

# FERC Order Affirms Increased Scrutiny Of Investor-Utility Ties

By **Scott Johnson, Stephen Hug and Ben Reiter** (July 26, 2023)

On July 3, the Federal Energy Regulatory Commission issued an order confirming more aggressive scrutiny of investors' exercise of control over public utilities through representation on their boards or the boards of companies holding interests in them. The order concerned a request for rehearing of an October 2022 order in *Evergy Kansas Central Inc.*

The order held that an investor will be deemed to be affiliated with a public utility if an individual accountable to that investor is appointed to the board of the utility, or the board of the utility's holding company — even if the investor holds less than 10% of the voting interests in the company at issue, or the voting rights of the shares held by the investor have been restricted.[1]

That determination represented a marked departure from FERC's historical approach to evaluating affiliation, in which FERC generally has accepted that investors holding an interest of less than 10% do not control a public utility — and, as a result, should not be considered to be an affiliate of the utility.

On rehearing, FERC sustained the holdings of the October 2022 order, but adjusted its "affiliation via board membership" analysis in some nuanced but important ways, and added some color on several other critical issues.[2] As discussed further below, as a result of the commission's rehearing order:

- Investors holding a direct or indirect ownership interest of less than 10% in a FERC-jurisdictional public utility that have the ability to appoint a nonindependent member to the board of the public utility or the public utility holding company will be deemed to be affiliates of the utility.
- Transactions that result in a transfer of a direct or indirect ownership interest in a FERC-jurisdictional public utility of less than 10%, but come with the right to appoint a board member, may require prior approval under Section 203 of the Federal Power Act, or FPA.

The determination that an investor is an affiliate of a public utility can have a number of implications for both the investor and the utility. For the investor, a finding that the investor is affiliated with a utility can subject the investor to regulation as a holding company.

Such regulation includes triggering application of FERC's books and records access requirements, and subjecting the investor to an obligation to obtain FERC approval for certain types of transactions.

For the public utility, the determination that an investor is an affiliate could require the utility to treat otherwise unrelated utilities in which the investor has an interest as an



Scott Johnson



Stephen Hug



Ben Reiter

affiliate for purposes of FERC regulations. This includes disclosing such affiliation with another utility when making filings with FERC, and abiding by FERC regulations limiting the ability of affiliates to engage in certain types of transactions absent FERC approval.

FERC's decision to affirm its October 2022 order highlights the need for both investors and utilities to consider the potential implications of transactions involving even limited ownership interests, to ensure that any necessary regulatory implications are evaluated prior to consummation of a proposed transaction — including a board appointment — and that any necessary FERC filings are submitted.

## **Background**

In the October 2022 order, FERC deemed Bluescape Energy Partners LLC to be an affiliate of certain public utility subsidiaries of Evergy Inc.

FERC's determination was "based on [a] finding that the appointment of a non-independent director from Bluescape to the Evergy Board rebutted the presumption of lack of control" under Title 18 of the Code of Federal Regulations, Section 35.36(a)(9)(v). This was in spite of the fact that Bluescape's equity interest in Evergy was well below 10%.<sup>[3]</sup>

Historically, FERC has applied a 10% threshold for determining whether an ownership interest results in affiliation — i.e., if an entity holds less than 10%, then it is not an affiliate.<sup>[4]</sup> FERC has also considered whether a transfer of voting securities results in a change in control, such that prior approval for a transaction under Section 203(a)(1)(A) of the FPA is required for the transaction.<sup>[5]</sup>

However, FERC found Bluescape to be affiliated with Evergy and its public utility subsidiaries because, it said, "Bluescape owned 1.1% of Evergy's outstanding voting shares of common stock and had two directors on Evergy's 13-member board, one of whom is independent of Bluescape and one of whom is Bluescape's Executive Chairman."<sup>[6]</sup> FERC concluded that:

[W]here an investor's non-independent director, such as its own officer or director, or other appointee accountable to the investor, 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). We will therefore treat that investor as an affiliate of the public utility or public utility holding company to which a non-independent director has been appointed. As a result, we find that the appointment of a non-independent director from Bluescape to the Evergy Board rebuts the presumption of lack of control under section 35.36(a)(9)(v) and that Bluescape is deemed to be an affiliate of Evergy and Evergy Sellers.<sup>[7]</sup>

This finding was largely based on FERC's reasoning that "board membership 'confers rights, privileges, and access to non-public information, including information on commercial strategy and operations.'"<sup>[8]</sup>

## **Decision on Rehearing**

On rehearing, FERC modified its discussion from the October 2022 order. But the commission "continue[s] to find that Bluescape is an affiliate of Evergy and [the] Evergy Sellers under section 35.36(a)(9)" of the Commission's regulations.<sup>[9]</sup>

Specifically, it "continue[s] to find that the appointment of a non-independent director, i.e., Bluescape's Executive Chairman, to the Evergy Board overcomes the rebuttable

presumption of a lack of control under subparagraph (v) of section 35.36(a)(9)."[10]

However, FERC modified its reasoning for that conclusion, stating that "not only does the appointment of a non-independent director rebut the presumption of a lack of control, but that appointment is a per se finding of control." [11] Thus, the governing rule is now that "appointment of a non-independent director is a per se finding of control" that is "sufficient to overcome the rebuttable presumption of a lack of control." [12]

According to the commission, treating the appointment of a nonindependent director as conferring control is appropriate for two reasons. The first is that "there is liable to be an absence of arm's length bargaining in transactions between an investor that appoints a non-independent director to the board of a seller or a seller's upstream affiliate and that seller." [13]

The second is that "an investor having a non-independent member on a utility's board results in control, based on the access to information and ability to influence decision-making that board membership grants." [14] FERC holds this to be the case even if a large board "cannot be controlled by a single director of a minority investor." [15]

FERC rejected Evergy's arguments that the commission's determination represented a departure from precedent, and that any decision to revamp the commission's policies respecting control and affiliation should be made through a rulemaking proceeding with appropriate notice to interested persons.

FERC acknowledged that there are no prior cases in which it has found that an entity with an ownership of less than 10% should be treated as an affiliate. But it found that it is "not required to initiate a separate proceeding under section 206 of the FPA, nor ... to initiate a rulemaking proceeding to provide guidance on control and affiliation." [16]

FERC's view is that it can provide guidance on control and affiliation in any case-specific proceeding. No other "notice and opportunity for hearing" is necessary. [17]

In addition, FERC rejected arguments that its actions exceeded its authority by regulating board appointments in a manner that is not supported by the FPA. FERC held that its "interpretation of its regulations does not extend the Commission's jurisdiction" or "preclude appointment of a non-independent director." [18]

Rather, all FERC has done, in its view, is adjudicate "whether entities are affiliates under the Commission's regulations." [19]

### **Clarification of FERC's Section 203 Jurisdiction Over Nonindependent Board Member Additions**

Finally, in the rehearing order, FERC notes that in TransAlta Energy Marketing (U.S.) Inc., [20] it held that "appointment of an investor's own officers or 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)" of the FPA. [21]

On rehearing, Evergy argued that FERC's "'non-independent director' rule conflicts with its jurisdiction" under Section 203, because Section 203 "conditions FERC's jurisdiction on [the value of a] transaction exceeding \$10 million." [22] Thus, Evergy argued, "[i]t is ... unclear why the election of [a] 'non-independent director' triggers a change in control but the

election of other directors do not." [23]

On this point, FERC clarifies that "an entity would need to make a FPA section 203 filing with the Commission when the Commission has jurisdiction under section 203 and there is a change in control based on the circumstances discussed above." [24] FERC's clarification raises its own questions, however.

Specifically, FERC's statement that an entity is required to file for Section 203 approval when a transaction is subject to FERC's jurisdiction does not address the substance of the arguments raised by Evergy — i.e., whether the \$10 million threshold must be met to trigger FERC jurisdiction under Section 203(a)(1)(A).

Thus, FERC's clarification could be read as suggesting that the \$10 million threshold is irrelevant when an individual accountable to an investor is appointed to the board of a public utility or the public utility's holding company, or that the \$10 million threshold would need to be satisfied before FERC jurisdiction would attach.

### **Separate Statements**

Chairman Willie Phillips issued a brief concurrence, stating his belief that FERC "should have instituted a section 206 proceeding, or provided for further briefing, prior to relying on section 35.36(a)(9)(iii)" of its regulations to find affiliation. [25] His view is that "[a] regulator must treat like cases alike" absent something that "justifies taking a different tack." [26]

He continued:

[E]ven putting aside the absence of any such distinction, basic fairness, and perhaps due process as well, counsel in favor of giving the parties a fulsome opportunity to litigate application of section 35.36(a)(9)(iii), which [FERC] expressly did not address in [the October 2022 Order], including by responding to the specific questions that the Commission deems relevant. [27]

Then, even if FERC had again reached the same result, "that process would have allowed [it] to fairly examine what is an issue of first impression before the Commission, helping ensure we reach legally durable results when exercising such an important aspect of our authority." [28]

Commissioner James Danly issued a brief dissent, asserting that the rehearing order "fails to fully and adequately respond to the arguments raised in Evergy, Inc.'s rehearing request regarding the implementation of 18 C.F.R. § 35.36(a)(9) and, therefore, it violates the Administrative Procedure Act. The Commission owes it to the parties and the public to clearly address the substantive issues raised on rehearing." [29]

### **Main Takeaways and Next Steps**

As a result of the October 2022 order and the rehearing order, if an investor holds a direct or indirect ownership interest of less than 10% in a FERC-jurisdictional public utility, but has board representation, or the ability to appoint a board member, at the public utility or holding company level, then the investor will be considered to be an affiliate of the public utility.

In addition, if a transaction would result in a direct or indirect transfer of an ownership

interest in a FERC-jurisdictional public utility of less than 10%, but comes with a right to appoint a nonindependent board member at the public utility or holding company level, then prior approval from FERC under Section 203 of the FPA may be required to consummate the transaction.

The October 2022 order and the rehearing order are on appeal to the U.S. Court of Appeals for the Eighth Circuit, in *Evergy Missouri West Inc. v. FERC*. The issuance of the rehearing order means that the appeal will likely move forward, providing parties with an interest in these issues with the opportunity to potentially intervene or provide their views.

While the rehearing order may not be the end of the story, FERC-jurisdictional public utilities and their upstream owners should continue to be attuned going forward to the implications of the decisions and their related compliance requirements.

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*Scott Johnson is senior counsel, Stephen Hug is a partner partner and Ben Reiter is counsel at Akin Gump Strauss Hauer & Feld LLP.*

*Akin partner Emily Mallen and paralegal Angelica Gonzalez contributed to this article.*

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[1] *Evergy Kan. Cent., Inc.*, 181 FERC ¶ 61,044 (2022) (the "October 2022 Order"). <https://elibrary.ferc.gov/eLibrary/filedownload?fileid=DB2841C9-0832-C3A6-976C-83F6B0500000>.

[2] *Evergy Kan. Cent., Inc.*, 184 FERC ¶ 61,003 (2023) (the "Rehearing Order"). <https://elibrary.ferc.gov/eLibrary/filedownload?fileid=DF9A64CA-01E1-C659-9493-891D50500000>.

[3] See *id.* at P 5.

[4] See, e.g., 18 C.F.R. § 35.36(a)(9)(v) (2022).

[5] See, e.g., *id.* § 33.3(c)(12).

[6] Rehearing Order at P 5.

[7] October 22 Order at P 45.

[8] See Rehearing Order at P 6.

[9] *Id.* at P 20.

[10] *Id.* (footnote omitted).

[11] *Id.*

[12] *Id.* at P 26.

[13] Id.

[14] Id. at P 28.

[15] Id.

[16] Id. at P 22.

[17] See id. at P 27.

[18] Id. at P 29.

[19] Id. at P 29.

[20] TransAlta Energy Mktg. (U.S.) Inc., 181 FERC ¶ 61,055 (2022).

[21] Rehearing Order at P 30.

[22] Id.

[23] Id.

[24] Id.

[25] Id., Phillips Concurrence at P 1.

[26] Id.

[27] Id.

[28] Id.

[29] Id., Danly Dissent at P 1.