

FERC Proposes to Revise Approach to Standards of Conduct For Transmission Providers

On March 21, 2008, the Federal Energy Regulatory Commission (FERC) issued a notice of proposed rulemaking that would modify the standards of conduct applicable to interstate natural gas pipelines and electric utilities. FERC states that the goal of the NOPR is to reorganize and clarify the standards of conduct to make compliance and enforcement easier and less confusing, without compromising their effectiveness in preventing undue discrimination in favor of affiliates. Comments on the proposed regulations are due 45 days after the NOPR is published in the *Federal Register*.

FERC'S EXISTING STANDARDS OF CONDUCT

The standards of conduct are intended to prevent natural gas pipelines and electric utilities from providing preferential access to service or information to affiliated entities. In Order No. 2004, FERC combined its previously separate standards of conduct for interstate natural gas pipelines and electric utilities (collectively calling them "transmission providers") and broadened the scope of the standards of conduct to govern relationships between these entities and their "energy affiliates." Generally, the term "energy affiliate" included any affiliate or unit that was involved in transmission transactions or other transactions involving natural gas or electric energy.

In 2006, the D.C. Circuit Court of Appeals vacated and remanded Order No. 2004 as it applied to natural gas pipelines, finding that FERC had not justified expanding the standards of conduct to non-marketing affiliates. Subsequently, FERC issued interim standards of conduct for natural gas pipelines, limiting the standards' scope to marketing affiliates and clarifying that the standards did not apply to pipelines' energy affiliates. FERC also issued a notice of proposed rulemaking to revise its standards of conduct applicable to both gas and electric transmission providers. Consistent with the interim standards, FERC proposed to cover only pipelines' relationships with marketing affiliates. With respect to electric utilities, FERC proposed to continue to apply the standards of conduct to energy affiliates, but proposed certain modifications to facilitate integrated resource planning and competitive procurement of power for a utility's bundled retail load.

FERC'S PROPOSED APPROACH TO STANDARDS OF CONDUCT

Characterizing the existing standards of conduct as too complex, overly broad, and difficult to enforce, FERC has decided to "refocus" the standards on areas presenting the greatest potential for affiliate preferences. Specifically, FERC seeks to simplify

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and clarify the standards of conduct by reorganizing them around three concepts: the independent functioning rule, the no-conduit rule, and the transparency rule. The proposed regulations also would require that transmission providers continue to post certain information.

The Independent Functioning Rule

The NOPR would retain the longstanding requirement that the transmission function operate independently from units or affiliates engaged in marketing activities, but would focus on the functions of individual employees rather than the corporate entity. The proposed regulations would define “transmission function employees” and “marketing function employees” and eliminate the concepts of “energy affiliate” and “shared employees” for all transmission providers. Marketing function employees would be prohibited from conducting transmission functions or having discriminatory access to the transmission system control center, and transmission function employees would be prohibited from engaging in marketing activities.

Consistent with Order No. 2004, the proposed standards of conduct would exempt the following from the definition of marketing functions: bundled retail sales; incidental purchases or sales of operational gas; sales from a transmission provider’s own production gas or its own gathering and processing facilities; and on-system sales by an intrastate pipeline or local distribution company. Reflecting a departure from the approach reflected in Order No. 2004, the definition of marketing function employee would not include employees engaged in system planning, including state-mandated Integrated Resource Planning. In addition, sales of electric energy by a transmission provider as a provider of last resort would be treated as exempt bundled retail sales.

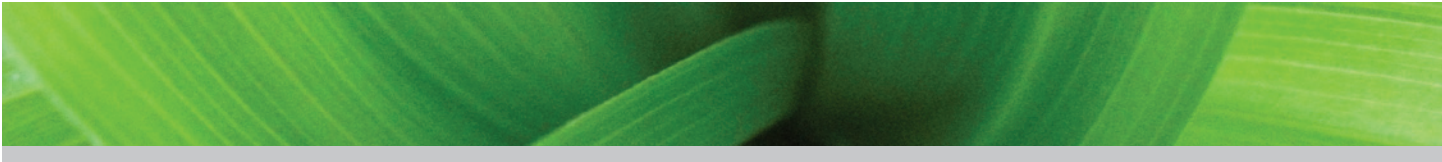
FERC proposes to exempt from the independent functioning requirement information exchanges that involve either generation necessary to perform generation dispatch or are necessary to maintain or restore transmission system operations. Transmission providers must, however, make contemporaneous records of these information exchanges, except in emergencies, when the record may be made after the fact.

The No-Conduit Rule

The NOPR would retain the long-standing no-conduit rule under which transmission function employees are prohibited from disclosing non-public transmission and customer information to marketing function employees either directly or through a conduit. Marketing function employees would be prohibited from receiving non-public information from any source, including transmission provider employees not engaged in transmission functions and non-marketing function employees of an affiliate that has marketing functions. Communications necessary to maintain or restore operation of the transmission system or that are related to generation necessary to perform generation dispatch would be excepted from the no-conduit rule, subject to the requirement that the transmission provider create a contemporaneous record of such communications.

The Transparency Rule

FERC proposes to require that a transmission provider immediately post non-public transmission information that is disclosed to a marketing function employee. If a disclosure of nonpublic transmission customer informa-



tion occurs, then the transmission provider must post a notice of the disclosure, but without revealing the information. The NOPR would retain long-standing exceptions to the posting requirement, including information related to a marketing function employee's specific request for service and information disclosed pursuant to a customer's voluntary consent.

Posting Requirements

The proposed regulations would no longer require the posting of organization charts, but would require that transmission providers post (i) notices of each waiver of a tariff provision and each exercise of discretion; (ii) offers of discounts; (iii) written procedures implementing the standards of conduct; (iv) names and addresses of affiliates that employ or retain marketing function employees; (v) facilities shared by transmission provider and affiliates employing or retaining marketing function employees; (vi) information concerning potential merger partners; (vii) job titles and descriptions of transmission function employees; and (viii) employee transfers between transmission function and marketing function positions and vice versa; (ix) the name of the chief compliance officer.

IMPLICATIONS OF THE PROPOSED STANDARD OF CONDUCT

In its NOPR, FERC acknowledges that the standards of conduct have become too complex and overly broad, interfering with legitimate corporate efficiencies and making compliance and enforcement difficult. Because of this, and in light of FERC's authority to assess substantial civil penalties, FERC decided to change course and reform the standards of conduct in an effort to provide clarity and certainty. According to FERC, the proposed standards of conduct reflect a reorganized and simpler approach that will apply more narrowly to relationships that present the greatest risk for preferences and will facilitate compliance and fair enforcement.

FOR ADDITIONAL INFORMATION

Van Ness Feldman represents natural gas pipelines and electric utilities before FERC on standards of conduct policy, and counsels clients on the full range of standards of conduct compliance matters. For additional information on the proposed rule, or for assistance in participating in the rulemaking proceeding or with other standards of conduct matters, please contact Susan Olenchuk, Paul Korman, or Doug Smith in Washington D.C. at (202) 298-1800 or Pam Anderson in Seattle, Washington at (206) 623-9372, or any other member of our Natural Gas or Electricity Practice Groups.

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