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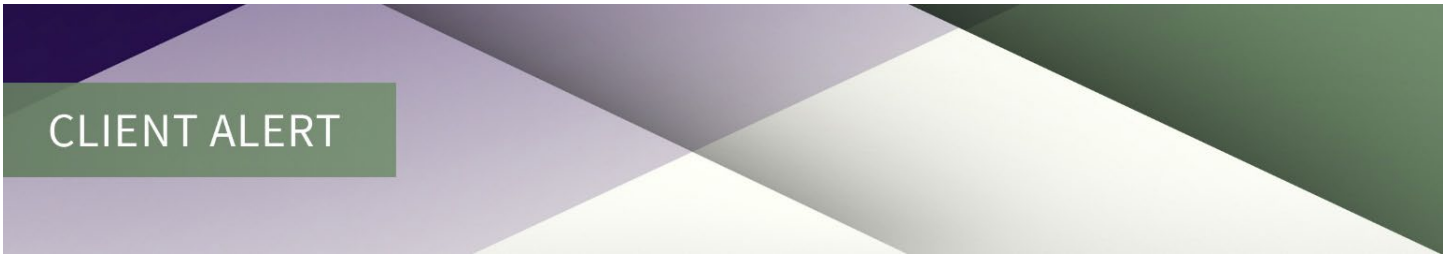

Recent FERC Decisions Have Widespread Regulatory Implications for Public Utilities and Investors

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The Federal Energy Regulatory Commission ("FERC" or the "Commission") recently issued two orders[1] expanding the scope of transactions involving public utilities and public utility holding companies that will require notification to FERC or FERC approval. In its October 20, 2022 Open Meeting, FERC issued decisions in *Evergy* and *TransAlta* finding that when an investor appoints non-independent directors to the board of a public utility or public utility holding company, the investor is deemed to have "control" of the public utility or public utility holding company even when the investor's interest in voting securities is under 10 percent. As a result, the Commission will treat the investor as an affiliate of the public utility or public utility holding company.

The Commission's findings in the *Evergy* and *TransAlta* orders, described in further detail below, will have widespread regulatory implications not only regarding the need to notify FERC or seek FERC approval for a broader set of transactions, but also for public utilities' market-based rate authority ("MBRA") filings, which must now disclose investors meeting the criteria set forth in the orders.

[1] *See Evergy Kans. Central, Inc.*, 181 FERC ¶ 61,044 (2022) (hereinafter *Evergy*) and *TransAlta Energy Mktg. (U.S.), Inc.*, 181 FERC ¶ 61,055 (2022) (hereinafter *TransAlta*).

Evergy Order

In *Evergy*, the Commission found that if an investor appoints non-independent directors, such as an investor's own officer, director, or similar appointee accountable to the investor, to the board of a public utility or public utility holding company, then the investor will be treated as an "affiliate" of that public utility or public utility holding company.[2]

In *Evergy*, Evergy Kansas Central, Inc., Evergy Missouri West, Inc., and Evergy Metro, Inc. ("Evergy Sellers"), each directly and wholly owned by Evergy, Inc. ("Evergy"), had filed a notice of change in status to the Commission explaining that The Vanguard Group, Inc. and its affiliates were the beneficial owners of over 12 percent of the publicly traded securities in Evergy. In response, Public Citizen, Inc. ("Public Citizen") and the Communication Workers of America intervened, arguing that Evergy Sellers had failed to notify the Commission of two other investors that had obtained control over Evergy: (1) the Elliot Management Corp. ("Elliot") and its affiliates, and (2) Bluescape Energy Partners, LLC ("Bluescape").[3] Public Citizen claimed that Elliot and Bluescape were upstream owners of Evergy Sellers that exert control over Evergy as activist hedge funds through the appointment of preferred board members, despite owning less than 10 percent of Evergy's shares.[4]

In response to data requests from the Commission, Evergy explained that in February 2020 it had entered into a nonpublic agreement with certain of Elliot's wholly owned affiliates that allowed Elliot to install two of its preferred board members on Evergy's board of directors.[5] Additionally, in February 2021 Evergy and Bluescape entered into an agreement wherein Bluescape purchased Evergy stock and allowed Bluescape to install two of its preferred board members to Evergy's board of directors.[6] Notably, one of the board members appointed to Evergy's board of directors was on Bluescape's own board as Executive Chairman.[7]

Evergy Sellers argued that neither Elliot nor Bluescape should be considered an affiliate of Evergy because both owned less than 10 percent of Evergy's stock, with Elliot owning only 4.597 percent and Bluescape owning only 1.1 percent. Accordingly, Evergy Sellers argued they could rely on the rebuttable presumption set forth in section 35.36(a)(9)(v) of the Commission's regulations, which states that "owning, controlling or holding with the power to vote, less than 10 percent of the outstanding voting securities of a specified company creates a rebuttable presumption of lack of control."[8] Evergy Sellers also cited to *Public Citizen, Inc. v. CenterPoint Energy, Inc.* for support, wherein the Commission had found this

2 *See Evergy* at P 45.

3 *See id.* at PP 9, 18.

4 *Id.* at P 18.

5 *See id.* at P 25.

6 *See id.* at PP 20, 26.

7 *Id.* at P 20.

8 *Id.* at P 31 (citing 18 C.F.R. § 35.36(a)(9)(v) (2021)).

presumption was not rebutted despite the existence of an agreement to appoint two new directors to CenterPoint Energy's board of directors at the direction of its investor.[9]

In *Evergy*, the Commission determined that while Elliot was not an affiliate of Evergy and Evergy Sellers, Bluescape was "individually an affiliate of Evergy and Evergy Sellers under section 35.36(a)(9)(v)" of the Commission's regulations.[10] The Commission explained that Elliot should not be considered an affiliate because it owns less than 10 percent of Evergy's outstanding voting securities, and its investment in and agreement with Evergy to appoint members to Evergy's board of directors is substantially similar to the investment in *CenterPoint.* Here, as in *CenterPoint*, the Commission concluded that there was not enough evidence to overcome the presumption of lack of control under section 35.36(a)(9)(v).[11]

However, the Commission concluded that Bluescape was in fact an affiliate of Evergy and Evergy Sellers. Though in many respects Bluescape's arrangement with Evergy was similar to Elliot's, it differed in one notable way: Evergy had appointed one of Bluescape's own directors, its Executive Chairman, to the Evergy board of directors.[12]

The Commission explained that board membership confers certain rights, privileges, and access to nonpublic information, and where an investor's own officer, director, or appointee is a member of the board, "the investor itself will have those rights, privileges, and access, and thus the authority to influence significant decisions involving the public utility or public utility holding company."[13] Accordingly, the Commission found that:

> where 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*.[14]

The Commission determined that as a result of the appointment of a non-independent director—the Executive Chairman of Bluescape—to Evergy's board, Bluescape was an affiliate of Evergy and Evergy Sellers.[15]

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9 *Id.* (citing 174 FERC ¶ 61,101 (2021)).

10 *Id.* at P 40.

11 *Id.* at P 42.

12 *Id.* at P 44.

13 *Id.* at P 45.

14 *Id.* (emphasis added).

15 *Id.*

The Commission directed Evergy Sellers to submit additional information in order for the Commission to process the notice of change in status. Moreover, Evergy Sellers must: amend any pending MBR filings that do not include the required applicable affiliate, update their asset appendix to include all of Bluescape's energy affiliates and their associated assets, update their horizontal and vertical market power analysis with their affiliates' generation and transmission assets, and update relevant information in the relational database.[16]

TransAlta Order

In a second order issued by the Commission at its Open Meeting on October 20, 2022, the Commission authorized Applicants' request for a change in control resulting from a transaction between TransAlta Corporation ("TransAlta") and Brookfield BRP Holdings ("Investor").[17] However, as explained in further detail below, the Commission noted that the request for approval was late-filed, and should have been sought earlier as a result of, among other factors, a change in control occurring due to the placement of non-independent directors on TransAlta's board.[18]

The proposed transaction at issue in *TransAlta* involved an agreement executed in 2019 wherein Investor (an affiliate of Brookfield Asset Management or "BAM") purchased debt securities in TransAlta with an option to convert into an equity interest in certain of TransAlta's hydroelectric assets. Further, as part of the agreement, Investor nominated two directors to TransAlta's board of directors. As part of the purchase agreement, TransAlta and Investor executed a related "Standstill Agreement" that prohibited Investor and its affiliates (including Shareholders) from exercising certain activities (e.g., effecting any restructurings or material dispositions of assets) for a period of approximately three years, ending around May 2022. The Standstill Agreement also limited the voting rights associated with the shares in TransAlta owned by Investor and its affiliates, such that they would have no real discretion to vote any common shares.[19]

In March of 2020, the Shareholders increased their aggregate holdings to 10.1 percent of the common shares of TransAlta.[20] Applicants did not seek authorization for a change in control in March 2020, despite owning more than 10 percent of common shares. Applicants argued that the acquisition by Shareholders of more than 10 percent of TransAlta's common shares in March 2020 did not result in a change in control, and so did not require Commission approval, because the restrictions in the Standstill Agreement ensured that Shareholders and other BAM affiliates could

16 *Id.* at P 48.

17 *TransAlta* at P 1. Applicants ("Applicants") included: (1) TransAlta Energy Marketing (U.S.) Inc., TransAlta Energy Marketing Corp., TransAlta Centralia Generation LLC, TransAlta Wyoming Wind LLC, Lakeswind Power Partners, LLC, and Big Level Wind LLC (the "TransAlta Companies"), which are all wholly owned subsidiaries of TransAlta; and (2) Eagle Canada Common Holdings LP and BIF IV Eagle NR Carry LP ("Shareholders"), which were formed to own common shares of TransAlta, and for which the voting interests are held by investment vehicles managed and controlled by a general partner that is a wholly owned indirect subsidiary of Brookfield Asset Management Inc. *Id.* at PP 3, 12.

18 *See id.* at P 29.

19 *See id.* at PP 18, 19.

20 *Id.* at P 20.

not exercise control.[21] However, in the instant proceeding, Applicants now sought authorization from the Commission for a change in control, explaining in their application that the upcoming termination of the Standstill Agreement would result in a change in control over the TransAlta Companies if Shareholders, and other BAM affiliates, owned 10 percent or more of the common shares (as they do at present).[22]

The Commission disagreed, finding that under both sections 203(a)(1)(A) and 203(a)(2) of the Federal Power Act ("FPA") prior approval had been required for the March 2020 acquisition by Shareholders of an aggregate 10.1 percent of TransAlta's common shares.[23] To support their argument that the initial March 2020 investment did not result in a change in control, Applicants cited to *Cascade Investment, L.L.C.*, where the Commission found that a proposed transaction that included a standstill agreement similar to the Standstill Agreement here did not result in the purchaser's ability to assert control over the public utility despite the purchaser holding more than 10 percent of outstanding voting securities.[24] However, in *TransAlta*, the Commission distinguished *Cascade* in three important ways:

- First, the application in *Cascade* was filed prior to the purchaser (Cascade) obtaining more than 10 percent of the voting securities in the public utility holding company (Otter Tail Corporation).[25]

- Second, unlike in *Cascade*, here Investor and its affiliates had an agreement with TransAlta to nominate two directors to TransAlta's board and, subsequently, placed two executives from BAM affiliates on the board of directors. The Commission cited to *Evergy*, noting that directors appointed by an investor have the ability to influence significant decisions involving a public utility or public utility holding company. Accordingly, "the appointment of two board members that are not independent from Investor and its affiliates to TransAlta's Board of Directors *does constitute a change of control*."[26] The Commission concluded that, "[g]oing forward, *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 [FPA] section 203(a)(1)(A)*."[27]

- Third, unlike the standstill agreement in *Cascade*, the Standstill Agreement here does not contain explicit prohibitions on Shareholders' ability to influence day-to-day activities of TransAlta.[28]

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21 *Id.* at P 23.

22 *Id.* at P 20.

23 *Id.* at P 24.

24 *Id.* at P 26 (citing 129 FERC ¶ 61,011 (2009)).

25 *Id.* at P 27.

26 *Id* at PP 28–29.

27 *Id.* at P 29 (emphasis added).

28 *Id.* at P 30.

The Commission concluded that the Standstill Agreement was not sufficient to prevent a change in control as a result of the Shareholder's purchase of over 10 percent of TransAlta's common shares in March 2020. However, though Applicants failed to file a timely request for the disposition of a public utility and acquisition of securities, the Commission did not take any further action and instead evaluated the proposed transaction on a prospective basis, ultimately approving the proposed transaction.[29]

Implications of the *Evergy* and *TransAlta* Orders

The Commission's decisions in *Evergy* and *TransAlta* have significant implications for investors, public utilities, and public utility holding companies going forward.[30] The concept of control is relevant under both sections 203 and 205 of the FPA. Section 203 applies to mergers and acquisitions. Section 205 governs wholesale rates and MBRA.

First, under section 203, parties contemplating arrangements similar to those described in *Evergy* and *TransAlta*, wherein non-independent directors will be appointed by an investor to the board of a public utility or public utility holding company, must now seek prior Commission approval if the transaction is in excess of $10,000,000, even if the investor will ultimately acquire less than 10 percent of the outstanding voting securities. Bluescape, for example, acquired only 1.1 percent of Evergy's stock.

Second, under section 205, public utilities must treat these investors as affiliates, which will complicate a public utility's MBRA filings. The public utility may have to make a number of related filings, including (1) a change in status filing, (2) update its asset appendix to include the investor's affiliates and their associated assets, (3) update its horizontal and vertical market power analysis with the affiliates' generation and transmission assets, and inputs to electric power production, and (4) identify their upstream owners, update the Ultimate Upstream Affiliate information in the relational database, and include the updated asset appendix serial number in the transmittal letter.[31] Moreover, to the extent the investor itself has MBRA, because the public utility is now deemed to be an affiliate, it may have its own obligations to make MBRA-related filings.

As a practical matter, one consequence of *Evergy* and *TransAlta* may be that investors acquiring less than 10 percent of the voting securities should be circumspect about seeking the right to appoint non-independent board members. Appointing independent board members may suffice, without risking additional regulatory burdens. In addition, although the Commission noted that its holdings were prospective in nature,[32] the question is what happens under section 205 for

29 *Id.* at P 33.

30 Notably, the Commission clarified that its finding in the orders are prospective. *See id.* at P 29 & n.36.

31 *Evergy* at P 48.

32 *TransAlta* at P 29 & n.36.

entities with MBRA that have investors who appointed non-independent board members. Under *Evergy*, it appears that such entities will need to begin learning more about their investors and making the appropriate MBRA filings.

Finally, *Evergy* and *TransAlta* are notable because they are the latest orders to signal Commission concern over when control arises under sections 203 and 205 of the FPA and when an investor should be deemed to be an affiliate of a public utility. A unanimous Commission issued both orders. Investors should expect to see more activity in this space, and there will likely be further Commission scrutiny, as the Commission parses a variety of fact patterns to determine whether an investor gained a controlling interest in an entity. The concept of control is important in other regulatory contexts, and it will be interesting to see whether any other agency follows the Commission's approach.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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