

[11] While the Commission had previously expressed "concern" with corporate structures in which an investor would be represented on the board through an appointee accountable to the investor, Evergy Order at P 44 (citing *Public Citizen, Inc. v. CenterPoint Energy, Inc.*, 174 FERC ¶ 61,101 at P 33 (2021)), it had not established a rule that such an arrangement rebutted the presumption against control if the investor owns less than 10% of the voting securities.

[12] Evergy Order at P 45 ("where an investor's non-independent director, such as its own officer or director, or other appointee accountable to the investor, is appointed to the board of a public utility or public utility holding company, that appointment functions to rebut the presumption of lack of control under section 35.36(a)(9)(v).")

[13] *Id.*

[14] *Id.* at P 44.

[15] *Id.* at PP 42-43.

[16] *Id.* at P 44.

[17] *Id.*

[18] *Id.* at P 44.

[19] *Id.* at P 45; TransAlta Order at P 29.

[20] *See* Order No. 669-A, 115 FERC ¶ 61,097 at P 101.

[21] *Id.*

[22] *See id.* at P 29 n. 36.

[23] *See id.* at P 29.