

ENERGY ALERT

ENERGY POLICY ACT OF 2005

TITLE XII - ELECTRICITY MODERNIZATION ACT OF 2005



Title XII of the Energy Policy Act of 2005 contains the Electricity Modernization Act of 2005 (Act).¹ The Act amends the Federal Power Act (FPA), expanding the jurisdiction of the Federal Energy Regulatory Commission (FERC) in many respects.

The Act addresses issues with which the FERC has dealt in recent years, including requirements for market transparency, the scope of the FERC's refund authority, enhanced FERC merger review authority and the value of economic dispatch on a regionwide basis. The Act also addresses critical infrastructure issues, such as reliability and transmission grid enhancement. The Act repeals the Public Utility Holding Company Act of 1935 (PUHCA) and eliminates the mandatory purchase obligation under the Public Utility Regulatory Policies Act of 1978 (PURPA), while also providing the opportunity to consider other new features of PURPA. In short, the Act will affect the landscape of competitive electricity markets throughout the nation in many different respects.

The Addendum attached hereto describes and specifies the timing of the various studies, reports and rulemakings that the Act requires the FERC, the secretary of the Department of Energy and states to undertake.

SUBTITLE A: RELIABILITY STANDARDS

THE FERC HAS JURISDICTION OVER AN ELECTRIC RELIABILITY ORGANIZATION AND RELIABILITY STANDARDS

The Act provides for the creation of an Electric Reliability Organization (ERO), certified and supervised by the FERC, and vests the FERC with jurisdiction over the ERO.

The ERO will have the authority to establish and enforce reliability standards, subject to FERC approval, for facilities, control systems and electric energy from generation facilities necessary for operating and maintaining the reliability of an interconnected energy transmission network (bulk-power system). All users, owners and operators of the bulk-power system must comply with the reliability standards. The ERO may enter into agreements to delegate its authority to regional entities, subject to the FERC determining such agreements and the regional entities to which that authority is being delegated meet statutory criteria. The ERO, or a regional entity, subject to review by the FERC, may impose penalties for noncompliance with reliability

¹ Electricity Modernization Act of 2005, Pub.L.No. __ - __, Sec. 1201-1298, __ Stat. __, __ (2005).

standards after notice and an opportunity for a hearing. The FERC may take action against the ERO or regional entities to ensure compliance with a reliability standard or FERC order.

The regional reliability standards encompass any requirements that provide for reliable operation of the bulk-power system, including requirements for the operation of existing bulk-power system facilities, the design of planned additions or modifications to such facilities and protection against cyber-security incidents. However, the regional reliability standards do not include any requirements to enlarge existing facilities or construct new transmission or generation capacity. Neither the FERC nor the ERO is authorized by the Act to order the construction of additional generation or transmission capacity, or to set and enforce compliance with standards for adequacy or safety of electric facilities or services.

The FERC must provide a process for the identification and resolution of any conflicts between ERO reliability standards and rules governing Regional Transmission Organizations (RTOs) or Independent System Operators (ISOs). Any change in the ERO's rules, along with the basis and purpose of the rule change, must be filed with the FERC for approval.

The Act makes federal agencies responsible for expediting approvals that are necessary to allow the owners and operators of transmission or distribution facilities to comply with any reliability standard that pertains to vegetation management, electric service restoration or resolution of situations that "imminently endanger the reliability or safety of the facilities."

The Act does not preempt any state from taking action to ensure the safety, adequacy and reliability of electric services within that state, so long as such state action is not inconsistent with any reliability standard. However, New York may establish rules that result in greater reliability within that state, if such action does not result in lesser reliability outside of New York than provided by the ERO reliability standards. The FERC, upon application by the ERO or other affected party, will review a state action to determine whether it is inconsistent with a reliability standard. The FERC, after consultation with the ERO and the state taking action, may stay the effectiveness of any state action pending the FERC's issuance of a final order.

The ERO is required to conduct periodic assessments of the reliability and adequacy of the bulk-power system in North America. The Act urges the president to negotiate international agreements with Canada and Mexico to provide for effective compliance with reliability standards and the effectiveness of the ERO in the United States and Canada or Mexico.

The Act provides for the establishment of regional advisory bodies on petition of at least two-thirds of the states within a region that have more than one-half of their electric load served within the region. The regional advisory bodies may include representatives of agencies, states and provinces outside the United States. The governor of each participating state will appoint one member of the regional advisory body. The regional advisory bodies may advise the ERO, a regional entity or the FERC regarding the governance of an existing or proposed regional entity within the same region, a proposed reliability standard, fees proposed to be assessed within the region and any other responsibilities requested by the FERC.

Akin Gump Note: Until now, compliance with reliability standards issued by the North American Electric Reliability Council (NERC) has been essentially voluntary. The Act gives the FERC jurisdiction over an ERO, which will be charged with establishing and enforcing mandatory reliability standards, and provides the FERC with the authority to enforce such reliability standards.

SUBTITLE B: TRANSMISSION INFRASTRUCTURE MODERNIZATION

THE FERC HAS ADDITIONAL AUTHORITY TO SITE INTERSTATE ELECTRIC TRANSMISSION FACILITIES

The Act requires the secretary of Energy, in consultation with affected states, to conduct a study of electric transmission congestion and issue a report designating any geographic area experiencing electric energy transmission

capacity constraints or congestion that adversely affects consumers as a “national interest electric transmission corridor” (electric transmission corridor). In designating an electric transmission corridor, the secretary of Energy may consider: (1) the economic vitality and development of the electric transmission corridor or the end markets served, (2) the need for supply diversification, (3) the energy independence of the United States, (4) national energy policy and (5) national defense and homeland security.

The Act authorizes the FERC to issue construction permits for transmission facilities in an electric transmission corridor under certain circumstances, including: (1) where a state lacks the authority to issue such a permit or consider the interstate benefits of the project, (2) where an applicant for a permit does not serve end users in the state or (3) where a state has withheld approval of the project for more than one year or conditioned its approval so that transmission congestion will not be reduced significantly. The FERC must afford each state in which a proposed transmission facility will be located, each affected federal agency and Indian tribe, private property owners and other interested persons a reasonable opportunity to present its views and recommendations regarding the need for and impact of a facility covered by the permit. Once the FERC issues a permit, if necessary, the permit holder can go to federal court to exercise eminent domain.

The Act provides for the creation of interstate compacts among three or more contiguous states, subject to approval by Congress, to establish regional transmission siting agencies. These regional agencies will have the authority to review, certify and permit siting of transmission facilities in an electric transmission corridor. The FERC has no authority to issue a permit for construction or modification of an electric transmission facility within a state that is a party to an interstate compact unless the members of the compact disagree and the secretary of Energy, after notice and an opportunity for a hearing, determines that the compact has withheld approval for more than one year or approval has been conditioned in such a manner that the proposed construction of the transmission facility will not significantly reduce transmission congestion or is not economically feasible.

Akin Gump Note: Various studies and reports have noted the serious need to upgrade the bulk-power transmission infrastructure in the United States. This provision provides the FERC with the authority to expedite the siting of transmission facilities in transmission areas that the secretary of Energy has identified as transmission constrained or congested.

THIRD-PARTY FINANCING OF WESTERN AREA POWER ADMINISTRATION AND SOUTHWESTERN POWER ADMINISTRATION FACILITIES

The secretary of Energy, in conjunction with one or both administrators of the Western Area Power Administration (WAPA) and the Southwestern Power Administration (SWPA), or in participation with other entities, may design, develop, construct, operate, maintain or own an electric power transmission facility and related facilities, or such facilities needed to upgrade transmission facilities owned by WAPA or SWPA, if the proposed facilities satisfy certain criteria. In addition, the secretary of Energy, acting through WAPA, SWPA or both, may develop, own or operate new transmission facilities located in any state in which WAPA or SWPA operates upon the satisfaction of certain public interest criteria. Specifically, a proposed project must: (1) be located in an electric transmission corridor, (2) reduce congestion of electric transmission in interstate commerce, (3) be necessary to accommodate actual or projected increase in demand and (4) be consistent with the expansion plans of the applicable RTO or ISO. The Act limits the amount of participant funding to \$100 million.

Akin Gump Note: This provision provides an opportunity for the private sector to own or operate transmission facilities with WAPA or SWPA.

PROMOTION OF ADVANCED TRANSMISSION TECHNOLOGIES

The Act directs the FERC to encourage the use of advanced transmission technologies. The Act also directs the secretary of Energy to establish an advanced power system technology incentive program to support the deployment of advanced power system technologies and to improve certain critical governmental, industrial and commercial

processes. The secretary of Energy may determine, in consultation with the secretary of Homeland Security, advanced power system technology facilities that are in critical need of secure, reliable and rapidly available high-quality power for critical governmental, industrial or commercial applications. The secretary of Energy is authorized to make incentive payments to eligible owners and operators of advanced power system technologies of 1.8 cents per kilowatt-hour for a qualifying advanced power system and an additional 0.7 cents per kilowatt-hour for electricity generated at a qualifying security and assured power facility.

SUBTITLE C: TRANSMISSION OPERATION IMPROVEMENTS

OPEN ACCESS BY UNREGULATED TRANSMITTING UTILITIES

The Act extends the FERC's jurisdictional reach to "unregulated transmitting utilities," which include publicly owned utilities, municipalities and federal power marketing agencies. These unregulated transmitting utilities are now required to provide transmission service pursuant to nondiscriminatory rates, terms and conditions. Unregulated transmitting utilities must file their transmission rates under Section 205 of the FPA. The Act excludes local distribution facilities.

The Act exempts entities that sell not more than 4 million MWh of electricity per year or whose facilities are not necessary for operating an interconnected transmission system. The FERC can withdraw the exemption if it later determines that the exemption impairs reliability of the transmission grid.

Akin Gump Note: This provision extends the FERC's jurisdiction to encompass essentially all entities that provide transmission service in interstate commerce. This provision will require unregulated transmitting utilities to file open-access transmission tariffs with the FERC.

TRANSMISSION RIGHTS FOR A LOAD-SERVING ENTITY

The Act provides that a load-serving entity is "entitled" to use firm transmission or equivalent financial transmission rights to the extent required to deliver output from generating facilities or wholesale purchase power contracts to meet its service obligations. A load-serving entity is defined as a "distribution utility" or an electric utility that has an obligation to serve. Retail aggregators in states that have implemented retail choice also are entitled to firm transmission and financial transmission rights. To the extent any portion of a "service obligation" covered by the firm transmission or financial transmission rights is transferred to another load-serving entity, the "successor load-serving entity" is entitled to the associated transmission rights. These firm transmission and financial transmission rights follow the load whenever it is transferred.

The Act addresses the allocation of transmission rights by a Transmission Organization. A Transmission Organization is defined as an RTO, ISO or other transmission organization approved by the FERC for the operation of transmission facilities. The Act provides that an existing or future methodology for the allocation or auction of transmission rights by a Transmission Organization that has been approved by the FERC as of January 1, 2005, or any future allocation or auction that the FERC determines is just and reasonable, will not be disturbed to accommodate a load-serving entity's right to transmission. However, if a Transmission Organization has never allocated financial transmission rights on its system that pertain to a period prior to January 1, 2005, and the Transmission Organization proposes to change the methodology for such allocation, the FERC must ensure that the allocation gives priority to load-serving entities to the extent generation or power purchase arrangements remain in effect.²

The FERC must issue a rule or order that addresses how transmission planning and expansion in organized markets will meet the "reasonable needs" of load-serving entities to satisfy their service obligations on a long-term basis.

² The FPA also is amended so that an electric utility that holds firm transmission rights and is located in the Pacific Northwest (including the geographic area proposed for a RTO in FERC Docket No. RT01-35) is not required to convert firm transmission rights to financial transmission rights.

Akin Gump Note: This provision addresses the disagreement over whether load-serving entities (including retail aggregators in states with retail choice) should be afforded a continual right to firm transmission and whether load-serving entities are being provided sufficient financial transmission rights through auctions conducted by existing RTOs.

STUDY ON THE BENEFITS OF ECONOMIC DISPATCH

The Act requires the secretary of Energy, in consultation with the states, to study the procedures currently used by electric utilities to perform economic dispatch, possible revisions to these procedures to increase the ability of non-utility generators to be included in economic dispatch and potential benefits to electricity customers of such revisions. The secretary of Energy must submit a report on the results of the study to Congress and the states for any suggested legislative or regulatory changes.

The Act also directs the FERC to convene “joint boards on a regional basis” to study security-constrained economic dispatch for the various market regions.³ The FERC will designate the appropriate regions to be investigated. The joint boards will be comprised of a representative nominated by each state for the appropriate regional joint board and a designated FERC member, who will both chair and participate as a member of each board. The “sole authority” of each joint board is to “consider issues relevant to security-constrained economic dispatch” and how this “mode of operating an electric energy system affects or enhances the reliability and affordability of service to customers in the specified region, and to make recommendations to the [FERC] regarding these issues.” The FERC must submit a report to Congress addressing the recommendations of the joint boards.

Akin Gump Note: These provisions may pave the way for the implementation of regionwide, security-constrained economic dispatch in markets where it does not currently exist and expand the reach of such economic dispatch to include non-utility generators. Likewise, it may create a record that shows whether regionwide security-constrained economic dispatch is worth the new costs presently being imposed by RTOs that rely upon such economic dispatch.

LOCATIONAL INSTALLED CAPACITY MECHANISM IN NEW ENGLAND

The Act notes that the governors of the states in New England have objected to the proposed Locational Installed Capacity (LICAP) mechanism and that Congress’ “sense” is that the FERC “should carefully consider the states’ objections.”

Akin Gump Note: This provision notes Congress’ awareness of the opposition to LICAP in New England, yet the provision does not take a position. In other words, Congress has left it to the FERC (and ultimately the courts) to decide the future of LICAP in New England.

PARTICIPATION IN TRANSMISSION ORGANIZATIONS

The Act formalizes that “Federal Utilities,” which include federal power marketing agencies and the Tennessee Valley Authority (TVA), may enter into agreements to transfer operational control of transmission facilities to a Transmission Organization. Further, although the FERC now has jurisdiction over “unregulated transmission utilities” for the purpose of requiring open-access transmission service, the Act does not give the FERC the authority to require an unregulated transmission utility to transfer operational control of its transmission facilities to a Transmission Organization.

³ The requirements in this paragraph come from Subtitle J, which, like Subtitle C, includes provisions addressing economic dispatch.

SUBTITLE D: TRANSMISSION RATE REFORM

THE FERC MUST ESTABLISH INCENTIVE-BASED RATES FOR TRANSMISSION INFRASTRUCTURE INVESTMENT

The Act requires the FERC to establish, by rule, “incentive-based rate treatments” for the transmission of electricity in interstate commerce. The rule must:

- (1) promote reliable and economically efficient transmission by fostering investment in the enlargement, improvement, maintenance and operation of interstate transmission facilities, regardless of the ownership of the facilities,
- (2) provide a return on equity that attracts new investment in transmission facilities,
- (3) encourage increased capacity and efficiency of existing transmission facilities through the implementation of new technology or other measures, and
- (4) permit recovery of all prudently incurred costs necessary to comply with applicable reliability standards and related to transmission infrastructure development.

In addition, the FERC must, consistent with its jurisdiction, provide incentives to utilities that join Transmission Organizations. Specifically, the FERC must “ensure” that any costs incurred by utilities are recovered through such utilities’ transmission rates or through the transmission rates charged by Transmission Organizations.

Akin Gump Note: This provision requires the FERC to establish transmission rates based on performance that, in theory, should motivate transmission providers to maximize efficiency. Further, it provides a measure of surety to entities that build transmission pursuant to directives of a Transmission Organization that the investment will be recovered in transmission rates.

FUNDING NEW INTERCONNECTION AND TRANSMISSION UPGRADES

The Act provides for the funding of new interconnection and transmission upgrades. Specifically, the Act states that the FERC may, without regard to whether the applicant is a member of a FERC-approved Transmission Organization, approve participant funding plans that allocate costs related to transmission upgrades or new generator interconnections so long as such plans result in rates that are: (1) just and reasonable, (2) not unduly discriminatory or preferential and (3) otherwise consistent with FPA Sections 205 and 206.

Akin Gump Note: This provision provides for participant funding of new interconnection and transmission upgrades generally, beyond participation with WAPA or SWPA as discussed above.

SUBTITLE E: AMENDMENTS TO THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978 (PURPA)

ELECTRIC UTILITIES MUST OFFER NET METERING AND PREPARE FUEL EFFICIENCY PLANS

The Act requires each electric utility:

- (1) to make available upon request net metering service to any electric consumer that has an eligible on-site generating facility served by the utility where electric energy generated on-site and delivered to the local distribution facilities may be used to offset electric energy provided by the electric utility to the electric consumer during the applicable billing period,

- (2) to develop a plan to minimize its dependence on one fuel source and to diversify the fuels and technologies it uses, including the use of renewable technologies, and
- (3) to develop and implement a 10-year plan to increase the efficiency of its fossil fuel generation.

Each state regulatory authority and each nonregulated electric utility is required to consider the new standards and determine whether or not it is appropriate to implement each standard to carry out the purposes of PURPA.

Akin Gump Note: This requirement will generate several initiatives on the state level. Further, although an “eligible on-site generating facility” has yet to be defined, it likely will include interconnected qualifying facilities and perhaps merchant facilities.

TIME-BASED RATES, METERING AND DEMAND RESPONSE INITIATIVES MUST BE PURSUED

Each electric utility or third-party marketer selling energy to retail electric customers must offer a time-based rate schedule to each of its customer classes – a schedule under which the rate charged by the electric utility varies during different time periods and reflects any variance in the utility’s cost of generating and purchasing electricity at the wholesale level – and provide, upon customer request, a time-based meter to individual customers. Time-based rates and meters must be offered within 18 months of enactment. Each state regulatory authority must investigate and decide whether it is appropriate for electric utilities to provide and install time-based meters and communication devices to enable customers to participate in time-based pricing rate schedules and other demand response programs.

The Act further charges the secretary of Energy with the responsibility for educating consumers on the availability, advantages and benefits of advanced metering communications technologies, including funding of demonstration or pilot projects. The secretary of Energy is directed to work with states, utilities, other energy providers and advanced metering and communications experts to identify and address barriers to the adoption of demand response programs. The secretary of Energy must provide technical assistance to states and regional organizations (formed by two or more states) to identify areas of potential demand response and develop plans to implement demand response programs among consumers.

THE MANDATORY PURCHASE AND SALE OBLIGATION MUST BE JUSTIFIED

An electric utility is no longer required to enter into a new contract or obligation to purchase electric energy from a qualifying cogeneration or small power production facility (QF) so long as the FERC finds that the QF has access to:

- (1) independently administered, auction-based day ahead and real-time wholesale markets for the sale of electric energy, and wholesale markets for long-term sales of capacity and electric energy, or
- (2) nondiscriminatory interconnection and transmission services that are provided by a FERC-approved regional transmission entity and administered pursuant to an open-access transmission tariff, and competitive capacity and electric energy wholesale markets, or
- (3) wholesale markets for the sale of capacity and electric energy that are, at a minimum, of comparable quality to the markets in (1) and (2).

Further, an electric utility is not required to enter into a new contract or obligation to purchase from, or sell electric energy to, a QF that is not an existing qualifying cogeneration facility, unless the facility meets the new criteria that the FERC establishes to qualify for the mandatory purchase obligation.

The FERC must issue a rule revising the criteria for new qualifying cogeneration facilities seeking to sell electricity pursuant to the mandatory purchase obligation provisions of PURPA. The criteria must ensure that: (1) the thermal energy output of the new qualifying cogeneration facility is used productively and beneficially, (2) the electrical, thermal and chemical output of the cogeneration facility is used fundamentally for industrial, commercial or institutional purposes and not for the sale to an electric utility and (3) progress toward the development of efficient electric generating technology continues. The existing criteria for qualifying cogeneration facilities will continue to

apply to facilities that already are a QF on the date of enactment or have filed a notice of self-certification, self-recertification or an application for certification prior to the date on which the FERC issues its final rule revising the criteria for new qualifying cogeneration facilities.

An electric utility may file an application with the FERC for relief from the mandatory purchase obligation on a service territory-wide basis, setting forth the factual basis upon which such relief is requested and why the market-access conditions discussed above have been met. After notice and an opportunity for comment, the FERC must make a final determination within 90 days of the filing of such an application. The FERC can reinstate the purchase obligation if it finds competitive conditions are no longer available to the QF. Existing purchase power agreements and noncontractual purchase obligations with QFs are not affected by the amendments.

An electric utility is no longer required to enter into a new contract or obligation to sell electric energy to a QF if the FERC finds (1) competing retail electric suppliers are willing and able to sell and deliver electric energy to the QF and (2) the electric utility is not required by state law to sell electric energy in its service territory.

Akin Gump Note: PURPA has been revised to eliminate the mandatory purchase obligation imposed on electric utilities since 1978, so long as a QF has a viable means to generate revenue from replacement power sales through access to the marketplace. Notably, this provision does not repeal PURPA but preserves a place for legitimate QFs, which will still be able to take advantage of exemptions from applicable FPA and state regulations.

OWNERSHIP LIMITATIONS ARE ELIMINATED

PURPA had required, as determined by prior rule of the FERC, that an electric utility or an electric utility holding company could not own more than 50 percent of the equity interest in a QF. The Act repeals this limitation.

Akin Gump Note: With this repeal, electric utilities now have additional investment options in QFs.

INTERCONNECTION SERVICE

Each electric utility is required to make interconnection service (which the Act defines as service under which a consumer's on-site generating facility is connected to local distribution facilities) available upon request to any electric consumer that the electric utility serves. The interconnection agreements and procedures by which an electric utility must provide such service must be just and reasonable, and not unduly discriminatory or preferential and promote current best practices of interconnection for distributed generation. State regulatory authorities and nonregulated utilities are required to consider this amendment, or set a hearing date for consideration, and to make a determination whether or not it is appropriate to implement the interconnection standard to carry out the purposes of PURPA.

Akin Gump Note: This provision, if implemented as described, could require the interconnection of a consumer's on-site generating facility to the local distribution facilities.

SUBTITLE F: REPEAL OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 (PUHCA)

The Act repeals PUHCA.

The Act requires each holding company, as well as any company within the same holding company system or any affiliate or subsidiary of a holding company, to maintain financial records and make available to the FERC any such records that the FERC determines to be relevant to costs incurred by electric public utility or natural gas company associates of a holding company and necessary or appropriate to the protection of public utility customers with respect to jurisdictional rates. The Act gives the FERC the authority to examine the financial records of any company in a holding company system, or any affiliate thereof, to protect customers from unjust and unreasonable rates. However, a bank, savings association or trust company, or their operating subsidiaries, is excluded from the definition of a holding company so long as the public utility voting securities it owns, controls or holds are held as collateral, in the

ordinary course of business as a fiduciary or solely for liquidation purposes. An exemption is provided to brokers and dealers that own, control or hold with the power to vote such securities as well.

In addition to the FERC, a state commission with jurisdiction to regulate a public utility company in a holding company system, the holding company itself, or any associate or affiliated company thereof may request the financial records of such regulated companies that: (1) have been identified in reasonable detail in a proceeding before a state commission, (2) a state commission determines are relevant to costs incurred by such regulated companies and (3) the state commission requires to discharge its responsibilities in the state proceeding.

The Act requires the FERC to issue a rule that exempts from the above-described requirements any holding company that is a holding company solely with respect to QFs, exempt wholesale generators or foreign utility companies.

The Act refrains from limiting the authority of the FERC (pursuant to the FPA) to ensure that jurisdictional rates are just and reasonable. The FERC maintains its authority to approve or deny the pass-through of costs and to prevent cross-subsidization between affiliated utility companies. Further, the FERC may issue regulations necessary to protect utility customers from such improper costs. Additionally, the Act maintains the FERC's authority to determine whether a public utility may recover in rates the costs of activities, goods or services performed by, or obtained from, an associate (affiliate) company.

Furthermore, the Act requires the FERC to review and authorize the allocation of costs for non-power goods, administrative services or management services provided to a public utility by an "associate company" specifically organized to provide such services.

The Act requires the FERC to issue regulations and to submit to Congress detailed recommendations on the amendments to federal law necessary to implement this provision. Further, the Securities and Exchange Commission (SEC) must transfer all books and records that primarily relate to the functions transferred to the FERC.

Finally, FPA Section 318 and its provisions relating to conflicts of jurisdiction between the FERC and the SEC is repealed.

Akin Gump Note: These provisions abolish the statutory standard that prohibited an entity from holding 10 percent or more of the voting securities of more than one public utility or natural gas company without obtaining an order from the SEC demonstrating that the affiliated utilities are integrated and operate in a single geographic region. Hence, the repeal of PUHCA paves the way for increased merger and acquisition activity among electric utility and natural gas companies. Further, the repeal of PUHCA will provide opportunities for utilities to invest in transmission assets located in diverse sections of the United States. These provisions may subject QFs, exempt wholesale generators and foreign utility companies to the record-keeping requirements of the Act except to the extent they are part of a holding company that qualifies for the limited exemption discussed above.

SUBTITLE G: MARKET TRANSPARENCY, ENFORCEMENT AND CONSUMER PROTECTION

THE FERC MUST PROMOTE MARKET TRANSPARENCY

The Act directs the FERC to facilitate price transparency in markets for the sale and transmission of electric energy in interstate commerce. The FERC may prescribe rules to provide for the dissemination of information regarding the availability and prices of wholesale electric energy and transmission service. The FERC is empowered to obtain such information from any "market participant."

In determining what information should be made available, the FERC must "seek to ensure that consumers and competitive markets are protected from the adverse effects of potential collusion or other anticompetitive behaviors." Entities that have a "de minimis market presence" are exempt from any reporting requirement the FERC may establish.

Akin Gump Note: To date, the FERC has stated that price transparency is necessary, but only has required a jurisdictional entity to advise the FERC whether it reports electric energy transaction information to publishers of electricity price indices. This new authority allows the FERC to proscribe rules that apply to any “market participant” and perhaps require market participants to provide electric energy transactional information to the FERC.

STRONG PROHIBITION AGAINST MARKET MANIPULATION

The Act prohibits certain types of behavior. It forbids any person or entity from knowingly reporting false information concerning wholesale electricity prices or available transmission capacity to a federal agency. In addition, it is unlawful for any person or entity to employ any manipulative or deceptive device in the wholesale purchase or sale of electric energy or transmission service that violates the rules and regulations the FERC may prescribe as it deems necessary in the public interest or for the protection of electric ratepayers.

The Act increases the criminal penalties that the FERC may assess for knowing and willful violations of the FPA from \$5,000 to \$1,000,000, and increases the maximum prison term from two years to five years. The maximum penalty for a knowing and willful violation of rules, regulations or conditions promulgated by the FERC or the secretary of the Army under the FPA is increased from \$500 per day to \$25,000 per day. In addition, the statutory exemption of certain provisions from these criminal penalties is removed. Also, the maximum civil penalty for violations of the FPA is increased from \$10,000 per day to \$1,000,000 per day.

The Act advances the refund effective date under Section 206(b) of the FPA. The Act removes the current 60-day lag associated with the refund effective date and allows refunds from the date on which a complaint alleging unlawful conduct is filed with the FERC. Further, if an entity voluntarily makes “short-term sales” of electric energy – defined as sales for a period of 31 days or less – in an organized market and the sales violate the FERC’s rules or terms of a tariff, the entity shall be subject to the refund authority of the FERC. However, entities that sell less than 8,000,000 MWh of electricity per year and electric cooperatives are exempt from this provision. The FERC also has refund authority with respect to short-term sales of energy by the Bonneville Power Administration (BPA), TVA and federal power marketing agencies.

Akin Gump Note: These provisions provide “teeth” in the form of strong penalties for market manipulation and violations of the FPA and rules, regulations and conditions promulgated thereunder.

THE FERC’S MERGER REVIEW STANDARDS ARE REFORMED AND ENHANCED

The Act amends the FERC’s merger review authority in several respects. First, the threshold at which FERC approval for the sale, lease or other disposition of jurisdictional facilities is required is increased from in excess of \$50,000 to in excess of \$10,000,000. This increased threshold to \$10,000,000 also applies to the purchase or acquisition of a security in a public utility. Second, the FERC now has authority over the purchase, lease or other disposition of an existing generation facility that is used for the sale of electric energy at wholesale in interstate commerce. The \$10,000,000 threshold applies. Third, the FERC now has unquestioned authority over holding companies involved in certain transactions. Specifically, no holding company in a holding company system that includes a transmitting utility or an electric utility may purchase, acquire or take any security with a value that exceeds \$10,000,000, or merge with a public utility or holding company in a holding company system that includes a transmitting utility, or an electric utility, with a value that exceeds \$10,000,000, without obtaining FERC authorization. Fourth, the standard of review the FERC applies has been enhanced. The FERC shall approve the transaction if it will be “consistent with the public interest” – which is the existing standard – and “will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the FERC determines that this cross-subsidization is consistent with the public interest.”

The Act directs the FERC to adopt procedures, by rule, for the expeditious consideration of applications for transactions subject to Section 203(a) of the FPA. The procedures must set forth classes of transactions or establish

criteria for transactions that would normally meet the elements of the public interest standards listed above. Furthermore, for any other applications, the FERC must grant or deny the application within 180 days after it is filed or the application will be deemed granted unless the FERC finds that further consideration is required and issues an order tolling the 180-day review period. In such a case, the FERC may take an additional 180 days to grant or deny the application. These amendments to the FERC's merger authority take effect in six months.

Akin Gump Note: In the past, the FERC did not have authority under Section 203 of the FPA over the acquisition of generating facilities that provide sales at wholesale in interstate commerce. Accordingly, no generation market power analysis was submitted in connection with the acquisition (and hence there rarely was opposition to such an acquisition). A generation market power analysis was submitted only if the acquirer was authorized by the FERC to sell power at market-based rates, in which case the acquirer would need to demonstrate, pursuant to Section 205 of the FPA, that the acquisition did not vest it with generation market power. The generation market power analysis under Section 205 of the FPA is not identical to the generation market power analysis required under Section 203 of the FPA.

This amendment requires acquirers of existing generating assets from which sales of electric energy will be sold in interstate commerce to obtain FERC approval under the requirements of Section 203 of the FPA. This requirement will increase the number of Section 203 filings, particularly in regard to acquisition of financially distressed assets, which, in turn, will provide an opportunity for consumers and competitors to provide comment. The requirement adds a layer of regulatory approval (and hence time) that did not exist before in regard to generation facility acquisitions. To the extent the FERC approves an acquisition under Section 203, it is likely that the acquirer simultaneously will be able to obtain FERC approval under Section 205 to sell or continue to sell electric energy at market-based rates.

Last, cross-subsidization, or the potential to transfer benefits from ratepayers to shareholders through transactions involving unregulated affiliates, has been raised recently in Section 203 proceedings, with the FERC incrementally modifying its policy to address the issue. This amendment now requires the FERC (and hence applicants) to address "cross-subsidization" in all Section 203 proceedings.

POWER SALES IN THE WESTERN INTERCONNECTION

The Act provides special relief with regard to any contract entered into in the Western Interconnection prior to June 20, 2001, with a seller of wholesale electricity which the FERC has found to have manipulated the electricity market resulting in unjust and unreasonable rates and whose authority to sell electricity at market-based rates it has revoked. In such circumstances, notwithstanding any provision of Title 11 of the U.S. Code (which is the Bankruptcy Code), the FERC has exclusive jurisdiction under the FPA to determine whether a requirement to make termination payments for power not delivered by the seller, or any successor in interest of the seller, is not permitted under a rate schedule or is otherwise unlawful on the grounds that the contract is unjust and unreasonable or contrary to the public interest. This legislation applies to any proceeding pending on the date of enactment in which there is not a final, nonappealable order by the FERC or any other jurisdiction determining the respective rights of the seller.

Akin Gump Note: In a specific proceeding involving Enron, an issue arose regarding whether the Bankruptcy Court, through the Bankruptcy Code, or the FERC, through the FPA, has jurisdiction over termination payments under a FERC-jurisdictional contract. This provision provides the FERC with exclusive jurisdiction over termination payments solely in regard to contracts involving sales in the Western Interconnection prior to June 20, 2001. Notably, the Act does not resolve whether the Bankruptcy Code or the FPA takes preeminence when the termination of a FERC-jurisdictional contract is at issue. Congress has left that issue to the courts to resolve.

SUBTITLE H: DEFINITIONS

The Act amends or changes several definitions in the FPA. It brings the TVA and each federal power marketing administration (such as BPA) within the definition of "electric utility," which is defined as a person or federal or state agency that sells electric energy.

The Act defines Regional Transmission Organization and Independent System Operator as “an entity of sufficient regional scope approved by” the FERC to: (1) exercise operational or functional control of interstate transmission facilities and (2) ensure nondiscriminatory access to such transmission facilities.

The Act amends Section 201(f) of the FPA to state that its provisions do not apply to electrical cooperatives that receive financing under the Rural Electrification Act of 1936 or that sell less than 4,000,000 MWhs of electricity per year.

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ADDENDUM

ENERGY POLICY ACT OF 2005

TITLE XII – ELECTRICITY MODERNIZATION ACT OF 2005

The following describes and specifies the timing of the various studies, reports and rulemakings that the Electricity Modernization Act of 2005 (Act) requires be undertaken by the Federal Energy Regulatory Commission (FERC), the secretary of the Department of Energy and the various states.

SUBTITLE A: RELIABILITY STANDARDS

Sec. 1211. Electric Reliability Standards

- Within 180 days, the FERC must issue a rule to implement the reliability requirements.

SUBTITLE B: TRANSMISSION INFRASTRUCTURE MODERNIZATION

Sec. 1221. Siting of Interstate Electric Transmission Facilities

- Within 90 days, the secretary of Energy, the secretary of the Interior, the secretary of Agriculture and the chairman of the Council on Environmental Quality must submit to Congress a joint report discussing the status of designated transmission and distribution corridors on federal lands.
- Within one year, and every three years thereafter, the secretary of Energy, in consultation with affected states, must conduct a study of electric transmission congestion and issue a report that may designate any geographic area experiencing electric energy transmission capacity constraints or congestion that adversely affects consumers as a national interest electric transmission corridor.
- Within one year, the secretary of Energy, and the heads of all federal agencies with authority to issue federal authorizations, must enter into a memorandum of understanding to ensure the timely and coordinated review and permitting of electricity transmission facilities.
- Within 18 months, the secretary of Energy must issue regulations regarding the siting of transmission on federal lands.
- The FERC must issue rules regarding applications for permits for the construction or modification of electric transmission facilities in a national interest electric transmission corridor. (No due date specified.)

SUBTITLE C: TRANSMISSION OPERATION IMPROVEMENTS

Sec. 1231. Open Nondiscriminatory Access

- The FERC may, by rule or order, require an unregulated transmitting utility to provide transmission service at rates comparable to those that the unregulated transmitting utility charges itself, and on terms that are not unduly discriminatory or preferential. (No due date specified.)

Sec. 1233. Native Load Service Obligation

- Within one year, the FERC must issue a rule or order that addresses how transmission planning and expansion in organized markets will meet the reasonable needs of load-serving entities to satisfy their service obligations on a long-term basis.

Sec. 1234. Study on the Benefits of Economic Dispatch

- Within 90 days, and on a yearly basis thereafter, the secretary of Energy must submit a report to Congress and the states addressing the results of a study on economic dispatch, including recommendations for any suggested legislative or regulatory changes.

SUBTITLE D: TRANSMISSION RATE REFORM

Sec. 1241. Transmission Infrastructure Investment

- Within one year, the FERC must issue a rule establishing incentive-based (including performance-based) rate treatments for the transmission of electric energy in interstate commerce.

SUBTITLE E: AMENDMENTS TO THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978 (PURPA)

Sec. 1251. Net Metering and Additional Standards

- Within two years, each state regulatory authority (with respect to each electric utility for which it has ratemaking authority) and each nonregulated electric utility must begin the consideration process in Section 111 of PURPA with regard to implementing net metering, a plan to minimize dependence on fuel sources and a 10-year plan to increase the efficiency of fossil fuel generation. Within three years, a determination must be made whether it is appropriate to implement these standards for the purposes of PURPA.

Sec. 1252. Smart Metering

- Within 180 days, the secretary of Energy must provide Congress with a report that identifies and quantifies the national benefits of demand response and makes recommendations on achieving specific levels of such benefits by January 1, 2007.
- Within one year, the FERC must prepare and publish an annual report, by appropriate region, that assesses demand response resources.
- Within 18 months, each electric utility must offer time-based rates and further provide a time-based meter to each customer requesting such a meter.
- Within 18 months, each state regulatory authority must conduct an investigation and issue a decision whether it is appropriate to implement time-based rates and provide time-based meters.
- Within one year, each state regulatory authority (with respect to each electric utility for which it has ratemaking authority) and each nonregulated utility must begin the consideration process in Section 111 of PURPA to determine whether it is appropriate for electric utilities to provide time-based meters and communication devices for each of their customers. Within two years, a determination must be made whether it is appropriate to implement this standard for the purposes of PURPA.

Sec. 1253. Cogeneration and Small Power Production Purchase and Sale Requirements

- Within 180 days, the FERC must issue a rule revising the criteria in 18 C.F.R. § 292.205 for new qualifying cogeneration facilities seeking to sell electric energy to an electric utility pursuant to Section 210 of PURPA.

- The FERC must issue regulations as necessary to ensure that an electric utility recovers prudently incurred costs associated with the purchase of electric energy or capacity from a qualifying cogeneration facility or qualifying small power production facility. (No due date specified.)

Sec. 1254. Interconnection

- Within one year, each state regulatory authority (with respect to each electric utility for which it has ratemaking authority) and each nonregulated electric utility must begin the consideration process in Section 111 of PURPA with regard to the requirement that each electric utility offer interconnection service to consumers with on-site generation. Within two years, a determination must be made whether it is appropriate to implement interconnection service for the purposes of PURPA.

SUBTITLE F: REPEAL OF THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 (PUHCA)

Sec. 1266. Exemption Authority

- Within 270 days, the FERC must issue a rule to exempt any person that is a holding company solely with respect to one or more qualifying facilities, exempt wholesale generators or foreign utility companies from the requirement to provide the FERC with access to books and records.

Sec. 1272. Implementation

- Within four months, the FERC must issue regulations as may be necessary or appropriate to implement the repeal of PUHCA (other than Section 1265, relating to state access to books and records) and submit to Congress recommendations on technical and conforming amendments to federal law necessary to carry out the repeal of PUHCA and the amendments made by the Act.

Sec. 1275. Service Allocation

- Within four months, the FERC must issue rules to exempt any company in a holding company system whose public utility operations are confined substantially to a single state, and any other class of transactions that the FERC finds is not relevant to the jurisdictional rates of a public utility, from the requirement that the FERC authorize the allocation of costs of goods or services among associate companies.

SUBTITLE G: MARKET TRANSPARENCY, ENFORCEMENT AND CONSUMER PROTECTION

Sec. 1281. Electricity Market Transparency

- Within 180 days, the FERC must conclude a memorandum of understanding with the Commodity Futures Trading Commission relating to information sharing.
- The FERC may prescribe rules as necessary to ensure the timely dissemination of information about the availability and price of wholesale electric energy and transmission service.

Sec. 1283. Market Manipulation

- The FERC may prescribe rules and regulations as necessary to prevent any entity from using any manipulative or deceptive device or contrivance in connection with the purchase or sale of electric energy or transmission service subject to the jurisdiction of the FERC.

Sec. 1289. Merger Review Reform

- The FERC must issue a rule adopting procedures for expedited consideration of applications under Section 203 of the FPA. (No due date specified.)

SUBTITLE J: ECONOMIC DISPATCH

Sec. 1298. Joint Boards on Economic Dispatch

- Within one year, the FERC must issue a report and submit such report to Congress regarding the recommendations of the joint boards in regard to security-constrained economic dispatch.

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