

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

James S. Pignatelli

Docket No. ID-3938-001

ORDER DENYING AUTHORIZATION TO HOLD INTERLOCKING POSITIONS

(Issued June 28, 2005)

1. On June 8, 2005, ISO New England, Inc. (ISO-NE), on behalf of James S. Pignatelli, filed an application pursuant to section 305(b) of the Federal Power Act (FPA)¹ for Commission authorization to hold the interlocking positions of Director of the ISO-NE and Chairman, President and Chief Executive Officer of Tucson Electric Power Company (Tucson Electric) and Director and President of UNS Electric, Inc. (UNS Electric).² As discussed below, the Commission will deny the application. Doing so in this instance will promote the underlying purpose of section 305(b) by responding to the potential for adverse effects on public or private interests.

The Application

2. ISO-NE has been authorized to be a Regional Transmission Organization (RTO) for New England.³ ISO-NE administers the energy markets and operates the bulk power system in New England pursuant to the ISO New England Inc.'s Transmission, Markets

¹ 16 U.S.C. § 825d(b) (2000).

² Mr. Pignatelli previously received automatic authorization for the interlocks among Tucson Electric and UNS Electric (sometimes collectively referred to as Tucson Electric) because the two entities are wholly-owned subsidiaries of UniSource Energy Corporation (UniSource). See James S. Pignatelli, *et al.*, Docket No. ID-3938-000 (filed September 9, 2004).

³ *ISO New England, Inc.*, 106 FERC ¶ 61,280, *order on settlement, compliance filings and reh'g*, 109 FERC ¶ 61,147 (2004), *order authorizing RTO operations*, 110 FERC ¶ 61,111, *order denying reh'g, accepting compliance filings and tariff revisions*, 110 FERC ¶ 61,335 (2005).

and Services Tariff and the Transmission Operating Agreement with the New England transmission owners. It also has the responsibility to protect the short and long-term reliability of the control area. Operating jurisdictional transmission facilities as an RTO makes an entity a public utility.⁴

3. UniSource is a holding company that has no significant operations of its own and operates through subsidiaries, each of which is a separate legal entity with its own assets and liabilities.⁵ UniSource owns substantially all of the outstanding common stock of Tucson Electric, and all of the outstanding common stock of UniSource Energy Services, Inc., Millennium Energy Holdings, Inc. and UniSource Energy Development Company.

4. Tucson Electric is an investor-owned public utility engaged in the business of generating, transmitting and distributing electricity to retail and wholesale customers. It also sells electricity at wholesale to other utilities and power marketing entities in the western United States.

5. On August 11, 2003, UniSource Energy purchased Arizona gas and electric system assets from Citizens Communications Company. UniSource Energy Services, Inc. was formed to hold the common stock of UNS Electric and UNS Gas, Inc., which operate these electric and gas system assets, respectively. UNS Electric is an electric transmission and distribution company serving retail customers in Arizona. UNS Electric also owns and operates the Valencia Power Plant in Arizona. Mr. Pignatelli has served as Director and President of UNS Electric and UNS Gas, Inc. since July 6, 1998.

6. Mr. Pignatelli was selected to be a Director of ISO-NE by the Nominating Committee of the ISO-NE.⁶ The ISO-NE Nominating Committee is now preparing to submit the slate, which includes Mr. Pignatelli, to the ISO-NE Board for election on

⁴ See 16 U.S.C. § 824(e) (2000) (which defines a public utility as “any person who owns or operates” jurisdictional facilities). See also *PJM Interconnection*, 103 FERC ¶ 61,170 at P 17 (2003); *PJM Interconnection*, 105 FERC ¶ 61,294 at P 31 (2003).

⁵ According to ISO-NE, UniSource Energy is not a public utility for purposes of section 305(b) and Mr. Pignatelli’s positions with it do not require Commission approval. ISO-NE cites, e.g., *Norman Barker, Jr.*, 53 FERC ¶ 61,223 at 61,932 n.48 (1990).

⁶ The nomination and election process for the ISO-NE Directors is governed by section 13 of the Participants Agreement. The Participants Agreement among ISO-NE, the NEPOOL Participants and any Individual Participants describes the desired composition of ISO-NE’s Board of Directors, as well as the Commission-approved process for nominating, endorsing and electing Directors with the involvement of market participants, transmission customers, state regulators and transmission providers.

September 15, 2005. ISO-NE requests expedited consideration of this application so that the impending vacancy on the ISO-NE Board of Directors can be filled upon expiration of the current Director's term. Consequently, ISO-NE requests a ruling from the Commission as soon as possible, but preferably no later than mid-July, in order to give the Board of Directors and stakeholders sufficient time to identify another candidate if Mr. Pignatelli's application is denied.

7. According to ISO-NE, this application threatens neither public nor private interests that Congress sought to protect through section 305(b). It notes that ISO-NE is a not-for-profit RTO located thousands of miles away from Tucson Electric. Also, it states that the ISO-NE Code of Conduct provides effective protection against even the perception of the concerns that section 305(b) is designed to address. In addition, ISO-NE provides that, by participating in the nomination and election process, the customers of ISO-NE have endorsed Mr. Pignatelli's election as an ISO-NE Director. Also, it adds that a representative of the New England Conference of Public Utilities Commissioners served on the Nominating Committee that selected Mr. Pignatelli. Finally, ISO-NE argues that approving Mr. Pignatelli's application will serve the public interest because Mr. Pignatelli will provide ISO-NE with operating and management experience in the electric utility industry.

8. Notice of Mr. Pignatelli's application was published in the *Federal Register*,⁷ with interventions and protests due on or before June 22, 2005. None was filed.

Discussion

9. Section 305(b) of the Federal Power Act prohibits persons from concurrently holding positions as officer or director of a public utility and positions as officer or director of, among other companies, another public utility, unless the Commission authorizes the interlock upon a finding that neither public nor private interests will be adversely affected.

10. Upon review of Mr. Pignatelli's application, we cannot make such a finding and we will deny authorization.

11. In 1981, the Court of Appeals for the District of Columbia Circuit addressed section 305(b) and stated:

It will suffice to note that during the passage of the Public Utility Holding Company Act in 1935, Congress exhibited a relentless interest in, bordering on an obsession with, the evils of concentration of economic power in the hands of a few individuals. It recognized

⁷ 70 Fed. Reg. 35,420 (2005).

that the conflicts of interest stemming from the presence of the same few persons on boards of companies with intersecting interests generated subtle and difficult-to-prove failures in the arm's length bargaining process. Its overriding concern with eliminating the source of "evils result[ing] from an absence of arm's length bargaining" was expressed in the preamble to the Act which Congress explicitly referenced for guidance in interpreting all other provisions of the Act. The legislative history makes clear too that Congress intended the Commission to have the broadest authority to achieve its objective of ameliorating the perceived evils of interlocking corporate relationships in the utilities field.⁸ ... The Act is prophylactic in nature; it allows the Commission to prevent, not merely remedy, abuses due to conflicts of interest. Thus, the Commission need not approve all applications for interlocks simply on the assurance, even if that assurance is backed by favorable history, that no such abuses will occur.⁹

12. The Commission, in turn, as early as 1940, explained that among the

"evils sought to be eliminated by the enactment of section 305(b)" were: (1) control over a large number and geographically widespread public utilities by a small group of individuals with perhaps a minimum of investment; (2) the evasion by means of common control of competition resulting in higher costs and poorer services to consumers; (3) the lack of arm's length dealings between public utilities and organizations furnishing financial services or electrical equipment; (4) the employment of dummy directors designated solely for the purpose of executing the orders of those in control, and nominal directors who give little time and attention to the affairs of the companies; and (5) violations of laws, ethics, and good business practices by those holding such interlocking positions whereby such relationship is employed for their own benefit or profit, or for the benefit or profit of any other person or persons and to the detriment of the companies, their security holders or the public interest.¹⁰

⁸ *Hatch v. FERC*, 654 F.2d 825, 832 n.14 (D.C. Cir. 1981) (*Hatch*).

⁹ *Id.* at 831-32.

¹⁰ *John Edward Aldred*, 2 FPC 247, 261 (1940) (*Aldred*); *Lelan F. Sillin, Jr.*, 33 FPC 1006, 1006-07 (1965); *Willis C. Fitkin*, 7 FERC ¶ 61,291 at 61,626-27 (1979); *George Fabian Brewer*, 15 FERC ¶ 61,020 at 61,036 (1981).

13. Although section 305(b) is prophylactic in nature and prohibits the holding of these interlocks *ab initio*, Congress allowed the Commission latitude to permit otherwise proscribed interlocks upon a showing that neither public nor private interests will be adversely affected. Thus, the Commission's regulations authorize interlocks between two or more public utilities, upon an informational filing, if the public utilities are part of the same public utility holding company system or, generally speaking, if the public utilities are affiliated (that is, one owns, wholly or in part, the other) and the "owned" public utility provides, as its primary business, transmission service to or electric power to the "owner" public utility.¹¹ As to the former (public utility holding company system) interlocks, the Commission reasoned that a holding company by virtue of its control of the voting stock of its subsidiary public utilities already controls those utilities; that close federal and state regulation of holding companies and their subsidiary public utilities means that these interlocks would not impede regulation; that these interlocks could enable the holding company to control and operate its system more efficiently and economically; that case-specific approvals of these interlocks are not necessary to ensure full public disclosure of the interlocks; and that a review of the interlocks approved to that date indicated that the abuses that section 305(b) was intended to preclude had never been alleged to result from the holding of these interlocks.¹² As to the latter (affiliated) interlocks, the Commission reasoned that none of the potential abuses appear to occur as a result of these interlocks. The Commission explained that the "owned" public utilities are essentially partnerships of "owner" public utilities with specific control arrangements in the initial agreements; that they were created for the purpose of taking advantage of economies of scale and sharing the risks of financing, constructing, and operating facilities for the joint benefit of the "owner" public utilities; and that, to that date, such interlocks had routinely been approved.¹³

¹¹ 18 C.F.R. § 45.9 (2004); *see also Automatic Authorization for Holding Certain Positions that Require Commission Approval Under Section 305(b) of the Federal Power Act*, Order No. 446, FERC Stats. & Regs. ¶ 30,686 (1986) (*Automatic Authorization*).

¹² *Id.* at 30,129-30.

¹³ *Id.* at 30,131.

14. In contrast, the Commission historically has looked with disfavor on interlocks between two or more public utilities when the public utilities are not affiliated.¹⁴ In *Fitkin*, the Commission explained that, as to interlocks between unaffiliated public utilities, “it is just such relationships which [section 305(b) of] the Federal Power Act seeks to curb.”¹⁵ The Commission further indicated that the holders of such interlocks could act in a manner which would be to the detriment of the public utilities and the public interest.¹⁶

15. In its order adopting automatic authorization for interlocks between affiliated public utilities, the Commission added that interlocks between unaffiliated public utilities would create potential conflicts of interest because the holders of such interlocks would be “performing duties for potentially competing systems.”¹⁷

16. The Commission continues to believe that interlocks between unaffiliated utilities may result in competitive abuses. These competitive abuses may arise, for example, in competing to serve customers, in bidding for services, or in attracting new customers. By definition, unaffiliated utilities are just that, unaffiliated, and do not operate as a single coordinated electric system; the decisions of interlocked officers and directors may create just the kind of abuses envisioned by Congress in enacting section 305(b).¹⁸

17. Moreover, because the holder of an interlock between unaffiliated utilities would be participating in the management decisions of potentially competing utility systems, it does not appear possible to fashion effective, enforceable restrictions to limit that individual’s participation in the business decisions of the two companies. Furthermore, restricting the participation of officers or directors in decisions involving competition for customers or services may undermine any benefit the utilities would otherwise receive from having that individual serve as an officer or a director on their respective boards. Consequently, authorization of an interlock between unaffiliated utilities with conditions is not an acceptable option.

18. Mr. Pignatelli’s application concedes that the Commission generally has not granted authorization for interlocks between unaffiliated public utilities. However, given the Participants Agreement preference for the Board to include persons with utility and bulk power management experience, and the requirement that “[a]t least three of the

¹⁴ *George A. Carlson*, 54 FPC 1211, 1212-13 (1975); *Willis C. Fitkin*, 7 FERC ¶ 61,291 at 61,626-27 (1979); see also *Automatic Authorization*, FERC Stats. & Regs. at 30,132.

¹⁵ *Willis C. Fitkin*, 7 FERC ¶ 61,291 at 61,626 (1979).

¹⁶ *Id.*

¹⁷ *Automatic Authorization*, FERC Stats. & Regs. at 30,132.

¹⁸ *Hatch*, 654 F.2d at 831-32; *Aldred*, 2 FPC at 261.

directors shall have prior relevant experience in the electric industry," ISO-NE argues that Mr. Pignatelli's experience as the head of an operating utility is valuable to the RTO because once elected he will be one of the few Board members that has utility industry experience similar to the outgoing Director, Mr. Berry, who has run a utility. Also, ISO-NE claims that Mr. Pignatelli is one of the candidates that meet ISO-NE's stringent Code of Conduct requirements that protect the RTO and its customers. We do not find that the fact that one of the utilities is an RTO is a sufficient basis to distinguish this case from those previously decided. Rather the same concerns enunciated in *Hatch*, *Aldred* and later cases, such as control over a large number of geographically widespread public utilities as well as the potential effect on competition just discussed,¹⁹ warrant denial of Mr. Pignatelli's application.

19. As noted above, section 305(b) is prophylactic in nature and is directed at precisely the kind of abuses that could arise if the same individual, regardless of whether he is well qualified, were to serve as an officer or to sit on the board of directors of unaffiliated public utilities, even when one of those utilities is an RTO.²⁰ Consistent with our discussion above, to eliminate any possibility that the abuses discussed above might occur, we shall deny Mr. Pignatelli's application for authorization to hold these interlocking positions.

The Commission orders:

James S. Pignatelli's application for authorization to hold the interlocking positions of Director of ISO-NE and Chairman, President and Chief Executive Officer of Tucson Electric Power Company and Director and President of UNS Electric, Inc. is hereby denied.

By the Commission. Chairman Wood dissenting with a separate statement attached.

(S E A L)

Linda Mitry,
Deputy Secretary.

¹⁹ Cf. *Hatch*, 654 F.2d at 831-32; *Aldred*, 2 FPC at 261; 15 U.S.C. § 79a(b)(2) (2000) (list of concerns underlying related Public Utility Holding Company Act).

²⁰ Accord *Robert G. Schoenberger*, 110 FERC ¶ 61,197 (2005).

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WOOD, Chairman, *dissenting*:

Section 305(b) of the Federal Power Act permits a director to serve on two separate boards if the Commission finds that “neither public nor private interests will be adversely affected thereby.” I believe that the Commission can easily make such a finding on this application. Mr. Pignatelli’s significant operating and senior management experience would be a benefit to ISO New England. In addition, he was chosen unanimously by the nominating committee as a board member with complete independence from members and customers of ISO New England. His participation as a director of a different utility across the country cannot be viewed as adversely affecting public or private interests in this day and age.

The nature of the electric utility business has changed significantly since the Federal Power Act and the Public Utility Holding Company Act were enacted. Where we have sufficient flexibility to permit a public utility decision, as we have been clearly given in Section 305(b), we should use our expertise with the industry to revisit the appropriateness of routinely denying approval of interlocking directorates rather than rely on older case law. Because I think this case presents the opportunity to adopt a more flexible approach, as is envisioned in the 1935 law, I respectfully dissent.

	<hr/> <p>Pat Wood, III Chairman</p>

