Updates
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FERC Sharpens Its Application of Change in Control and Affiliation Concepts Regarding Utility Board Representation

In a pair of recent orders, the Federal Energy Regulatory Commission (FERC) announced significant clarifications regarding (1) what constitutes a change of control of a public utility or public utility holding company (FERC Regulated Entity) under Section 203 of the Federal Power Act (FPA), and (2) how FERC will assess the rebuttable presumption that investors who own less than 10% of the voting securities of a FERC Regulated Entity are not affiliated with that entity for purposes of Section 205 of the FPA. Specifically, in *TransAlta Energy Marketing (U.S.) Inc.*, 181 FERC ¶ 61,055 (2022) (*TransAlta*), FERC clarified that, going forward, the appointment of an investor's own officers or directors, or other appointees accountable to the investor, to the board of a FERC Regulated Entity will require the utility to seek prior FERC approval under section 203(a)(1)(A), even where such an investor holds less than 10% of the voting securities of the FERC Regulated Entity. FERC found in *Evergy Kan. Central, Inc.*, 181 FERC ¶ 61,044 (2022) (*Evergy*) that, where an investor's own officer or director, or other appointee accountable to the investor, is appointed to the board of a FERC Regulated Entity, that appointment functions to rebut the presumption of lack of control under FERC's regulations, even where such an investor holds less than 10% of the voting securities of the FERC Regulated Entity.

Evergy and TransAlta Decisions

In *Evergy*, FERC addressed whether market-based rate subsidiaries of Evergy, Inc. should be deemed affiliated with two hedge funds—Elliot Management Corp. (Elliot) and Bluescape Energy Partners LLC (Bluescape). Affiliates of Elliot held approximately 4.597% of Evergy's voting shares of common stock, and an affiliate of Bluescape held only 1.1% of Evergy's outstanding shares. Both Elliot and Bluescape entered into agreements with Evergy entitling them to appoint directors to Evergy's board. The director appointed to Evergy's board under Elliot's agreement was independent of, and not compensated by, Elliot. By contrast, the director appointed under Bluescape's agreement was Bluescape's executive chairman. Evergy argued that since neither hedge fund held 10% or more of Evergy's outstanding shares, it was entitled to rely on the rebuttable presumption in Section 35.36(a)(9)(v) that "owning, controlling or holding with power to vote, less than 10 percent of the outstanding voting securities of a specified company creates a rebuttable presumption of lack of control" to conclude that there was no affiliation with either fund.

FERC concluded that the rebuttable presumption held in the case of Elliot's investment but was rebutted with respect to Bluescape. While FERC noted that Elliot's and Bluescapes' investment arrangements were the same in most ways, FERC focused on a critical difference: the director installed through Elliot's agreement was independent of Elliot, whereas the director installed through Bluescape's agreement was not independent of Bluescape. Finding that board membership "confers rights, privileges and access to non-public information, including information on commercial strategy and operations," FERC concluded that appointment of an investor's own officer or director, or "other appointee accountable to the investor," to the board of a FERC Regulated Entity "confers on the investor authority to influence significant decisions" of the FERC Regulated Entity. *Evergy*, at 45. "Accordingly, . . . where an investor's non-independent director . . . is appointed to the board of a public utility or public utility holding company, that appointment functions to rebut the presumption of lack of control under section 35.36(a)(9)(v)." *Id*. As a result, FERC concluded that the rebuttable presumption of lack of control over Evergy was rebutted as to Bluescape but not as to Elliot.

FERC extended this analysis to apply to prior authorizations under section 203 of the FPA in TransAlta. There, FERC addressed an application for prior authorization of a change in control caused by the termination of certain standstill provisions in a 2019 debt securities agreement between TransAlta Corporation and Brookfield BRP Holdings (Canada) Inc. The debt securities agreement granted Brookfield an option to convert its debt securities into an equity interest in certain hydroelectric assets in Canada. It also provided that TransAlta's board of directors would be expanded from 10 to 12 members, two of whom could be nominated by Brookfield while it holds the debt securities. The agreement also included standstill provisions prohibiting Brookfield from acquiring over 19.9% of TransAlta stock and limiting its actions with respect to voting its shares. Crucially, FERC found that the standstill agreement did not expressly prohibit Brookfield from influencing the day-to-day management or operations of TransAlta or its utility subsidiaries. An application seeking FERC prior authorization was filed *after* affiliates of Brookfield increased their aggregate holdings to 10.1% of TransAlta common stock. Applicants cited FERC precedent in *Cascade Investment, L.L.C.* to argue that the initial investment did not result in a change of control given the limitations in the standstill agreement. 129 FERC ¶ 61,011 (2009).

FERC concluded that the application was late filed, distinguishing its precedent in *Cascade* in three key ways. First, FERC pointed out that the parties in *Cascade* filed for prior authorization under section 203 before the 10% ownership threshold for the rebuttable presumption of lack of control was exceeded. *See* Order No. 669-A, 115 FERC ¶ 61,097, at 101 (2006). In this case, they did not. *TransAlta*, at 27. Second, FERC found the standstill provisions were not sufficient to prevent a change of control as a result of the purchase of over 10% of TransAlta common stock because they lacked explicit prohibitions on or commitments regarding Brookfield's affiliates' ability to influence the day-to-day activities of TransAlta. *Id*. at 30-31.

Finally, FERC also concluded that the ability of Brookfield to nominate its own executives for appointment to two out of twelve positions on the TransAlta board constituted a change in control requiring prior authorization under section 203(a)(1)(A) of the FPA. FERC stated that "[g]oing forward, appointment of an investor's own officers and directors, or other appointee accountable to the investor, to the board of a public utility or holding company that owns public utilities will require prior Commission approval under section 203(a)(1)(A)."

Analysis

Assessment of Affiliation in the Context of Non-Independent Directors

By making these broadly applicable and broadly worded pronouncements in dockets regarding fact-specific transactions, rather than a rulemaking or policy docket, FERC introduced more questions than clarity for FERC Regulated Entities. It is clear that:

- If an investor acquires 10% or more of a FERC Regulated Entity's voting securities, absent limiting conditions on the investor's ability to influence management and operation of the FERC Regulated Entity's day-to-day operations, the acquisition will require prior authorization under section 203 and the investor will be deemed an affiliate of the FERC Regulated Entity regardless of whether its officers or directors hold any board seats of the FERC Regulated Entity.
- If an investor acquires less than 10% of a FERC Regulated Entity's voting securities and none of the investor's officers or directors hold any board seats of the FERC Regulated Entity, the rebuttable presumption against change of control and affiliation remains intact.
- If an investor acquires less than 10% of a FERC Regulated Entity's voting securities and it appoints an independent director to the board of the FERC Regulated Entity, the rebuttable presumption against change of control and affiliation remains intact.

However, the decisions have led to considerable uncertainty around how these pronouncements will be applied in other contexts:

- FERC announced no minimum percent ownership of shares below which the rebuttable presumption is *not* rebutted due to the appointment of an investor's own officers or directors to the FERC Regulated Entity's board. That means if an individual or entity owns even one share, a change of control and affiliation could be triggered with the appointment of an "appointee accountable to the investor" to the board.
- FERC did not clarify whether the existence of a formal agreement between the investor and the FERC Regulated Entity is necessary to its conclusions. In both *Evergy* and *TransAlta*, the investors at issue had agreements with the FERC Regulated Entities that granted rights to appoint board seats. However, FERC's policy clarifications were not limited to instances where such an agreement exists.
- While FERC stated it would apply its clarifications in TransAlta prospectively, FERC did not clarify whether prior authorization under section 203 will be required (1) to re-appoint directors "accountable to" an investor after their current board terms expire, (2) to increase the number of board seats held by directors "accountable to" an investor beyond the initial seats acquired[1], (3) to change the overall size of the FERC Regulated Entity's board (thereby affecting the proportion of total board seats held by persons "accountable to" an investor) or (4) in instances where, after an individual who qualifies as independent is appointed to a FERC Regulated Entity's board, that individual joins the board or takes an executive position with an investor in the FERC Regulated Entity or an entity for which that individual holds an executive position or board seat becomes an investor in the FERC Regulated Entity.

Since the prior authorization requirement falls on the FERC Regulated Entity, not the investor, under section 203(a)(1), FERC Regulated Entities must consider how best to address FERC's pronouncements in *Evergy* and *TransAlta* when vetting potential board members, including cross-referencing potential directors' positions with other entities against the FERC Regulated Entity's investors. Utilities may look to their practices for compliance with the FERC's interlock rules as a starting point for a compliance method here.

In addition, utilities with market-based rates will also need to consider if and when the rebuttable presumption regarding non-affiliation of investors holding less than 10% of their voting securities has been rebutted in light of FERC's analysis in *Evergy*. Market-based rate sellers are required to update the FERC relational database with any new affiliations by the 15th of the month after the month in which such affiliations arise, and must also file a change in status notification regarding new affiliations by the end of the month after the quarter in which such new affiliations arise.

Endnote

[1] *See, e.g., PDI Stoneman, Inc.*, 104 FERC ¶ 61,270 (2003) (requiring additional authorizations for a change of control under section 203 where an entity that already held more than 10% of the voting interests of a public utility acquired 2/3 and finally all of the voting interests in the public utility).

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