

FERC Proposes to Strengthen Hold-Harmless Policy for Electric Mergers

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The policy would impose greater scrutiny and controls on “transaction-related” costs that utilities commit not to pass through to ratepayers and would open the door to cost recovery for acquisitions driven by utility need.

On January 22, the **Federal Energy Regulatory Commission (FERC)** proposed to modify its policy that protects ratepayers in electric utility merger and acquisition proceedings. If adopted, the policy would impose greater scrutiny on those “transaction-related” costs that utilities commit not to pass through to ratepayers when seeking FERC approval of proposed transactions under section 203 of the Federal Power Act. The draft policy also offers flexibility to the industry when acquisitions are motivated by a need to satisfy reliability, resource adequacy, or other regulatory requirements; under FERC’s proposal, those transactions would not require a hold-harmless commitment, even if they would lead to increased rates.

Although many FERC-jurisdictional transactions are conducted under blanket authorizations or do not have an effect on FERC rates because the utility parties are permitted by FERC to sell electricity at negotiated rates, the proposed policy would apply to many larger, high-profile transactions, particularly those that involve transmission-owning utilities or those that otherwise involve utilities with cost-of-service rates.

FERC may authorize a transaction under section 203 of the **Federal Power Act** only if it concludes that the transaction would be consistent with the public interest. For those utility transactions not granted blanket authorizations, a key part of FERC’s analysis involves the effect that a proposed transaction would have on rates, including whether that effect would be adverse and, if so, whether that adverse effect is offset by other benefits that flow from the transaction. FERC has traditionally provided several methods by which utilities that undertake a transaction can demonstrate that the merger or acquisition would not have an adverse effect on rates, including open seasons, rate freezes, rate reductions, or hold-harmless commitments under which the utilities commit to not pass transaction-related costs through to ratepayers for a stated period, often five years. However, FERC has not previously defined the precise nature of the costs considered “transaction related,” nor has it mandated a process for tracking such costs.

The draft policy statement proposes to provide that detail and strengthen the ratepayer protections provided by a hold-harmless commitment. FERC proposes to classify “transaction-related” costs into two categories: (a) costs to “explore, agree to, and consummate a transaction” and (b) costs to “integrate individuals and assets into the acquiring utility” and “achieve merger synergies.”

In the first category of those costs directly related to developing and consummating the transaction, FERC placed the following and noted that this list is not exclusive:

- Costs of securing appraisals and evaluations for the transaction
- Costs of developing the structure of the transaction, including tax advice
- Costs of preparing the documents necessary to accomplish the transaction
- Costs from internal and external personnel tasks to advise on, negotiate, and execute the transaction

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- Costs related to shareholder approvals
- Costs for professional services, such as legal or accounting professionals
- Costs for ensuring operability of the merged or acquired facilities

In the second category of costs, those related to integration and costs to achieve merger synergies, FERC placed the following:

- Costs of internal and external personnel who work on transition issues, such as reorganizations and consolidations
- Integration costs, such as engineering studies, severance, operational integration, back-office IT system integration, duplication resolution, and the refinancing of existing obligations

In describing this second category of costs, FERC explained that it could include capital items, such as new computer systems, or expense items, such as the costs for eliminating redundancies and combining departments.

To ensure that ratepayers are protected from these costs, FERC also proposed to require utilities that offer hold-harmless commitments to implement strict controls for identifying and accounting from those costs and ensuring that they are excluded from rates. Those controls would need to be described in detail in the section 203 application, including the process and criteria for identifying those direct and indirect transaction-related costs and classifying them as nonoperating, transmission, distribution, production, and other costs. FERC would require that, along with the merger accounting, a utility provide the accounting entries and amounts for all transaction-related costs as of the date that the utility submits its merger accounting. Those transaction-related costs may be passed through only when a utility can demonstrate that it has achieved offsetting savings.

FERC also proposed to remove the time limit on hold-harmless commitments. As a result, all transaction-related costs, no matter when they are incurred, would need to be tracked and withheld from the costs passed through to ratepayers. Given the complexity of postmerger integration for large transactions, removing an end date on the hold-harmless commitment could create material difficulties and materially drive up the cost of the commitment.

Finally, FERC proposed to clarify that some increases in rates that result from a transaction do not create an “adverse impact” on rates when the transaction is necessary to resolve utility service needs, such as resource adequacy requirements, system reliability requirements, or other regulatory requirements. Utilities that undertake transactions resulting in rate increases for those purposes need not provide ratepayer protections such as hold-harmless commitments but must be able to demonstrate the utility or regulatory need driving the acquisitions.

Comments on the proposed policy statement are due March 30. The scope and definition of transaction-related costs, particularly those that are synergy related, and the unlimited duration of the hold-harmless commitment are likely to be key topics for comments, along with the potential for additional utility acquisitions that may cause rate increases but are nevertheless consistent with the public interest because of their nexus with utility service requirements.

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