

# FERC Makes Adjustments to Standards of Conduct

April 20, 2004

On April 16, the Federal Energy Regulatory Commission (FERC) modified and clarified its rule on Standards of Conduct for electric and natural gas transmission providers. The order, designated as Order No. 2004-A, addresses numerous requests for rehearing and clarification of the final rule on Standards of Conduct issued on November 25, 2003.

FERC's Standards of Conduct are designed to ensure that transmission providers do not provide affiliated market participants with preferential access to service or information. In Order No. 2004, FERC consolidated the previously separate Standards of Conduct for the gas and electric industries and dramatically expanded the range of affiliates covered by the standards. A summary of Order No. 2004 is available on the Van Ness Feldman website at [www.vnf.com](http://www.vnf.com).

## Key Modifications and Clarifications

**Implementation Date.** The deadline for transmission providers to be in full compliance with the revised standards was extended from June 1, 2004 to September 1, 2004.

**Definition of Transmission Provider.** Order No. 2004-A modifies the definition of "transmission provider" to exclude natural gas storage providers that (1) have authority to charge market-based rates, (2) are not interconnected with the jurisdictional facilities of any affiliated interstate natural pipeline, and (3) have no exclusive franchise area, captive ratepayers, or market power.

**Definition of Affiliate.** FERC modified the definition of "affiliate" to include "a division that operates as a functional unit." This change, which received little explanation, may expand the applicable restrictions in some circumstances and could narrow the applicability of the rules in others.

**Definition of Marketing Affiliate.** The rehearing order codifies a definition of "marketing affiliate" that includes affiliates and units engaged in marketing activities. The definition is ambiguously worded and can be read to sweep up all affiliates within the coverage of the rule, but that does not appear to be what FERC intended.

**Energy Affiliates.** The rehearing order largely denied requests to narrow the definition of energy affiliate, but made several clarifications which are outlined below:

- **Local Distribution Companies (LDCs).** LDCs making only *de minimis* off-system natural gas sales or purchases in order to comply with pipeline balancing requirements are not energy affiliates. However, FERC denied requests to expand the LDC exemption to cover those LDCs making off-system sales but not transporting gas on an affiliated pipeline. FERC clarified that LDCs that are also Hinshaw pipelines but otherwise qualify for the LDC exception will not be treated as an energy affiliate simply because of their Hinshaw status. In contrast, an LDC division of a combined utility will be considered the functional equivalent of an energy affiliate.
- **Affiliated Intrastate Pipelines, Hinshaw Pipelines, Producers, Gatherers, and Processors.** FERC declined to categorically exclude affiliated intrastate pipelines, Hinshaw pipelines, producers, gatherers and processors from the definition of energy affiliates covered by the rules. FERC clarified, however, that it did not

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intend to automatically include all affiliates in these categories either. The determinant is whether the affiliate participates in energy affiliate activities – e.g., engaging in or being involved in transmission markets, managing transmission capacity, buying or selling electricity or natural gas, or engaging in related financial transactions. FERC clarified that an affiliate “engages in transmission transactions” by holding transmission capacity as a shipper or buying or selling transmission capacity in the secondary capacity market, and is “involved in transmission transactions” when acting as agent, asset manager, or broker or managing, controlling, or aggregating capacity on behalf of customers or shippers. Simple transmission-related interactions between a transmission provider and an interconnected affiliate necessary for operational and maintenance activities would not trigger energy affiliate status. In FERC’s view, with this clarification, the majority of gatherers, processors and intrastate pipelines will not be treated as energy affiliates because they do not engage in energy affiliate activities.

- *Parent Company Activities.* FERC clarified that a parent company that does not otherwise engage in energy affiliate activities may provide financial security for subsidiaries and approve financial expenditures for subsidiaries without becoming an energy affiliate. The order also clarified that a parent company that engages in marketing activities, but also is a transmission provider required to apply Standards of Conduct, may receive non-public transmission information from transmission provider subsidiaries as long as that information is not provided to a marketing unit or energy affiliate.
- *Service companies.* The final rule clarifies that service company employees who work on behalf of a transmission provider or a marketing or energy affiliate must comply with the Standards of Conduct. If they provide only support services, then such employees may be shared. Service company employees performing energy-related or transmission-related functions, however, must be segregated. Moreover, service companies engaging in wholesale commodity activities, such as executing NYMEX financial transactions, will be treated as energy affiliates.

Independent Functioning. FERC modified and clarified the rule regarding shared non-operating employees in several respects:

- *Shared Senior Officers and Directors.* FERC reiterated that officers, directors, and risk management employees may be shared and may receive non-public transmission information as long as they do not participate in transmission system operations or marketing functions and do not act as a conduit for that information. FERC clarified, in response to a motion by Williams, that parent company senior officials do not become “transmission function employees” by approving major capital expenditures. However, FERC disapproved the creation of an executive officer team composed of business unit heads who are operating employees of transmission providers or energy affiliates.
- *Shared Risk Management Functions.* FERC clarified that shared risk management activities may include: (1) managing corporate-wide business risk exposure of the corporation and/or affiliates; (2) evaluating business risk exposure to third parties on an aggregate basis; (3) managing overall corporate investment for the entire corporation; (4) approving expansion projects; and (5) establishing spending, trading and capital authorities for each business unit. A shared risk management function cannot, however, assess the creditworthiness of a particular customer under a pipeline’s tariff – that is a transmission function.
- *Field and Maintenance Personnel.* Order No. 2004-A clarifies that field personnel and their supervisors may be shared even if they can shut down facilities, as long as they are not involved in advance planning for facility shut downs or in shutting down facilities for economic reasons.

Information Access and Disclosure. Order No. 2004-A clarified several exceptions to the final rule's restrictions on sharing non-public transmission information:

- *Crucial Operating Information.* FERC clarified that a transmission provider may share with energy affiliates information necessary to maintain the operations of the transmission system. Thus, the crucial operating information exception is not limited to emergency circumstances.
- *Transaction-Specific Exception.* Discussions between a transmission provider and energy affiliate regarding the construction of facilities for the energy affiliate will be covered by the transaction-specific exception. However, a transmission provider must post on the Internet or OASIS advance notice of its intent to conduct a meeting with an energy affiliate on facility expansion, and transcribe all such meetings.

Discounts. The rule clarified that an offer of a discount becomes contractually binding at the time that both parties are bound to the contract. FERC rejected requests to find that posting is not required until all conditions of a precedent agreement are satisfied.

Training. FERC clarified that transmission providers are not required to train employees who do not have access to information about transmission, energy, or natural gas functions.

### **Dissents**

Commissioners Brownell and Kelliher dissented in part from Order No. 2004-A. Commissioner Brownell would have excluded affiliated producers, gatherers, processors, intrastate pipelines and Hinshaw pipelines from the energy affiliate definition. Commissioner Kelliher expressed concern that the evidentiary record before FERC does not support expanding the scope of the Standards of Conduct beyond the previously covered marketing affiliates. He also expressed concern that the rule impedes the ability of senior management to engage in informed decision making and thus is inconsistent with principles of sound corporate governance.

### **Next Steps and Additional Information**

FERC has announced that it will convene a staff conference in Houston, Texas on May 10, 2004 to address compliance, training, and best practices for implementing the Standards of Conduct.

Van Ness Feldman has been actively involved in this rulemaking on behalf of clients. The firm also counsels a number of clients on design and implementation of Standards of Conduct compliance programs; represents clients on company-specific exemption requests; and has represented clients in audit and enforcement proceeding related to these issues. This experience enables Van Ness Feldman to effectively assist clients with all types of Standards of Conduct matters. 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 Electricity or Natural Gas practices at (202) 298-1800.

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