



JONES DAY
COMMENTARY

FEDERAL ENERGY REGULATORY COMMISSION REGULATION OF SECURITIES

The Federal Energy Regulatory Commission (“FERC”) has jurisdiction under the Federal Power Act (“FPA”)¹ over the issuance or assumption of securities by public utility companies subject to its jurisdiction.² FERC also has jurisdiction over the acquisition by a public utility company or a holding company of securities issued by a public utility company.³ FERC also mandates that public utilities file with FERC documentation regarding certain “cash management” or “money pool” arrangements. This *Commentary* outlines FERC’s authority in these areas and the steps public utilities should take to ensure compliance.

ISSUANCE OF SECURITIES

Only “public utilities” are subject to the restrictions on securities issuance or assumption. A public utility

is any entity that “owns or operates facilities subject to the jurisdiction of the Commission.”⁴ Jurisdictional facilities are those involving the “transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce.”⁵ Traditional vertically integrated electric utilities are thus subject to FERC jurisdiction. In addition, entities such as power marketers,⁶ stand-alone transmission companies, and certain electric generating companies⁷ are also included.

¹ 16 U.S.C. § 791a et seq.

² FPA Section 204 (16 U.S.C § 824c).

³ FPA Section 203 (16 U.S.C. § 824b).

⁴ 16 U.S.C. § 824(e).

⁵ 16 U.S.C. § 824(b)(1).

⁶ FERC considers contracts for the sale or purchase of electricity in interstate commerce and certain other papers to be “facilities” that subject the contracting party to “public utility” status. Citizens Energy Corporation, 35 FERC ¶ 61,198 (1986).

⁷ In general, FERC does not have jurisdiction over electric generating assets. However, most independent power producers or exempt wholesale generators own “step up transformers” and other transmission equipment necessary to deliver their output to the grid. These facilities are sufficient to constitute the owner a “public utility.”

Under Section 204 of the FPA, without FERC approval, no public utility may:

issue any security, or assume any obligation or liability as guarantor, indorser, surety, or otherwise in respect of any security of another person....⁸

FERC is directed to give such approval only if the issuance or assumption:

(a) is for some lawful object, within the corporate purposes of the applicant and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the applicant of service as a public utility and which will not impair its ability to perform that service, and (b) is reasonably necessary or appropriate for such purposes.⁹

This is a broad authority and, unlike for some state utility commissions, extends to the “assumption” or “guaranty” of the obligation of another person. The definition of “security” is likewise quite broad:

“security” means any note, stock, treasury stock, bond, debenture, or other evidence of interest in or indebtedness of a corporation subject to the provisions of [the Federal Power Act].¹⁰

There are two important exceptions to the general rule that all securities issuances or assumptions must be approved by FERC. Small amounts of short-term debt can be issued without approval. Also, if a state utility commission approves a security issuance or assumption, no FERC approval is needed.¹¹

The small issue exemption is limited. It is applicable only to debt maturing in not more than one year. The aggregate amount of such short-term debt cannot be more than 5 percent of the par value of the other securities of the public utility then outstanding.¹² A public utility relying on this exemption must file a notice of issuance of the debt with FERC within 10 days.¹³

The second exemption eliminates the need to get FERC approval if a state utility commission has jurisdiction to approve the issuance or assumption and has done so.¹⁴ The state utility commissions of most states regulate the issuance of equity securities and long-term debt. Fewer states regulate the issuance of short-term debt. Thus, many traditional vertically integrated electric utilities will not need any FERC authorization to issue or assume securities. In the case of those in states that do not regulate short-term debt, electric utilities routinely seek FERC approval of short-term debt programs. The ability to issue short-term debt under the 5 percent of par value exemption usually does not offer sufficient short-term debt capacity.

If an issuance or assumption of a security requires FERC approval, application is made under Part 34 of FERC’s regulations.¹⁵ The application includes a description of the filing utility, the date by which FERC action is requested (approval usually takes 45 to 60 days), a description of the securities offered, and the purpose of the offering (which must include a description of any construction program being funded by the offering or a description of securities being refunded). In addition, the applicant must show in detail how the offering is within the corporate purposes of the applicant and is

8 16 U.S.C. § 824c(a).

9 *Id.*

10 16 U.S.C. § 796(16).

11 In addition, any cogeneration or small power production facility that is exempt pursuant to 18 C.F.R. § 292.601 need not comply with the FPA Section 204 approval requirement. FERC also grants “blanket authorization” (i.e., a general approval without the need of specific application) for any securities issuance or assumption by a public utility such as a power marketer or power producer that is not a franchised public utility or does not otherwise provide requirements service at cost-based rates. See *Market-Based Rates For Wholesale Sales Of Electric Energy, Capacity And Ancillary Services By Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252 (2007) at P 999 (2007).

12 16 U.S.C. § 824c(e). In the case of securities having no par value, the par value for the purpose of this calculation is the fair market value as of the date of issue.

13 *Id.*

14 16 U.S.C. § 824c(f). A condition that causes some utilities to be ineligible for this exemption is the requirement that the utility be organized under the law of the state that provides the security issuance approval. Thus, a utility that is incorporated in Delaware, for example, but provides service in and is regulated by the state commission of another state, cannot take advantage of this exemption.

15 18 C.F.R. pt. 34. Technically, the filing is on FERC Form No. 523. However, this is not a preprinted form to be filled in. Rather, the applicant prepares a document with all the required information and files it with FERC in accordance with general filing guidelines.

compatible with the public interest. The application requires a description of any applicable restrictive covenants in the applicant's articles of incorporation or bond indentures (such as dividend restrictions, interest coverage tests for issuance of indebtedness, or similar restrictions). Finally, the applicant must describe recent changes in its approved state and federal electric rates.¹⁶ No filing fee is currently required in connection with an application.¹⁷

Applicants, especially those seeking approval for short-term debt, typically seek FERC approval to issue identified types of securities, up to a specified maximum amount and for a period of two years. Thus, while an applicant can seek approval of one specifically identified transaction, FERC will also approve a "shelf" type application that gives the public utility the authority to issue the identified securities from time to time over the two-year period, subject to the conditions and limits contained in the application and FERC's order.¹⁸ A public utility that participates in a cash management or money pool agreement that includes issuance by it of securities (*i.e.*, borrowing under the agreement) will usually seek approval for these short-term borrowings in a shelf application (unless it is required to get state commission approval for these borrowings, which would then be exempt from FERC approval).

The application must be accompanied by various required exhibits.¹⁹ Although the regulations continue to specify that the applicant supply a form of notice for FERC to publish in the Federal Register, FERC now merely compiles minimal information about a number of filings and publishes generic

omnibus notices.²⁰ The notice invites interested parties to protest or seek to intervene.²¹ Generally, the deadline for taking such action is 20 days after the notice appears in the Federal Register.

Included in the exhibits to be filed are financial statements, including a calculation of interest coverage of all outstanding indebtedness. FERC typically requires a showing that earnings available for interest will be at least two times total annual interest charges (*i.e.*, a 2.0x coverage ratio).²² An applicant that will not satisfy this requirement, on a pro forma basis taking into account debt proposed to be approved by FERC for issuance, will have to demonstrate why the issuance will be in the public interest and will not impair its ability to perform its public utility service.²³

FERC traditionally required most securities offerings to be competitively bid. FERC's rules allow competitive bids or negotiated placements if multiple bids or placement offers are obtained and the utility accepts the offer for the lowest cost of money or highest offering price.²⁴ Some offerings are exempt from the competitive bid requirement, including securities offered to existing holders, securities with a maturity of one year or less, or securities issued in support of or to guarantee securities issued by a governmental body.²⁵ Many applicants now request a waiver from the competitive bidding obligations that otherwise would apply, which is typically granted.²⁶

FERC prohibits the placement of securities to any person who preformed services or accepted any fee prior to the

16 18 C.F.R. § 34.3(a) through (j).

17 18 C.F.R. § 34.9 directs the applicant to pay the fee, if any, prescribed in Part 381 of FERC's regulations. That part does not currently prescribe any fee for applications under Part 34.

18 Authorization for a period of two years is not codified in any regulation but is a FERC policy. Occasionally for good reason, the authorization period may be longer or shorter than two years.

19 These include the statement of purpose clause from the articles of incorporation, resolutions of its board of directors authorizing the issuance, historical financial statements for specified periods together with pro forma statements showing the effect of the proposed issuance, a calculation of interest coverage on long-term and short-term debt, and, if applicable, a copy of the applicant's registration statement for the securities filed with the Securities and Exchange Commission.

20 The applicant is not required to provide any form of notice. See the Notice Formats page of the FERC web site, <http://www.ferc.gov/docs-filing/not-form.asp>.

21 Intervention or protest is accomplished in accordance with Rules 211 and 214 of FERC's Rules of Practice and Procedure (18 C.F.R. § 385.211 and § 385.214).

22 *Startrans IO, L.L.C.*, 122 FERC ¶161,253 at P 18 (2008). The ratio must be calculated using the financial information kept in accordance with the FERC Uniform System of Accounts.

23 *Id.* at n.7.

24 18 C.F.R. § 34.2(a).

25 18 C.F.R. § 34.2(b).

26 See, e.g., *AEP Texas Central Company*, 126 FERC ¶ 62,156 (2009).

time the securities were put out to bid or negotiations for placement started. Further, no securities can be sold that would violate the prohibition on interlocks between public utilities and investment banks or underwriters.²⁷

Since 2003, FERC has imposed in every authorization order for securities issuances a set of conditions designed to address potential risks to public utility ratepayers occasioned by diversification into non-utility businesses. The so-called *Westar* conditions are designed to ensure that indebtedness related to non-utility activities does not impair a utility's ability to provide its utility service.²⁸ The *Westar* conditions are:

First, public utilities seeking authorization to issue debt backed by a utility asset must use the proceeds of the debt for utility purposes. Second, if any utility assets that secure debt issuances are divested or "spun off," the debt must follow the asset and also be divested or "spun off." Third, if any of the proceeds from unsecured debt are used for non-utility purposes, the debt must follow the non-utility assets. Specifically, if the non-utility assets are divested or "spun off," then a proportionate share of the debt must follow the divested or "spun off" non-utility asset. Finally, if utility assets financed by unsecured debt are divested or "spun off" to another entity, then a proportionate share of the debt must also be divested or "spun off."²⁹

These conditions are most relevant to those public utilities that engage in non-utility activities either directly by the utility corporation itself or in subsidiaries of the public utility. For utilities in a holding company system, where diversified activities are undertaken by sister corporations to the utility, indebtedness of the utility is not likely to be associated with diversified activities, and, therefore, these conditions are less likely to be important. Nevertheless, all utilities should carefully consider these conditions and their possible impact on future divestiture or spin-off transactions.

27 18 C.F.R. § 34.2(c). The restriction on interlocks is in Section 305 of the FPA (16 U.S.C. § 825d).

28 *Westar Energy, Inc.*, 102 FERC ¶ 61,186 at PP 20-21 (2003), *order on reh'g*, 104 FERC ¶ 61,018 (2003) ("*Westar*").

29 See, e.g., *NorthWestern Corporation*, 127 FERC ¶ 62,241 (2009); *NSTAR Electric Company*, 124 FERC ¶ 62,165 (2008); *Consumers Energy Company*, 123 FERC ¶ 62,167 (2008).

Further, if a utility believes the conditions could affect future transactions, it may wish to include provisions in its debt obligations that would allow it to "transfer" this indebtedness as required by the condition or allow the utility to call the indebtedness for redemption in such circumstances.

A report describing the amount and terms of equity or long-term debt securities issued or assumed under authority of a FERC order must be filed within 30 days following such issuance or assumption.³⁰ No report is required for short-term debt.

ACQUISITION OF SECURITIES

Section 203 of the Federal Power Act regulates the acquisition of securities of a public utility company in certain cases.³¹ Making loans to the public utility under cash management programs (which are discussed in more detail under the next heading in this *Commentary*) is considered the acquisition of a security of that public utility. Recognizing that routine cash management transactions are beneficial, FERC decided to provide a blanket authorization (*i.e.*, no separate application or approval is required) for certain transactions. Accordingly, any public utility in a holding company system is granted a blanket authorization under section 203(a)(1) of the Federal Power Act to purchase, acquire, or take any security of a public utility in connection with an intra-system cash management program, subject to

30 18 C.F.R. § 34.10. The information required in the report, which also requires certain information about proposals for placement received, is found at 18 C.F.R. §§ 131.43 and 131.50.

31 16 U.S.C. § 824b. Under Section 203(a)(1)(C) (16 U.S.C. § 824b(a)(1)(C)), no public utility may "purchase, acquire, or take any security with a value in excess of \$10,000,000 of any other public utility." Further, under Section 203(a)(2) (16 U.S.C. § 824b(a)(2)), certain "holding companies" need FERC approval to directly or indirectly acquire securities with a value in excess of \$10,000,000 of a transmitting utility or an electric utility company. "Transmitting utility" means an entity that owns, operates, or controls facilities used for the transmission of electric energy in interstate commerce for the sale of electric energy at wholesale. 16 U.S.C. § 796(23). "Electric utility" means a person or federal or state agency that sells electric energy. 16 U.S.C. § 796(22). Section 203(a) also regulates mergers, sales of utility assets, and acquisition of certain generating facilities involving holding companies and public utility companies. These aspects of Section 203(a) are not discussed in this *Commentary*.

safeguards to prevent cross-subsidization or pledges or encumbrances of utility assets.³² Similarly, the acquisition by a holding company of the securities of its public utility subsidiary is entitled to a blanket authorization.³³ Together, these blanket authorizations cover the typical transactions of a cash management money pool arrangement: loans from the parent to subsidiary public utilities and loans and borrowings between the public utility subsidiaries of the same holding company system.

CASH MANAGEMENT PROGRAMS

In June 2003, FERC extended its jurisdiction to mandate new documentation and disclosure requirements for several different types of “cash management programs.” Some programs concentrate and transfer funds from multiple accounts into a single bank account in the parent company’s name. Another type is known as “cash pooling” or “money pooling.” This system uses a single summary account with interest earned or charged on the net cash balance position. A third type, known as a “zero balance account,” empties or fills the balances in an affiliated company’s account at a bank into or out of a parent’s account each day.³⁴

The cash management rules apply to FERC regulated public utilities and licensees and natural gas and oil pipeline companies. Any new or modified cash management arrangement of a jurisdictional entity must be in writing and must be filed with FERC within 10 days following the adoption or change.³⁵ Filed cash management agreements will be made public, subject to the usual procedures for seeking confidential status.

In adopting these requirements, FERC emphasized that cash management agreements are filed for informational purposes of the commission only. FERC will not entertain public comments on the filings. Further, FERC noted that the rules do not require that any jurisdictional entity alter its existing cash management agreement and emphasized that FERC will not alter any agreement after it is filed.³⁶ FERC made it clear that its requirements do not dictate the terms of these agreements or mandate any particular provisions.³⁷

FERC modified its Uniform System of Accounts to provide for reporting regarding cash management agreements.³⁸ A public utility that participates in a cash management program must maintain supporting documentation for all deposits into, borrowings from, interest income from, and interest expense to such program. The written documentation must include the following information:

- (1) For deposits with and withdrawals from the cash management program: the date of the deposit or withdrawal, the amount of the deposit or withdrawal, and the maturity date, if any, of the deposit;
- (2) For borrowings from a cash management program: the date of the borrowing, the amount of the borrowing, and the maturity date, if any, of the borrowing;
- (3) The security, if any, provided by the cash management program for repayment of deposits into the cash management program and the security required, if any, by the cash management program in support of borrowings from the program; and
- (4) The monthly balance of the cash management program.

The public utility must maintain current and up-to-date copies of the documents authorizing the establishment of the cash management program, including the following:

- (1) The duties and responsibilities of the administrator and the public utilities or licensees in the cash management program;
- (2) The restrictions on deposits or borrowings by public utilities or licensees in the cash management program;

32 18 C.F.R. § 33.1(c)(7). As noted above, FERC approval for the short-term borrowings by a public utility under a cash management or money pool agreement is required under Section 204 of the FPA, unless the state commission approves such transactions.

33 18 C.F.R. § 33.1(c)(2)(iii).

34 *Regulation of Cash Management Practices*, Order No. 634, FERC Stats. & Regs. ¶131,145 at P 3 (2003), *amended*, Order No. 634-A, FERC Stats. & Regs. ¶ 31,152 (2003).

35 See 18 C.F.R. § 141.500 for electric public utilities and licensees.

36 Order No. 634-A at PP 36, 45.

37 Order No. 634-A at P 31.

38 18 C.F.R. pt. 101, Accounts 145 and 146.

- (3) The interest rate, including the method used to determine the interest earning rates and interest borrowing rates for deposits into and borrowings from the program; and
- (4) The method used to allocate interest income and expenses among public utilities or licensees in the program.

If any of the specified record-keeping items for a cash management program are inapplicable to an entity's arrangement, it must nevertheless state that the requirement is inapplicable in its documentation that is filed with the FERC. For example, the rules require the documentation to specify the duties and responsibilities of the "administrator" of a cash management program. If there is no administrator, such as in a bilateral agreement between a jurisdictional entity and its parent, the agreement must specify that the provisions of the rule regarding such duties and responsibilities are inapplicable to the agreement.³⁹

Each jurisdictional entity that participates in any cash management program is required to report to FERC if its proprietary capital ratio is less than 30 percent at the end of any annual or quarterly reporting period.⁴⁰ In such event, the entity must describe the significant events or transactions causing the proprietary capital ratio to be less than 30 percent, and the extent to which it has amounts loaned

39 Order No. 634-A at P 78.

40 For electric utilities, the report is made on page 108, item 14 of the FERC Form 1 or Form 3Q. The proprietary capital ratio is, generally, the ratio of equity capital to total capitalization. Previously, reports were to be made in a separate filing required by 18 C.F.R. § 141.500. That rule, before it was amended when the reports were included in the FERC Form 1 and Form 3Q, specified how to calculate the ratio. The proprietary capital ratio must be computed using a formula in which the numerator is the total of the balances in the Proprietary Capital Accounts, Account 201, Common stock issued, through Account 219, Accumulated other comprehensive income, in the Uniform System of Accounts (18 C.F.R. pt. 101), and the denominator is the total proprietary capital plus the total of the Long-Term Debt Accounts, Account 221, Bonds, through Account 226, Unamortized discount on long-term debt - Debit, in the Uniform System of Accounts.

or money advanced to its parent,⁴¹ subsidiary, or affiliated companies through a cash management program. The company must describe plans, if any, to regain at least a 30 percent proprietary ratio.

FERC initially proposed that a jurisdictional entity would be barred from participating in a cash management system during any time when its proprietary capital ratios fell below the 30 percent level.⁴² FERC did not adopt that proposal, deciding to rely on the obligation to report such condition. FERC emphasized that the purpose of the capitalization ratio notification was informational and to assist it in its regulatory duties. There is no penalty or other consequence specified in the rules in the event a jurisdictional company gives notice that it has fallen below the 30 percent equity capital level. The discussion of these rules by the commission makes no reference to any other consequence it might impose. FERC would presumably give the fact appropriate consideration in any pending or future rate proceeding. FERC likely would take this fact into account in approving securities issuances under Section 204 of the Federal Power Act, as described above.

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41 Under the Public Utility Holding Company Act of 1935, a public utility was prohibited in all cases from lending money to its parent holding company. There is no equivalent prohibition under the Public Utility Holding Company Act of 2005, the FPA, or FERC regulations.

42 Order No. 634.

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