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CLIENT ALERT

FERC Provides New Guidance on Federal Power Act Approvals Required for Passive Investments in Public Utilities

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The Federal Energy Regulatory Commission has issued a declaratory order, finding that tax equity interests in public utilities or public utility holding companies do not constitute "voting securities" for the purposes of Section 203 of the Federal Power Act (FPA), so long as the voting/consent/veto rights of such securities have the same characteristics as those identified in the Commission's order in *AES Creative Resources, L.P.*, 129 FERC ¶ 61,239 (2009).

Under *AES Creative*, the Commission found that interests in a public utility that do not entitle their holders to vote in the management of the public utility (directly or indirectly), such as consent rights on incurring indebtedness, selling assets, making capital expenditures, and changing the purpose of the company, were not "voting securities" for the purposes of the Commission's rate regulation under FPA § 205. Thus, entities holding such "passive" securities (directly or indirectly) were not considered affiliates of (or having control over) the public utility in which they invested.

However, since *AES Creative* was issued in the context of FPA § 205, it was unclear, until now, whether the Commission would apply the same passive analysis for purposes of FPA § 203. Often when a tax equity investment is contemplated that might be considered passive under the *AES Creative* precedent, the public utility typically files an application under FPA § 203 out of an abundance of caution seeking the Commission's approval under FPA § 203 for the transfer of equity interests in the public utility should the Commission consider that transfer to be a change in control over the public utility. In addition, because a FPA § 203 application was made for such passive tax equity investment, the public utility would also file a notice of change in status under its market-based rate authority utilizing the same assumption made in the FPA § 203 application. In these filings, the public utility would demonstrate that, under *AES Creative*, the tax equity investor held passive securities, and that the tax equity investor therefore was not an affiliate of (and did not have control over) the public utility. Going forward, having made the *AES Creative* showing, the public utility typically would not treat the tax equity investor as an affiliate or as having any control over the public utility in future Commission filings.

The declaratory order extends *AES Creative* to FPA § 203, which means that the issuance or transfer of securities with the passive characteristics defined in *AES Creative* does not constitute a change in control over a public utility and, thus, no prior approval under FPA § 203 would be required for the issuance or transfer to be effectuated. Similarly, a holding company will qualify for blanket authorization under FPA
§ 203(a)(2) for the acquisition of such securities.

What does this mean for the public utility?

The public utility cannot simply conclude on the basis of the declaratory order alone that it does not need authorization under FPA § 203 for the issuance or transfer of tax equity interests. In order to determine whether the public utility can reasonably rely on the declaratory order and conclude that it does not need prior authorization under FPA § 203 for an upstream tax equity

investment, an assessment must be made with respect to each and every voting, consent, and/or veto right of a tax equity investor as to whether it fits within the characteristics set forth in *AES Creative* in connection with passive securities.

If the rights fall squarely within *AES Creative*, the declaratory order states that the issuance or transfer of the tax equity investor's securities does not constitute a transfer of control of the public utility and, therefore, the public utility should not require prior authorization under FPA § 203 for such issuance or transfer. Similarly, the declaratory order says, under such circumstances, a holding company acquiring such a security would qualify for a blanket authorization under FPA § 203 for such acquisition. However, if any such voting/consent/veto right does not fit squarely within the *AES Creative* characteristics, a determination must be made as to whether prior FPA § 203 approval is required for the transaction.

Importantly, the legal requirement as to whether a public utility needs FPA § 203(a)(1) authorization for a transaction involving an upstream ownership change falls on the public utility and not on the tax equity investor. Therefore, the public utility itself must ultimately make the determination as to whether it needs FPA § 203(a)(1) authorization for the issuance or transfer of the tax equity securities. With respect to FPA
§ 203(a)(2), the tax equity investor itself must determine whether it requires its own separate prior FPA
§ 203 authorization to acquire such interests.

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