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Accounting for FERC's Ability to Revoke MBR Authority in Project Financing Agreements

On June 9, the Federal Energy Regulatory Commission (“FERC”) issued an order revoking authority to charge negotiated “market-based” rates (“MBR Authority”) previously granted to several subsidiaries of Berkshire Hathaway Energy Company (the “Berkshire MBR Sellers”) for wholesale sales of electricity in four balancing authority areas in the western US¹ This order serves as a reminder of the possibility that FERC may revoke MBR Authority and the need to address this when structuring financing for entities relying on MBR Authority.

MBR Authority

FERC grants MBR Authority for wholesale sales of electric energy, capacity and ancillary services by sellers that can demonstrate in an application filed with FERC that they and their affiliates lack, or have adequately mitigated, horizontal and vertical market power in the relevant market(s). FERC grants MBR Authority under Section 205 of the Federal Power Act (“FPA”) which requires, among other things, that wholesale sales of electricity in interstate commerce be made only at rates approved by FERC and that rates for wholesale sales of electricity in interstate commerce be “just and reasonable.” Since the late 1990’s, FERC policy provides that, where there is an absence of market power, negotiated, “market-based” rates may be deemed “just and reasonable.”

Upon receipt of MBR Authority from FERC, a seller has on file an MBR tariff under which it may enter into power purchase agreements with purchasers that include a negotiated rate. Among other things, MBR tariffs include provisions (1) requiring compliance with FERC’s regulations, (2) identifying any limitations on the MBR Authority (including identifying markets where the MBR Authority does not apply), and (3) any exemptions from or waivers of FERC’s regulations in FERC’s order granting MBR Authority. FERC typically grants certain holders of MBR Authority, such as power marketers, independent power producers or affiliated power producers, waivers of certain filing, accounting and reporting requirements under FERC’s regulations, and also grants blanket authorization to issue securities and assume liabilities under Section 204 of the FPA.

Holders of MBR Authority must file electric quarterly reports of transactions under their MBR tariffs, Notices of Change in Status when the facts or circumstances FERC relied on in granting a seller MBR Authority change (including, for example, the seller’s acquisition of transmission or of generation over 100 megawatts or the seller’s new affiliation with any entity owning or controlling such assets), and for certain holders of MBR Authority, periodic updates of market power analyses.

FERC’s MBR Authority Revocation Order

In January 2014, the Berkshire MBR Sellers filed a Notice of Change in Status with FERC reporting the consummation of a merger under which Nevada Power Company and Sierra Pacific Power Company became wholly-owned subsidiaries of Berkshire Hathaway, and providing market analyses to demonstrate that this new

affiliation of the Berkshire MBR Sellers did not result in the ability to exercise market power in the markets where the Berkshire MBR Sellers sell electricity.

In response to the filing, FERC issued an order in December 2014 finding that the Berkshire MBR Sellers had failed to rebut a presumption of market power and instituted a proceeding under Section 206 of the FPA to determine whether the Berkshire MBR Sellers and their affiliates' MBR Authority in the PacifiCorp—East ("PACE"), PacifiCorp—West ("PACW"), Idaho Power Company ("IPC"), and NorthWestern Corporation ("NWC") balancing authority areas remains just and reasonable.²

Among other things, Section 206 of the FPA authorizes FERC, "after a hearing held upon its own motion," to find that an existing rate is unjust, unreasonable, unduly discriminatory or preferential, and to determine the just and reasonable rate to be charged on a prospective basis. Section 206 of the FPA also allows FERC to establish a "refund effective date" with respect to such unjust and unreasonable rates and to require refunds with interest for a 15-month period, as measured by the difference between the existing rate and the FERC—established just and reasonable rate.

In the June 9 Order, based on its findings that the Berkshire MBR Sellers had not provided information sufficient to rebut the presumption of market power in the PACE, PACW, IPC and NWC balancing authority areas, and that the continuation of the Berkshire MBR Sellers' MBR Authority in these four balancing authority areas is not just and reasonable, FERC revoked their MBR Authority for sales of electricity in the four balancing authority areas. Under the June 9 Order, the Berkshire MBR Sellers may continue to sell at market—based rates in the California Independent System Operator ("CAISO") balancing authority area.

FERC ordered the Berkshire MBR Sellers to (1) file revised MBR tariffs limiting sales to areas outside of the PACE, PACW, IPC and NWC balancing authority areas, to be effective during the refund period (January 9, 2015 to April 9, 2016) and prospectively from June 9, 2016 (the date of FERC's order); (2) file separate tariffs to provide for cost—based rates to be effective during the refund period and prospectively from June 9, 2016 (the date of FERC's order), and (3) provide refunds base on FERC— established default cost—based rates. The June 9 Order does not preclude the Berkshire MBR Sellers from filing an application requesting MBR Authority prospectively for the PACE, PACW, IPC and NWC balancing authority areas.

In a footnote, FERC stated that the revocation "does not apply to, or affect, existing market—based rate contracts" that were entered into prior to January 9, 2015.³ The conclusion that may be drawn from this statement is that refunds are due to purchasers under contracts for sales within the PACE, PACW, IPC and NWC balancing authority areas that were entered into from January 9, 2015 through April 9, 2016, and that contracts entered into after June 9, 2016, must be made under the cost—based rate tariffs, which will have to be approved by FERC.

The June 9 Order also indicates that certain waivers and authorizations previously granted in connection with the Berkshire MBR Sellers' MBR Authority, such as with respect to issuance of securities and assumption of liabilities under Section 204 of the FPA "may no longer be applicable."

The June 9 Order raises issues whether FERC's revising the rates set out in contracts entered into from January 9, 2015 through April 9, 2016 between the Berkshire MBR Sellers and purchasers is inconsistent with the long—standing "Mobile—Sierra doctrine," which requires FERC to presume that a rate set out in a freely negotiated

wholesale energy contract is “just and reasonable,” unless it concludes that the contract harms the public interest,⁴ and whether the June 9 Order satisfies the requirements of Section 206 of the FPA. The Berkshire MBR Sellers have until July 11 to seek rehearing of the June 9 Order.

Accounting for Potential Revocation of MBR Authority in Project Financing Documents

The June 9 Order is not the first time that FERC has revoked a seller’s MBR Authority.⁵ The June 9 Order may serve as a reminder to parties to project financing transactions involving a project company with MBR Authority that financing documents should account for the possibility that MBR Authority may be revoked. Examples of such provisions in loan/financing documents include:

- where the project company already has received MBR Authority, representations that the project company has MBR Authority, such MBR Authority is in full force and effect as of the date of the execution of the agreement and as of subsequent funding or draw dates, and the MBR Authority is not subject to condition or limitation that could result in a material adverse effect;
- where the project is not yet at a stage where the project company requires MBR Authority, covenants that the project company will obtain MBR Authority as required by applicable law and will maintain it throughout the term of the agreement;
- events of default for loss of MBR Authority or subsequent modification or condition of MBR Authority which could reasonably be expected to have a material adverse effect; and
- an event of default for loss of MBR Authority unless the project company either regains MBR Authority or obtains FERC approval of cost—based rates within a specified period of time, and such cost—based rates do not have a material adverse effect.

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1. *Nevada Power Company, et al.*, “Order on Response to Show Cause Order,” 155 FERC ¶ 61,249 (2016)(the “June 9 Order”).
2. *Nevada Power Company, et al.*, “Order on Notice of Change in Status, Instituting Section 206 Proceeding and Establishing Refund Effective Date,” 149 FERC ¶ 61,219 (2014).
3. June 9 Order at 3, n.6.
4. *Morgan Stanley Capital Group Inc., v. Public Utility District No. 1 of Snohomish County, Washington*, 554 US 527 (2008).
5. See, e.g., *Duke Power, et al.*, “Order on Market—Based Rates,” 111 FERC ¶ 61,506 (2005).

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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