

FERC Proposes Rules for Market-Based Rate Authorization

May 25, 2006

On May 19, the Federal Energy Regulatory Commission (FERC) issued a Notice of Proposed Rulemaking (NOPR) to adopt proposed regulations that codify, with some changes, FERC's existing requirements to obtain and retain authorization for the sale of electric energy, capacity, and ancillary services at market-based rates (MBRs). **Comments on the proposed rule are due 60 days after publication in the Federal Register; reply comments are due 30 days thereafter.**

Horizontal Market Power

FERC will continue to rely on the current pivotal supplier analysis (based on the annual peak demand) and market share analysis (applied on a seasonal basis) as indicative screens for a seller's market power with respect to generation owned or controlled through contract. The NOPR proposes to modify the existing methodology by (i) eliminating the exemption for generation facilities built after July of 1996; (ii) adjusting upward the proxy for native load used in the market share analysis; and (iii) adopting a narrower definition of native load commitments.

The NOPR proposes to continue to use control areas or certain Independent System Operators (ISOs) or Regional Transmission Organization (RTOs) as the default geographic markets for the market power analysis. However, the NOPR seeks comments on using certain submarkets within an ISO or an RTO or markets larger than a single control area as alternative geographic markets. In addition, the NOPR seeks comments on whether generic findings on control for entities that manage generating facilities under energy or asset management agreements are appropriate.

Vertical Market Power

The NOPR proposes to combine into one analysis the review of a seller's ability to exercise market power in transmission and its ability to erect barriers to entry in the market. For sellers that own transmission facilities, or are affiliated with transmission owners, FERC will continue to find that having an Open Access Transmission Tariff (OATT) on file with FERC sufficiently mitigates market power in transmission. However, OATT violations may result in revocation of the MBR authorization of both the transmission owner and its affiliates. The NOPR also clarifies which inputs to electric power production FERC will consider in the analysis of barrier to market entry, and specifically proposes not to consider FERC-regulated interstate pipelines.

Affiliate Issues

The NOPR proposes to codify in FERC's regulations the prohibition against power sales between a franchised public utility and its affiliates. It also proposes to condition all MBR authorizations on compliance with a uniform code of conduct regulating the relationship between a franchised public utility and its affiliates. The proposed uniform code of conduct largely mirrors the model code of conduct developed by FERC through individual determinations, but the NOPR acknowledges that some utilities currently have codes of conduct different from the model. Unlike FERC's Standards of Conduct, the model code of conduct has not gone through a generic notice and comment review process.

FERC will require authorization of power sales between a franchised public utility and its affiliates on a case-by-case basis, upon review of evidence of competitive solicitations, RTO or non-RTO price indices, or other benchmarks. The NOPR seeks comments on the characteristics of acceptable non-RTO price indices and on whether other evidence should be considered when authorizing affiliate power sales. The NOPR also proposes that energy and asset managers acting on behalf of the franchised utility or its affiliates be treated, respectively, as the utility or as affiliates for purposes of compliance with the affiliate power sale prohibition and the code of conduct requirements.

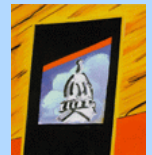
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Mitigation

FERC may impose default cost-based mitigation on sellers that have market power. The NOPR seeks comments on the rate methodology for designing the cost-based mitigation. It also seeks comments on whether mitigated sellers should be permitted to offer selective discounts, be required to offer power for sale in a mitigated market, or be permitted to make MBR sales in a mitigated market, if the sales “sink” in a different market. Furthermore, the NOPR seeks comments on whether mitigation implemented by ISOs or RTOs is sufficient to mitigate against sellers’ market power in those markets.

Pro Forma Tariff, Triennial Updates, and Changes in Status

The NOPR proposes to adopt a standard tariff of general applicability for all sellers with MBR authorization. A single MBR tariff would apply to each corporate family, with affiliates with MBR authority separately identified in the tariff.

The NOPR also proposes to eliminate the requirement to file triennial updates for sellers that own or control no more than 500 MW of generation, do not own or control transmission facilities, and are not affiliated with a franchised public utility. For all other sellers, the NOPR proposes to schedule the filing of triennial updates by regions in which sellers own or control generation. As a result, companies that own or control generation in different markets would file triennial reviews for each market.

The NOPR further seeks comments on whether it should revise the type of events that trigger the requirement to file a change in status.

Waivers

The NOPR seeks comments on whether FERC should continue to grant MBR sellers a waiver of certain financial accounting requirements and a blanket authorization to issue securities and assume liabilities. In case of loss of MBR authorization for any market, the NOPR proposes that any waivers remain in effect for an additional 60 days to allow for an orderly transition.

Ancillary Services Sales

FERC proposes to retain its policy on sales of ancillary services at MBR outside certain organized markets (CAISO, ISO-NE, NYISO, and PJM), which includes the requirement to establish an Internet-based site similar to OASIS for posting and transacting ancillary services sales and limitations on permissible transactions. The NOPR seeks comments on whether FERC should revise its current approach.

For Additional Information

Van Ness Feldman regularly assists energy companies in obtaining market-based rate authorization and advises clients on market power issues, affiliate transaction and code of conduct requirements, and regulatory compliance. We also assist clients in a broad range of energy-related policy matters, including counsel relating to active participation in similar rulemakings. For assistance in evaluating the implications of the NOPR or participating in the FERC proceeding, please contact Peg Moore, Doug Smith, Gary Bachman, Vincenzo Franco, or any member of our Electricity practice at (202) 298-1800.

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