

FERC Issues New Standards of Conduct, Expands Regulation of Affiliate Relationships

November 26, 2003

On November 25, the Federal Energy Regulatory Commission (FERC) issued a final rule revising the standards of conduct applicable to jurisdictional electric transmission providers and natural gas pipelines (collectively defined by the rule as “transmission providers”) and their “energy affiliates.” The new rule unifies the previously different standards of conduct applicable to the gas and electric industries, and dramatically expands the range of affiliated entities covered by the standards. The standards of conduct are designed to ensure that transmission providers do not provide preferential access to service or information to affiliated entities.

Key changes made by the new rule, designated as Order No. 2004, include:

Uniform Standards of Conduct — The final rule replaces the previous gas and electricity standards of conduct, adopted in Order Nos. 497 and 889 respectively, with new unified standards of conduct applicable to both electric and natural gas transmission providers.

General Principles — As with the current rules, the new rule generally requires that transmission function employees operate independently of the marketing function employees and energy affiliates, and that all transmission customers be treated on a non-discriminatory basis and without preference for any affiliate.

Transmission Providers — The rules apply to “transmission providers,” which are defined to be interstate natural gas pipelines that transport gas for others and public utilities that own, operate, or control transmission facilities used for the transmission of electric energy in interstate commerce. Commission-approved Regional Transmission Organizations (RTOs) or Independent System Operators (ISOs) are not covered. Transmission providers that are members of RTOs or ISOs may seek an exemption from the rule. Non-jurisdictional transmitting utilities with reciprocity tariffs will be required to abide by the new rules.

Energy Affiliates — In general, the energy affiliates of a transmission provider must operate independently and may not receive access to non-public transmission information. “Energy affiliate” is defined broadly to include affiliates of transmission providers that (1) engage in, or are involved in, transmission transactions in U.S. markets; (2) manage or control transmission capacity of a transmission provider in U.S. markets; (3) buy, sell, trade or administer natural gas or electric energy in U.S. markets; or (4) engage in financial transactions relating to the sale or transmission of natural gas or electric energy in U.S. markets. FERC resolved key requests for exceptions as follows:

- Affiliated Transmission Providers. The rule excludes affiliated transmission providers from the definition of “energy affiliate.”

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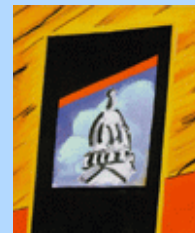
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- Affiliated Local Distribution Companies. In a significant change from the proposed rule, FERC excluded state-regulated local distribution companies that do not make any off-system sales of natural gas from the definition of “energy affiliate.”
- Holding, Parent and Service Companies. Holding, parent and service companies are excluded from the definition of “energy affiliate” if they do not engage in energy commodity or transmission transactions.
- Producers, Gatherers, Processors, Intrastate Pipelines, Hinshaw Pipelines. Notwithstanding considerable public comment, the new rule does **not** exclude affiliated natural gas producers, gatherers, processors, intrastate pipelines or Hinshaw pipelines from the “energy affiliate” definition. Commissioner Brownell dissented on this point, and would have excluded these entities from the coverage of the rule.

Marketing Employees — The proposed rule would have included bundled retail sales function employees within the definition of “sales and marketing employees,” and thereby would have required functional separation of the transmission and bundled retail sales functions within electric utilities. The final rule does not require separation of these functions as long as the retail sales unit engages solely in bundled retail sales, and makes neither wholesale nor unbundled retail sales.

Independent Functioning — The new rule adopts separation of functions requirements based on the current electric standards of conduct – transmission function employees must operate independently of marketing and energy affiliate employees, except in reliability emergency situations. The less restrictive language in the current natural gas standards of conduct, requiring transmission function and marketing functions to operate independently “to the maximum extent practicable,” has been eliminated.

- Shared Employees. The regulation expressly authorizes shared support and field and maintenance employees. The preamble also permits shared officers and directors and shared risk management functions, as long as these employees are not operating employees of either the transmission provider or the energy affiliate, and do not act as a conduit for any transmission information they receive.

Information Access and Disclosure — The new rule bars transmission providers from disclosing to marketing employees or energy affiliates information about other transmission customers or non-public information about the transmission system. The regulations include express exceptions from these requirements if: (1) a non-affiliated transmission customer consents to disclosure; (2) the communication relates to the marketing unit or energy affiliate’s specific request for service; (3) information is needed for generation dispatch; or, (4) information is “crucial operational information.”

- No Conduit Rule. The Commission adopted the “no conduit” rule, not an “automatic imputation” rule. Thus, shared non-operational employees may receive non-public transmission information, but must not serve as a conduit of any transmission information they receive to marketing function or energy affiliate operating employees.

Discounts — Discounts offered must be posted when the offer becomes “contractually binding.”

Exemptions — Transmission providers may file a request for exemption from some or all parts of the rule’s requirements for good cause.

Implementation Schedule — The final rule will become effective 60 days after it is published in the *Federal Register*. By that date, each transmission provider must file with FERC and post on the OASIS or Internet website a plan and schedule for implementing the revised standards of conduct. By June 1, 2004, each transmission provider must comply with the new rule's requirements and post procedures that will enable customers and FERC to determine whether the transmission provider is complying with the new standards.

Compliance Procedures — The rule requires the posting of written compliance procedures, and provides some details about elements that are expected to be included in such procedures, including distribution of the procedures to employees, employee training, employee affidavits concerning training, and designation of a Chief Compliance Officer.

Audits and Enforcement — The order contains a number of references to recent audit and enforcement actions that have uncovered noncompliance with the current standards of conduct, and also identifies areas (e.g., shared employees) that FERC would subject to heightened audit scrutiny to ensure compliance with the new rules. This rule does not discuss sanctions for violation of the new rules, but in another recent action FERC adopted conditions to all electric market-based rates that subject violators of the standards of conduct to remedies including disgorgement of profits and revocation of market-based rate authority. Moreover, the energy bill under consideration by Congress would authorize civil penalties of up to \$1,000,000 per day for violations of FERC rules or orders under Part II of the Federal Power Act.

For Additional Information

Van Ness Feldman has been actively involved in this rulemaking on behalf of clients. The firm has also counseled a number of clients on design and implementation of standards of conduct compliance programs, and represented clients in audit and enforcement proceedings related to these issues. This experience will allow Van Ness Feldman to help clients navigate the new requirements spelled out by the Commission. If you have any questions about the issues raised in this alert, or if we can be of assistance on these matters, please feel free to contact Curt Moffatt, Doug Smith, or any member of the Van Ness Feldman Energy Practice at (202) 298-1800.

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