

February 2008

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FERC Broadens Restrictions on Utility Affiliate Transactions

The Federal Energy Regulatory Commission (“FERC”) recently issued a new rule—Order No. 707—that broadens the scope of rules governing transactions between traditional utilities with captive customers and their affiliates. FERC issued Order No. 707 in conjunction with a related rule—Order No. 708—that adopts new “blanket authorizations” for certain dispositions of public utility securities and contracts under Section 203 of the Federal Power Act (“FPA”). In conjunction with this Client Alert, we are also circulating an alert on Order No. 708.

Order No. 707 expands the applicability of recently-adopted affiliate transaction restrictions. FERC’s restrictions are meant to prevent franchised public utilities (that is, utilities with franchised service obligations under state law) with captive customers from unfairly subsidizing their unregulated affiliates at the captive customers’ expense. FERC traditionally has addressed this issue in the context of market-based rate sellers, and recently codified in its regulations a series of restrictions on transactions between franchised public utilities with captive customers and their affiliates that sell power at market-based rates. Even more recently, in a 2007 order approving the acquisition of KeySpan by National Grid, FERC applied those conditions not only to the relationship between a franchised public utility with captive customers and its affiliates that sell power at market-based rates, but also to the relationship between the utility and all of its other affiliates, even those that do not engage in power sales.

Order No. 707 further broadens the scope of the affiliate transaction restrictions so that the rules adopted in the National Grid merger proceeding will apply to all FERC-jurisdictional franchised

utilities that either (1) serve wholesale or retail customers under cost-based regulation, or (2) own or provide transmission service over FERC-jurisdictional transmission facilities. However, FERC clarifies that if a franchised public utility has received a determination from FERC that it does not have captive customers, it may continue to rely on that determination.

If a franchised public utility is subject to the affiliate restrictions under Order No. 707, it must comply with the following rules:

- FERC approval is required for any wholesale sale by the utility to an affiliate eligible to sell wholesale energy at market-based rates, or by such an affiliate to the utility.
- Sales of non-power goods and services to any affiliate must be at the higher of cost or market price.
- With the exception of purchases from “centralized service companies” (i.e., a service company providing legal, accounting, tax, human resources, and related services) purchases of non-power goods and services from any affiliate must be at a price no higher than the market price.
- Purchases by a franchised utility of non-power goods and services from a “centralized service company” must be at cost.

For more information concerning Order Nos. 707 and 708, as well as other FERC issues, please contact Hunton & Williams through one of the attorneys listed on the “Contacts” section of this Client Alert.