Published on *The National Law Review* https://natlawreview.com

FERC Issues Policy Statement Clarifying Hold Harmless Commitments Under FPA § 203

Article By:

Energy and Public Utilities Group

On May 19, 2016, the Federal Energy Regulatory Commission (FERC or Commission) issued a Final Policy Statement clarifying FERC's implementation of hold harmless commitments in Federal Power Act (FPA) Section 203 applications seeking change of control authorization. The Final Policy Statement largely tracks a Proposed Policy Statement that was issued in January of 2015.

For FERC approval under Section 203, a transaction must be "consistent with the public interest." The Commission considers three factors in determining whether a transaction meets this requirement: the effect of the transaction on (1) competition; (2) rates; and (3) regulation. The Policy Statement relates to the second prong of FERC's analysis (the effect on rates).

FERC will not grant an application if it results in cross-subsidization such that utility ratepayers subsidize nonutility affiliates. Hold harmless commitments by the utilities involved in the transaction are a common means of preventing cross-subsidization. Under a hold harmless commitment, a Section 203 applicant commits to not recover, through jurisdictional rates, any transaction-related costs for five years, unless the applicant can show that the benefits of the transaction outweigh the costs. FERC accepts these commitments as proof that a transaction will not have an adverse effect on rates.

The Commission addresses four components of hold harmless commitments in the Policy Statement:

1. The scope and definition of transaction-related costs subject to hold harmless commitments;

2. The controls and procedures that must be in place to track costs that fall within the purview of hold harmless commitments;

3. The rejection of hold harmless commitments that are limited in duration; and

4. How applicants can prove that no adverse effects on rates will occur from a given transaction and avoid making hold harmless commitments.

The Commission provides a list of costs that would typically be transaction-related and excluded from rate recovery under a hold-harmless commitment. The Commission splits costs into those that are "incurred to explore, agree to, and consummate a transaction" and transition costs that "integrate the operations and assets of the merging companies in order to achieve merger synergies." The list provided is not exhaustive, nor will all of these costs be present in every transaction. The Commission also reaffirmed its policy of barring goodwill from acquisition premiums from jurisdictional rates unless "specific, measureable, and substantial benefits to ratepayers" are shown in a separate FPA Section 205 proceeding. In responding to comments about the scope of transaction-related costs, the Commission stresses that each transaction requires a case-by-case approach to determining which costs are recoverable and that the burden falls on applicants to show that cost categories provide commensurate benefits necessary to be excluded from hold harmless commitments. Companies must provide specific data of ratepayer benefits to exclude transaction-related transition, capital, and internal labor costs from a hold harmless commitment.

In the Proposed Policy Statement, FERC suggested considerable changes to the Section 203 requirement that applicants "describe how they intend to protect ratepayers from transaction-related costs, consistent with their obligation to show that their transaction is consistent with the public interest." FERC proposed that applicants should create internal controls and procedures to ensure "proper identification, accounting, and rate treatment of all transaction-related costs incurred prior to and subsequent to the announcement of a proposed transaction, including all transition costs."

In the Final Policy Statement, FERC slightly lowered these requirements, holding that applicants need not describe their accounting procedures and practices and how they maintain the accounting data for a 203 filing. However, FERC kept the rest of the suggestions from the Proposed Policy Statement. Now, applicants must at a minimum, make clear what they are committing to and show the ability to record and track costs. Applicants must provide an accounting filing that details amounts related to all transaction-related costs incurred at the time of the application. The current practice of including stock provisions that guarantee ratepayer protection will no longer pass FERC review. Applicants will need to include a detailed description of how they "define, designate, accrue, and

allocate transaction-related costs, and explain the criteria used to determine which costs are transaction related," in their Section 203 applications. FERC is demanding better tracking of costs, particularly if an applicant attempts to recover transaction-related costs in a subsequent FPA Section 205 filing.

FERC has removed its proposal to no longer accept hold harmless commitments that are time-bound. The Commission has determined that the current practice of limiting hold harmless commitments to five years provides enough ratepayer protection.

FERC lastly clarifies that its only intent in making the suggestions on transactions without an adverse effect on rates was to provide companies with evidence of examples where hold harmless commitments are unnecessary. The Commission maintains that applicants whose transactions are meant to meet "resource adequacy requirements at the state level, to improve system reliability, and to meet other regulatory requirements," can show that even though a transaction may affect rates, that effect is not adverse. The Commission will not exempt certain class of transactions from the requirement to make this showing. This portion of the Policy Statement does not change current practices regarding hold harmless commitments.

The changes from the Policy Statement will become effective 90 days after it is published in the*Federal Register*.

National Law Review, Volume VI, Number 148