

109 FERC ¶ 61,047
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

UniSource Energy Corporation
Tucson Electric Power Company
UNS Electric, Inc.
Saguaro Utility Group I Corp.
Saguaro Acquisition Corp.
Saguaro Utility Group L.P.

Docket No. EC04-92-000

ORDER AUTHORIZING DISPOSITION
OF JURISDICTIONAL FACILITIES

(Issued October 12, 2004)

1. On April 7, 2004, UniSource Energy Corporation (UniSource Energy), Tucson Electric Power Company (Tucson Electric), UNS Electric, Inc. (UNS Electric), Saguaro Utility Group I Corp., Saguaro Acquisition Corp., and Saguaro Utility Group L.P. (collectively Applicants) filed an application pursuant to section 203 of the Federal Power Act (FPA)¹ for Commission authorization for an indirect disposition of jurisdictional facilities associated with the acquisition of UniSource Energy, Tucson Electric and UNS Electric by Saguaro Utility Group I Corp. On September 15, 2004, Applicants filed an amendment to their application containing certain modifications to their proposed Market Monitoring Plan. As discussed below, the Commission has reviewed the transaction under its Merger Policy Statement² and will authorize the

¹ 16 U.S.C. § 824b (2000).

² Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592, 61 Fed. Reg. 68,595 (1996), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement); *see also* Revised Filing Requirements Under Part 33 of the Commission's Regulations, Order No. 642, 65 Fed. Reg. 70,983 (2000), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 66 Fed. Reg. 16,121 (2001), 94 FERC ¶ 61,289 (2001).

transaction as consistent with the public interest. This order benefits customers by approving an indirect disposition of facilities which satisfies the requirements specified in section 203 of the FPA.

I. Background

A. The Applicants

2. UniSource Energy is an exempt public utility holding company pursuant to the Public Utility Holding Company Act of 1935 (PUHCA).³ UniSource Energy directly owns nearly 100 percent of Tucson Electric, and indirectly owns all of UNS Electric. Tucson Electric is vertically-integrated public utility which provides regulated retail electric service in Southeastern Arizona, including the City of Tucson and surrounding areas in Pima County. It also owns or leases 2,002 megawatts (MWs) of net generating capacity, and owns certain transmission facilities which it uses primarily to deliver power generated at remote generating stations to its service territory for use by retail customers. Tucson Electric also has five non-utility subsidiaries. UNS Electric is an electric utility company which owns and controls a small amount of transmission facilities and has no wholesale transmission service customers and provides retail electric service in Northwestern and Southeastern Arizona. UNS Electric owns approximately 47 MW of peaking generation located within the Arizona Public Service Company control area, and purchases most of its requirements under a long-term wholesale contract.

3. Saguaro Acquisition Corp. is a wholly-owned subsidiary of Saguaro Utility Group I Corp., and was formed specifically for the purpose of facilitating the transaction that will result in the disposition of jurisdictional facilities at issue in the instant proceeding. Saguaro Utility Group I Corp. is wholly-owned by Saguaro Utility Group L.P., and was also formed for the purposes of facilitating the purchase of UniSource Energy. Saguaro Utility Group L.P. has one general partner, Sage Mountain, L.L.C. (Sage Mountain), which holds all of its voting rights. Additionally, Saguaro Utility Group L.P. has certain limited partners with limited consent rights who are not involved in the day-to-day management of the partnership. These limited partners are not primarily engaged in energy-related business activities.

B. Description of the Transaction and Filing

4. Applicants seek approval for an indirect disposition of jurisdictional facilities that will result from the acquisition of UniSource Energy by Saguaro Utility Group I Corp. Specifically, Saguaro Acquisition Corp. (wholly-owned by Saguaro Utility Group I

³ See 15 U.S.C. § 79c(a)(1) (2000).

Corp.) will be merged with and into UniSource Energy, who will be the surviving entity. Saguardo Acquisition Corp. will then cease to exist, and UniSource Energy will be wholly-owned by Saguardo Utility Group I Corp. According to the Applicants, the corporate form and day-to-day operation of UniSource Energy and its subsidiaries (including Tucson Electric and UNS Electric) will not be altered by the transaction. Additionally, Applicants state that pursuant to the terms of the transaction, the equity component of Tucson Electric's capital structure will be increased from 25 to 40 percent, due to its receipt of cash equity of up to \$168 million and the repayment by UniSource Energy of a \$95 million inter-company note owed to it.

Market Monitoring Plan

5. Applicants propose to implement a Market Monitoring Plan to monitor Tucson Electric's and UNS Electric's generation dispatch and the operation of their transmission systems, and to identify and report to the Commission regarding any potential anticompetitive conduct. Applicants state that the Market Monitoring Plan, as amended, will ensure that Tucson Electric's transmission system is operated in a fully competitive, non-discriminatory manner. The Market Monitoring Plan will be implemented simultaneously with the closing of the transaction and will continue in effect until the date on which the market monitor's function is overtaken by the implementation of a Commission-approved regional market monitoring plan.⁴

II. Notice of Filing, Interventions, Comments and Protests

6. Notice of Applicants' April 7 filing was published in the *Federal Register*⁵ with comments, protests and interventions due on or before April 28, 2004. Timely motions to intervene were filed by El Paso Electric Company (El Paso) and Arizona Public Service Company (APS). APS also filed comments. APS states that it does not seek to comment on the specific merits of the Market Monitoring Plan, but rather emphasizes that any proposal for an independent market monitor should be limited to Tucson Electric and its affiliates.

⁴ Applicants have retained Potomac Economics as the Market Monitor. Potomac Economics is presently the independent market monitor for the Midwest ISO and the independent market advisor for the New York ISO and ISO-New England.

⁵ 69 Fed. Reg. 20,869 (2004).

7. Notice of Applicants' September 15 filing of an amendment to their application was published in the *Federal Register*⁶ with comments, protests and interventions due on or before September 27, 2004. None was filed.

III. Discussion

A. Procedural Matters

8. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,⁷ the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

B. Standard of Review

9. Section 203(a) of the FPA provides that the Commission must approve a disposition of jurisdictional facilities if it finds that the disposition "will be consistent with the public interest."⁸ Under the Merger Policy Statement, the Commission's analysis of whether a disposition of facilities is consistent with the public interest generally involves the consideration of three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.⁹ As discussed below, we will approve the proposed disposition of jurisdictional facilities as consistent with the public interest.

C. Analysis and Commission Determinations

1. Effect on Competition

10. Applicants assert that the transaction raises no concerns with effects on competition. They state that the transaction will not result in any horizontal or vertical combination of electric generation, transmission or facilities that provide inputs to electricity products, and there will be no effect on the day-to-day operations of, or the services provided by, Tucson Electric or UNS Electric.

11. The Commission agrees with Applicants' analysis of the competitive effects of the proposed transaction. The transaction will not result in the consolidation of generation

⁶ 69 Fed. Reg. 56,752 (2004).

⁷ 18 C.F.R. § 385.214 (2004).

⁸ See 16 U.S.C. § 824b.

⁹ See generally Merger Policy Statement at ¶ 30,111.

because the Saguaro entities do not own or control any other generation. In addition, unlike a merger between existing competitors or an acquisition by an existing competitor in the relevant market, which could harm competition, the transaction will not eliminate a competitor in any relevant market. Moreover, because the Saguaro entities do not own or control any electric transmission facilities, inputs into electricity production (e.g. natural gas production or transportation assets), or have dominant control of sites suitable for entry of new generation facilities, the transaction does not raise vertical market power issues. Accordingly, we find that the change in upstream ownership will have no adverse effect on competition.

2. Effect on Rates

12. Applicants contend that the transactions will not adversely affect rates. They indicate that under Tucson Electric's contracts with its wholesale customers, the rates are either fixed or can vary due to the recovery of fuel-related costs.¹⁰ Therefore, Tucson Electric is not able to recover transaction-related costs under these contracts. However, as further assurance to the Commission that the transaction will not result in any adverse effect on rates, Applicants commit to hold transmission customers harmless from any wholesale rate increase resulting from costs related to the transaction for a period of five years, to the extent that such costs exceed transaction-related savings.¹¹

13. We agree with the Applicants and note that nothing in the application indicates that rates to customers will increase as a result of the transaction and no customer argues otherwise. We will, however accept the hold harmless commitment offered by Applicants. As a result, we find that the proposed transaction will not adversely affect rates.

3. Effect on Regulation

14. Applicants state that the transaction will not adversely affect Commission regulation because none of the Applicants are registered holding companies under PUHCA, and the transaction will not result in the formation of a registered public utility holding company. Moreover, the rates, terms, and conditions of wholesale sales and transmission service will continue to be subject to the Commission's jurisdiction, and

¹⁰ According to the application, UNS Electric provides service to only one wholesale power customer with a demand of 0.1 MW, and the contract does not allow for any transaction-related costs to be imposed.

¹¹ Applicants state that their proposed hold harmless commitment does not preclude changes in transmission rates attributable to non-transaction costs, such as the Tucson-Nogales transmission line project, regional transmission organization (RTO) compliance, or RTO rate incentives.

retail services provided by Tucson Electric and UNS Electric will continue to be regulated by the ACC. Applicants also note that the proposed transaction is subject to the prior approval of the ACC.

15. The Commission concludes that the proposed transaction will not affect federal or state regulation. The transaction does not impair any state's ability to regulate Tucson Electric and UNS Electric, and we note that no state Commission intervened. Thus, we conclude that the proposed transaction will not adversely affect regulation.

4. Market Monitoring Plan

16. As noted above, Applicants filed a Market Monitoring Plan together with their application for section 203 authorization. Applicants state that the purpose of the Market Monitoring Plan is to identify and investigate any anticompetitive conduct by Tucson Electric which causes binding transmission constraints, thereby foreclosing competition by rival suppliers. To identify anticompetitive conduct, the Market Monitor will develop and utilize performance indices and screens to identify market events, and will independently review Tucson Electric's actions for anticompetitive conduct.

17. Under the Market Monitoring Plan, as amended by the Applicants' September 15 filing, monitoring and reporting will be conducted concerning six general areas: (1) generation dispatch of Tucson Electric and loadings on constrained transmission facilities in relevant areas; (2) details on binding transmission constraints in relevant areas, such as transmission refusals; (3) operating guidelines and procedures designed to relieve transmission constraints and their effectiveness; (4) information concerning the volume of transactions and prices charged by Tucson Electric in markets affected by Tucson Electric before and after it implements redispatch or other congestion management actions; (5) the calculation of Available Transmission Capability and Total Transfer Capability, as well as Tucson Electric's communication of data regarding such calculations to the westTTRans.net OASIS; and (6) Tucson Electric's plans for the construction of expansions to its transmission facilities. In carrying out its monitoring and reporting role, the Market Monitor will have access to several categories of data and information that may be necessary to investigate issues, including hourly load, flow and output data, transmission limits, generation and transmission facility outage data, information on redispatch to manage congestion, proposals submitted to various regional groups regarding operating protocols or business practices applicable to transmission systems, and ten-year transmission plans developed by Tucson Electric and provided to the Arizona Corporation Commission (ACC). In making its evaluation, the Market Monitor will construct and utilize performance indices and screens in several categories, including market statistics on prices and fuel costs, transmission capability and usage, load and supply statistics, generation availability and withholding and bidding scheduling correlations.

18. The Market Monitor will report its findings directly to the Commission and Tucson Electric simultaneously on a quarterly basis, but may also report findings at other times when necessary. Additionally, the Market Monitor will report potentially anticompetitive conduct within 48 hours of its discovery of the conduct. The Market Monitor will also respond to Commission requests for additional data and analysis on an as-required basis, as well as to complaints by customers or competitors of Tucson Electric. Finally, as amended, the Market Monitoring Plan states that outside of the confidentiality provisions, "Tucson Electric does not expect that any limitations will be placed on the Market Monitor's ability to inform the Commission of relevant facts or opinions."¹²

19. We accept Applicants' Market Monitoring Plan as proposed. We believe that the establishment of an independent market monitor for Tucson Electric benefits customers and market participants in the region by providing continued, independent analyses to identify potential anticompetitive conduct. This vigilant oversight advances competition and will further ensure that Tucson Electric's transmission system is operated on a non-discriminatory basis.

20. Additionally, in response to APS' comments, the Commission clarifies that the Market Monitoring Plan applies only to Tucson Electric and its affiliate companies.

5. Applicants' Proposed Accounting Treatment

21. Applicants propose to account for the acquisition using the "purchase" method of accounting. Saguardo Utility Group I Corporation, the acquiring entity, will allocate the purchase price to the assets acquired and the liabilities assumed based on their estimated fair values. Any excess remaining after the allocation of the cost of the acquisition to the assets acquired and the liabilities assumed will be recognized as goodwill on the books and records of UniSource Energy. As currently contemplated, the accounting to record the proposed merger transaction will not have any direct effect on the regulatory books and records of UniSource Energy's operating subsidiaries, as any difference between the purchase price and book value of the subsidiaries will be kept at the non-jurisdictional, parent company level.

22. However, the Applicants indicate that they may subsequently elect to use push-down accounting for the differences to the operating subsidiaries level. Under "push down" accounting, the difference between the purchase price and the book value of the operating company acquired may be "pushed down" to the books of the acquired

¹² See Proposed Market Monitoring Plan, § 1.1(c).

operating company. To the extent that this method is used, Applicants are directed to submit the full particulars of their accounting for the transaction within 60 days of the date on which the merger is consummated.

The Commission orders:

(A) Applicants' proposed disposition of jurisdictional facilities is hereby authorized, as discussed in the body of this order.

(B) The foregoing authorization is without prejudice to the authority of the Commission or any other regulatory body with respect to rates, service, accounts, valuation, estimates or determinations of costs, or any other matter whatsoever now pending or which may come before the Commission.

(C) Nothing in this order shall be construed to imply acquiescence in any estimate or determination of cost or any valuation of property claimed or asserted.

(D) The Commission retains authority under sections 203(b) and 309 of the FPA to issue supplemental orders as appropriate.

(E) Applicants shall make appropriate filings under section 205 of the FPA, as necessary, to implement the transaction.

(F) If the "push down" method of accounting is used, Applicants are directed to submit the full particulars of their proposed final accounting within 60 days after the transaction is consummated. The accounting submission should provide all merger-related accounting entries made to the books and records of its public utility operating subsidiaries, along with appropriate narrative explanations describing the basis for the entries.

(G) Applicants shall notify the Commission within 10 days of the date that the disposition of the jurisdictional facilities has been consummated.

By the Commission. Commissioner Kelliher concurring with a separate statement attached.

(S E A L)

Linda Mitry,
Acting Secretary.

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Docket No. EC04-92-000

(Issued October 12, 2004)

Joseph T. KELLIHER, Commissioner *concurring*:

I agree with the Commission's decision to authorize the Applicants' proposed disposition of jurisdictional facilities, however, I write separately to explain my reasoning with respect to the Market Monitoring Plan accepted by this order. This order does not condition approval of this disposition of jurisdictional facilities on implementation of a Market Monitoring Plan. Moreover, the Commission's finding with respect to the effect on competition of the transaction did not rely on the Applicants' proposal to implement a Market Monitoring Plan. The transaction does not result in any increase in generation or transmission market power, and for that reason the Commission found it will have no adverse effect on competition. The Market Monitoring Plan accepted by this order appears designed more to prevent undue discrimination in the provision of transmission service, rather than to mitigate any adverse effects on competition resulting from the transaction. Indeed, since the transaction does not result in an increase in generation or transmission market power, the Market Monitoring Plan cannot be fairly viewed as a mitigation measure. In my view, implementation of a Market Monitoring Plan would not have been necessary to secure approval from the Commission for this transaction.

Joseph T. Kelliher