

FERC LAUNCHES INVESTIGATION OF PIPELINE RATES AND CLARIFIES WHAT TRIGGERS "CONTROL" CONCERNS IN PUBLIC UTILITY TRANSACTIONS

The Federal Energy Regulatory Commission (FERC) recently initiated a somewhat unprecedented investigation of the rates of three gas pipeline companies to determine if their existing rates are excessive. FERC also approved orders that clarify situations that trigger concern with "control" of public utilities in acquisitions and explained how some of the conditions it imposed address those concerns.

PIPELINE RATES INVESTIGATIONS

For the first time in twenty years, FERC initiated an investigation of gas pipeline rates under section 5 of the Natural Gas Act based on its review of information filed with the agency. The rates of three pipeline companies will be investigated to determine if they are over-recovering costs: Northern Natural Gas, Great Lakes Transmission, and Natural Gas Pipeline. Staff's review of 2008 Form 2 cost and revenue information estimates that these companies' earned return on equity (ROE) is 24.36%, 20.83% and 24.5%, respectively.

In determining which companies to investigate, staff used a "screen" of 12% ROE and excluded companies whose rates are determined by settlement, those scheduled to soon begin NGA section 4 rate cases, and those with rates under moratoria. The orders note that the investigation will determine what would constitute a just and reasonable return on equity for each company.

Staff's review also indicates that Northern Natural may be substantially over-recovering its cost of service for fuel and lost and unaccounted for gas.

Hearings were ordered and ALJ decisions are due in 47 weeks. Commissioner Spitzer issued concurrences in each of the orders, noting the "unprecedented step, post-Order No. 636, of initiating an NGA section 5 investigation" and that he would have preferred to have held the hearing in abeyance for a short period of time pending settlement discussions.

The FERC orders are available at:

<http://www.ferc.gov/whats-new/comm-meet/2009/111909/G-3.pdf>

<http://www.ferc.gov/whats-new/comm-meet/2009/111909/G-4.pdf>

<http://www.ferc.gov/whats-new/comm-meet/2009/111909/G-5.pdf>

"CONTROL" ISSUES: THE *HARBINGER* CASES

Under FERC policy, a transfer of 10% or more of the voting stock of a public utility, or a transfer that results in the acquiring entity holding 10% or more of

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the voting stock of a public utility, is presumed to constitute a change in control that requires FERC's approval. In November 2008, FERC issued three orders that authorized, subject to conditions, the acquisition of up to 20-25 % of the voting securities of various public utility companies by two funds managed by Harbinger Capital Partners. FERC has now issued orders that address rehearing and clarification of some of the conditions imposed.

In two of the November 2008 orders, FERC approved Harbinger's acquisition of up to 20% of Sunoco and up to 25% of Mirant, and imposed the following reporting conditions in each:

- Quarterly report of utility holdings by Harbinger
- Any Schedule 13G or 13D filings at the SEC pertaining to Sunoco or Mirant and annually report any changes to the information on those filings.
- Any comment or deficiency letter from the SEC that concerns 13G- or 13D-related compliance audits.

In the recent orders on these two cases, FERC clarified that the only comments or deficiency letters from SEC that must be filed are those that relate to Harbinger's investments in Sunoco or Mirant, and that all of the conditions apply only to the extent Harbinger holds 10% or more of Sunoco's or Mirant's outstanding voting securities. FERC refused to limit the SEC comment or deficiency letters that must be filed to those that are public, but said Harbinger could request confidential treatment of letters the SEC designated as confidential.

In the third case, FERC had approved Harbinger's acquisition of up to 20% of the Entegra Power Group but imposed a different set of conditions. Entegra owns generating plants in the Southeast U.S. Harbinger also owns 21% (with approval for up to 40%) of Calpine, which also owns generating plants in the Southeast. In November 2008, FERC found that Harbinger had the ability to control Calpine. With control of Calpine's generating plants attributed to Harbinger, Harbinger's acquisition of up to 20% of Entegra raised horizontal market power concerns in the Entergy market. To address these concerns, FERC imposed the following conditions to address to restrict Harbinger's control of Entegra:

(i) Harbinger will not seek to exercise control over Entegra;

(ii) Harbinger will not seek representation on Entegra's board of directors and will not hold any seat on Entegra's board of directors;

(iii) Harbinger will not become Entegra's largest shareholder;

(iv) Harbinger will not act in concert with one or more minority shareholders to achieve the ends described in (i) or (ii);

(v) Harbinger will continue to be able to represent that, notwithstanding its beneficial ownership of 20% of the shares of Entegra, it has not acquired the securities of Entegra with any purpose, or with the effect of, changing or influencing the control of the issuer, or in connection with or as a participant in any Proposed Transaction having that purpose or effect; and

(vi) Harbinger will not cast any votes or take any action that directly or indirectly dictates the price at which power is sold from Entegra's generating facilities, or directly or indirectly specifies how and when power generated by the facilities will be sold.

Harbinger sought rehearing, arguing that FERC erred in finding that it could control Calpine for market power purposes, and contested all of the conditions, except condition (vi), on the grounds that they are vague, unduly burdensome, unworkable and unrelated to the purposes FERC seeks to achieve. Harbinger also argued that the conditions are unnecessary because Harbinger does not have day-to-day control over Entegra's operations and sales of power. Harbinger also contested FERC's finding of horizontal market power concerns even if Harbinger controlled Calpine.

In rejecting Harbinger's arguments regarding control of Entegra, FERC said Harbinger's argument was based on a narrow reading of Commission precedent that focuses solely on control over day-to-day facility operations, sales activities and operational control. FERC said determining control is based on a review of the totality of the circumstances on a fact-specific basis. No single factor or factors necessarily results in control. Rather, the term "control" should be interpreted broadly to ensure there is no "jurisdictional void" that would allow relevant matters to "escape Commission oversight.

FERC explained that Harbinger's minority interest in Entegra could enable Harbinger to control Entegra and its generators, noting that Harbinger's Schedule 13D filings with the SEC indicate that Harbinger may take an active role with its investment in Calpine and that Harbinger's ownership of approximately 21%, with authorization to hold up to 40%, of Calpine's outstanding voting securities allows Harbinger to exert control over Calpine. In addition, FERC noted that Harbinger filed a Schedule 13D and taken an active role in operational strategy or had contact with boards of directors in other companies in which it holds only a minority shareholder interest. The order noted that Harbinger has not persuaded FERC that it will not take similar actions with respect to Calpine absent the conditions imposed, and that the relevant inquiry in the context of section 203 acquisitions is "whether voting rights could (but may not necessarily) result in the exercise of control over a public utility company."

In addressing another of Harbinger's arguments, FERC clarified that in addressing harm to energy consumers, it focuses on harms to energy customers that could result from control over public utilities, and not just control over jurisdictional facilities.

Turning to the conditions imposed, FERC explained that the general condition (i) is necessary to prevent actions by Harbinger to exercise control over Entegra in ways or by means not specifically contemplated by the other conditions. FERC gave a number of specific examples of such activities or actions relevant to control.

FERC clarified that the purpose of condition (ii) is to ensure that Harbinger may not control Entegra by controlling its board. Accordingly, no person who directly or indirectly receives compensation from Harbinger may be a member of Entegra's board, or take an action to become a member of Entegra's board. The term "seek representation" refers to actions taken by Harbinger with the purpose of acquiring or gaining a seat or seats on Entegra's board of directors (or equivalent governing body), and/or proposing the nomination of and/or nominating for election to the board of directors of Entegra any employee, officer, or shareholder of Harbinger, or proposing a director or slate of directors in opposition to the nominee or slate of nominees proposed by the management of Entegra.

In clarifying condition (iii), FERC recognized it pertains to matters beyond Harbinger's control because Harbinger could become Entegra's largest shareholder without acquiring additional shares of Entegra's securities but as a result of another shareholder selling its shares of Entegra's securities. Accordingly, FERC clarified that: (1) Harbinger is not required to sell its shares of Entegra securities if it becomes Entegra's largest shareholder as a result of the action of another shareholder but Harbinger is prohibited from acquiring

additional shares in Entegra that would result in Harbinger becoming Entegra's largest shareholder; and (2) Harbinger is prohibited from acting in concert with other shareholders to achieve largest shareholder status.

The FERC orders are available at:

<http://www.ferc.gov/whats-new/comm-meet/2009/111909/E-23.pdf>

<http://www.ferc.gov/whats-new/comm-meet/2009/111909/E-24.pdf>

<http://www.ferc.gov/whats-new/comm-meet/2009/111909/E-28.pdf>

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