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Energy Policy Act Of 2005:
Implications For The Electric Utility Industry

July 29, 2005

As you are likely aware, on July 29, 2005, Congress passed the Energy Policy Act of 2005 (the "Energy Act"), which the President is expected to sign into law. The Energy Act will make a number of significant changes to the regulation of electric utilities. The following changes are likely to be of particular interest to investors in the electric utility industry:

- **Repeal of PUHCA.** The Public Utility Holding Company Act of 1935 (PUHCA), one of the most formidable barriers to investments in utilities, will be repealed effective six months after the enactment of the Energy Act. The removal of PUHCA's broad restrictions is expected to encourage increased industry consolidation, as well as increased investment by non-utilities.

- **Expanded FERC Authority**. The jurisdiction of the Federal Energy Regulatory Commission (FERC) will be expanded to cover a limited number of holding company activities. In particular, FERC approval will be required for an electric utility holding company to acquire securities of, or directly or indirectly merge with, another electric utility or electric utility holding company. FERC also will have jurisdiction to review costs charged to electric utilities under inter-affiliate sales and service agreements, and FERC and state regulators will be able to review the books and records of companies in any electric or gas utility holding company system. Although the effect of these changes will be subject to FERC rulemaking and further interpretation, it is possible that FERC will move to fill in the gap left by the repeal of PUHCA through renewed regulation of utility holding companies, including possible regulation of holding companies currently exempt from most PUHCA regulations (such as owners of exempt wholesale generators).

- **Incentives to Transmission Companies.** FERC will be required to adopt incentives for transmission companies, including performance-based rates, assured recovery of costs to comply with reliability requirements, and an authorized return on equity sufficient to attract new investment. In addition, accelerated depreciation will be available for certain new transmission lines. These incentives should make transmission investment more attractive.

- **Mandatory Transmission Reliability Requirements.** FERC will appoint and oversee an "electric reliability organization" (ERO) to establish and enforce mandatory reliability requirements on owners, operators and users of the interstate electric transmission system. These requirements will replace the current voluntary rules, and likely will result in increased investment in transmission facilities.

- **Removal of PURPA Ownership Limits.** The Energy Act will repeal the ownership requirements relating to "qualifying facilities" (QFs) under the Public Utility Regulatory Policies Act of 1978 (PURPA), which limit ownership of QFs by utilities and utility holding companies to 50%. This repeal may spur sales of interests in existing QFs.

- **Incentives for Nuclear, Renewable Energy and Clean Coal Projects.** Government-funded "risk insurance" will be created to cover certain permitting and construction delays for the first six new nuclear power reactors. In addition, $1.25 billion will be made available to fund construction of the "next generation power plant" to produce hydrogen fuel from nuclear energy. Tax credits for renewable energy facilities will be expanded and extended, and loan guarantees will be available for certain renewable energy technologies. Tax credits and loan guarantees also will be available for the development of certain clean coal and emissions technologies.

A more detailed summary of the provisions of the Energy Act affecting the electric utility industry is attached. We note that this summary provides only an outline of limited portions of the Energy Act, and does not address details relevant to all industry participants and investors. In addition, many of the provisions of the Energy Act must be implemented or otherwise interpreted in future FERC orders, rules and regulations that will help shape the effect of the Energy Act.

Please feel free to contact Mark Tibberts (at (212) 455- 2627 or mtibberts@stblaw.com) or Brian Chisling (at (212) 455-3075 or bchisling@stblaw.com) with any questions or for assistance. We look forward to providing you with a more detailed explanation of relevant provisions of the Energy Act at your convenience.

Summary Of Electricity Provisions Of The Energy Policy Act Of 2005

The following is a brief summary of the portions of the Energy Policy Act of 2005 (the "Energy Act") relating to the electric utility industry.

1. **Repeal of the Public Utility Holding Company Act of 1935 (PUHCA)**

   - PUHCA will be repealed, effective 6 months from the effective date of the Energy Act.

2. **Expanded FERC Authority**

   - Upon the repeal of PUHCA, the authority of the Federal Energy Regulatory Commission (FERC) will be expanded to cover a limited number of holding company activities. In particular, FERC approval will be required for a holding company with an electric utility subsidiary (which includes any entity that sells or transmits electricity) to acquire any securities with a value in excess of $10 million of, or to directly or indirectly merge with, another electric utility or electric utility holding company with a value in excess of $10 million.

   - FERC also will take over authority to review and authorize costs charged by service companies to electric utilities in the same holding company system. Exemptions from this requirement will be available to holding companies with electric utility operations confined substantially to a single State and for other transactions that FERC finds not relevant to electric utility rates.

   - FERC and state regulators will be granted access to the books and records of all companies within any utility holding company system, similar to the access granted to the SEC under PUHCA. Exemptions from certain of these access requirements will be available, including an exemption from FERC access for holding companies that limit their utility ownership to "qualifying facilities" (as defined below) or "exempt wholesale generators" or "foreign utility companies" (as those terms were defined under PUHCA).

   - FERC's merger review authority will be expanded to specifically include review of the purchase or lease of electric generation facilities, although FERC currently exercises that authority through its regulation of transfers of wholesale power agreements and transmission facilities (including substations and generator interconnections) commonly held by electric generation companies.

- FERC will retain authority over the sale or lease of jurisdictional facilities (which include transmission facilities and wholesale power contracts), as well as the merger of electric utilities and the acquisition of the securities of an electric utility by another electric utility. However, only transactions involving facilities or securities valued in excess of $10 million will be subject to FERC approval, as opposed to the current threshold of $50,000.

- FERC will be required to adopt rules to expedite approval of transactions, with all approvals to be issued within 180 days unless FERC finds good cause for further delay.

3. Incentives to Transmission Companies

- FERC will be required to grant incentives to transmission owners to encourage reliability and promote investment. Incentives will include performance-based rates, guaranteed recovery of "prudently incurred" costs related to compliance with mandatory reliability standards, and an authorized return on equity sufficient to attract new investment in transmission facilities. Additional incentives may be adopted for utilities that join regional transmission organizations (RTOs).

- Transmission owners will be permitted to submit "participant funding" plans to FERC, which would require interconnecting generation companies, such as independent power projects, to pay some portion of the necessary transmission upgrades and interconnection facilities. This represents a change from FERC's current policy of requiring the transmission owner to include those costs in system-wide rates for all customers.

- FERC will be required to encourage advanced transmission technologies such as underground cables and advanced conductor technology.

- The depreciation period for electric transmission lines rated at or above 69 kilovolts and first put in use after April 11, 2005 will be reduced from 20 years to 15 years for tax purposes.

- Current tax provisions permit capital gains from the sale of electric transmission companies or facilities to an "independent transmission company" to be recognized ratably over an 8-year period if the proceeds of such sale are used to purchase electric or gas utility properties. This treatment will be extended for an additional year to cover transactions consummated prior to January 1, 2008.

- A five-year carryback of net operating losses will be allowed for up to 20% of capital expenditures for electric transmission facilities.

4. **Mandatory Electric Reliability Standards**

- FERC will appoint and oversee an "electric reliability organization" (ERO) to establish and enforce mandatory reliability requirements on owners, operators and users of the interstate electric transmission system. FERC likely will select the North American Electric Reliability Council (NERC), the industry's existing voluntary organization, as the applicable ERO. The ERO will be permitted to delegate its authority to regional organizations, such as the existing regions of NERC.

- Unlike current voluntary standards, compliance with the new reliability standards (which generally govern the design and operation of transmission facilities) will be mandatory for all owners, operators and users of the transmission system, and the ERO will have authority to impose penalties for non-compliance.

- Notwithstanding these mandatory standards, transmission companies cannot be required to construct new facilities or enlarge existing facilities to comply with any reliability requirements.

5. **Federal Siting Authority for Transmission Facilities**

- FERC will be permitted to designate a geographic area as a "national interest electric transmission corridor" if it determines that the construction of transmission facilities within that area would serve the national interest by eliminating transmission capacity constraints or congestion.

- FERC will be able to override state authorities and issue a permit to construct transmission facilities in any "national interest electric transmission corridor," including granting eminent domain rights to acquire necessary rights of way, if state authorities withhold approval for the siting of those facilities for more than one year. This is a significant change from existing law, which permits states to exercise sole authority over transmission siting.

6. **Selective Repeal of the Public Utility Regulatory Policies Act of 1978 (PURPA)**

- Mandatory power purchase requirements under PURPA relating to the output of cogeneration and small power production facilities ("qualifying facilities" or "QFs") will be repealed as wholesale markets develop. However, existing contracts will not be affected by the repeal.

- The mandatory obligation of a utility to sell power to a QF will be repealed if the QF has the ability to purchase power from a competing seller and state law does not impose an obligation to serve QFs.

- The current ownership requirements relating to QFs (which limit ownership by utilities and holding companies to 50%) will be repealed.

- Certain requirements for new cogeneration facilities (particularly concerning the use of the thermal output) will be tightened.

7. Nuclear Energy Provisions

- Indemnification of nuclear licensees under the Price Anderson Act will be extended through December 31, 2025, subject to specified increases in the applicable liability limits.

- "Advanced nuclear power facilities" will be granted tax credits and will be eligible for federal loan guarantees.

- Government-funded "risk insurance" will be created to cover certain permitting and construction delays for the first six new nuclear power reactors.

- "Next Generation Power Plant Project" will authorize $1.25 billion for the design and construction of nuclear-hydrogen cogeneration projects at the Idaho National Laboratory and at existing reactors to explore production of hydrogen fuel from nuclear energy.

8. Renewable Energy Production Incentive

- Tax credits for electricity generated from renewable sources, including wind, biomass and solar technologies, will be extended and expanded and loan guarantees will be made available for certain renewable energy technologies.

- The Federal Government will be required, to the extent that it is economically feasible and technically practicable, to obtain at least 3% of its electricity requirements from renewable energy by 2007, and at least 7.5% by 2013.

9. Clean Coal and Pollution Control Technology Incentives

- Tax credits and loan guarantees will be available for the development of certain clean coal and pollution control technologies.

- Owners of certain electric generation facilities will be allowed to amortize the costs of new pollution control facilities over 7 years (as opposed to current 5-year amortization).

- A five-year carryback of net operating losses will be allowed for up to 20% of capital expenditures for pollution control facilities.

10. Increased Market Transparency and Enforcement Authority

- FERC will be required to establish a system for public access to wholesale energy market information (including prices), except for disclosures that would be detrimental to the efficient market or would jeopardize security.

- Activities associated with alleged market manipulation will be explicitly prohibited, including the filing of false information or employing a deceptive device in contravention of FERC's rules and regulations.

- FERC will have increased authority to impose criminal and civil penalties for intentional violations of the Federal Power Act, including fines of up to $1 million for each day a violation continues (up from $5,000) and imprisonment for up to 5 years (up from 2 years).

11. Native Load Service Protection

- Electric utilities will be entitled to use firm transmission rights (including existing rights) to serve their native load customers. FERC will facilitate the planning and expansion of transmission facilities to meet the reasonable needs of native load customers and to enable utilities to secure firm transmission rights to serve those customers.

12. Refund Authority

- FERC may set a refund date as of the date of any complaint, as opposed to 60-days after such complaint under current rules.

- FERC may order retroactive refunds for violations of FERC-approved tariffs or market rules in connection with "short-term" wholesale sales, defined as sales for a period of 31 days or less (excluding monthly contracts that automatically renew) in an organized market with rates established by FERC-tariff (as opposed to bi-lateral contract).

13. Consumer Privacy and Unfair Trade Practices

- The FTC may adopt rules protecting the disclosure of customer information, prohibiting unauthorized changes in service providers (called "slamming") and prohibiting the sale of unauthorized goods or services in addition to utility services (called "cramming").