

144 FERC ¶ 61,200
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
Cheryl A. LaFleur, and Tony Clark.

Arizona Public Service Company

Docket Nos. ER13-1402-000
ER13-1402-001

ORDER ACCEPTING NOTICE OF CANCELLATION
AND DENYING REQUEST FOR RATE RECOVERY

(Issued September 13, 2013)

1. On May 2, 2013, as amended on June 21, 2013, pursuant to section 205 of the Federal Power Act (FPA),¹ Arizona Public Service Company (APS) filed a notice of cancellation of its Rate Schedule 38, a Transmission Service Agreement that it entered into with Southern California Edison Company (SoCal Edison) on July 20, 1966. APS also requests Commission authorization to defer and amortize over 10 years a proposed \$40 million payment from APS to SoCal Edison for the termination of the Transmission Service Agreement. Alternatively, APS proposes to treat the proposed \$40 million payment as an immediate miscellaneous transmission expense and flow it through its wholesale transmission formula rate. APS seeks an effective date of the date of closing of its purchase of Units 4 and 5 of the Four Corners Power Plant (Four Corners purchase transaction) from SoCal Edison. As discussed below, we accept APS's notice of cancellation, effective on the date APS's Four Corners purchase transaction closes, but we deny APS's request for approval to recover the \$40 million payment through its wholesale transmission rates, without prejudice.

I. Background

2. APS states that, in July 1966, it agreed to construct, own, and operate a 500 kV transmission line from the Four Corners Power Plant in New Mexico to the Arizona-Nevada border (Arizona Transmission Line). In exchange for the rights to all of the transmission capacity on the Arizona Transmission Line, SoCal Edison agreed to pay

¹ 16 U.S.C. § 824d (2006).

APS monthly transmission charges based on the sum of APS's investment in the Arizona Transmission Line in accordance with the terms of the Transmission Service Agreement.²

3. APS states that, in 2010, SoCal Edison announced its plan to sell its interest in the Four Corners Power Plant to APS, and consequently SoCal Edison would no longer need the transmission capacity on the Arizona Transmission Line.³ As a result, on November 8, 2010, APS agreed to both purchase the Four Corners Power Plant generation facilities from SoCal Edison and pay SoCal Edison to terminate the Transmission Service Agreement.⁴ In connection therewith, APS states that it agreed to pay SoCal Edison a negotiated amount of \$294 million associated with the generation facilities⁵ and to pay SoCal Edison a one-time termination payment of \$40 million, which it purports reflects the relative costs and benefits of the capacity on the Arizona Transmission Line to each party. APS filed the application for approval of the purchase of the Four Corners Power Plant facilities in Docket No. EC12-106-000 and to recover the termination fee in wholesale transmission rates herein.

4. APS herein requests that the Commission approve: (1) cancellation of the Transmission Service Agreement with SoCal Edison; and (2) rate recovery of the \$40 million termination payment and APS's proposed rate amortization of that payment. APS requests that, in the event the Commission declines to grant APS authorization to defer and amortize the costs associated with the termination of the Transmission Service Agreement, the Commission allow APS to treat such costs as an immediate expense and to flow them through in its next annual transmission formula rate update as a miscellaneous transmission expense.

5. APS notes that the Transmission Service Agreement is a bilateral contract with SoCal Edison, and claims that its cancellation will not result in any undue discrimination or preferential treatment with respect to any third party and, therefore, is just and reasonable. APS states that, under the termination agreement, 257 MW of the capacity

² APS Filing at 3, n.8 ("The total capacity of the Arizona Transmission Line is currently 1,490 MW between Four Corners and Moenkopi and 1,555 MW between Moenkopi and the Arizona-Nevada border.").

³ *Id.* at 5 & n.17. APS states that its acquisition of SoCal Edison's interests in the Four Corners Power Plant was authorized by the Commission under FPA section 203 on November 27, 2012 (citing *Arizona Public Service Company*, 141 FERC ¶ 61,154 (2012)) (*Four Corners Order*).

⁴ *Id.* at 4.

⁵ *Id.* at 5.

on the Arizona Transmission Line will be used for network load service and the remaining capacity will be made available via APS's Open Access Same-Time Information System for wholesale service.⁶ APS contends that the capacity made available to native load customers through the termination of the Transmission Service Agreement will relieve existing transmission constraints that will be exacerbated by its acquisition of the Four Corners Power Plant. As a result, APS argues that the termination of the Transmission Service Agreement and APS's contract termination payment will ensure that rates paid by APS's native load customers are the lowest possible.

6. Additionally, APS states that the \$40 million payment was mutually agreed upon through arms-length commercial negotiations that took into account the prevailing circumstances. APS asserts that the terms for terminating the Transmission Service Agreement are governed by paragraph 25.3 of the agreement.⁷ APS proposes to defer the \$40 million termination payment and associated carrying costs as a regulatory asset and amortize the costs over a 10-year period beginning after the effective date of the termination.⁸ APS asserts as part of its request for regulatory asset approval that the Commission has previously recognized that costs associated with future benefits are appropriately assigned and collected through rates during the period in which the related benefits are expected to be realized.

⁶ *Id.* at n.15. APS states that it intends to make 824 MW of firm capacity and 731 MW of conditional firm capacity available for third party wholesale use. *Id.* at 7.

⁷ *Id.* at 3, paragraph 25.3 of the Transmission Service Agreement states:

In the event of termination by [SoCal Edison] pursuant to paragraph 25.2, [SoCal Edison] shall pay [APS] on or as of the date of termination a lump sum equal to (a) the Net Investment of the Arizona Transmission System as of the effective date of termination plus estimated removal costs and minus the estimated salvage value of the facilities removed (with adjustments to actual removal costs and salvage value after removal has been completed); and (b) the Termination Charges, if any, as defined in paragraph 24.8. [SoCal Edison] shall be given credit, under the circumstances then prevailing, for any beneficial use to [APS] of the Arizona Transmission System which [APS] may retain.

⁸ The carrying costs associated with the regulatory asset would be calculated at a rate equal to the weighted average cost of capital generated in the APS formula.

7. APS also states that, because the \$40 million payment relates to facilities APS already owns, the proposed transaction does not constitute an acquisition adjustment. However, even if the termination cost were evaluated under the Commission's precedent on acquisition adjustments, APS argues that the recovery of such costs through rates would be just and reasonable. APS states that the cost of constructing comparable facilities is estimated to be more than 18 times greater than the negotiated termination payment to SoCal Edison. APS also asserts that termination of the Transmission Service Agreement benefits wholesale customers by making additional transmission capacity available for use by third parties. Lastly, APS estimates that, if its proposed rate treatment is accepted, the revenue resulting from third-party transmission service will lower APS's overall transmission revenue requirement by increasing transmission demand and revenue credits.

8. On June 21, 2013, APS submitted a supplemental filing that revises its requested effective date for termination of the Transmission Service Agreement from July 1, 2013 to a later date. Specifically, APS states that there has been a delay in the acquisition of the Four Corners Power Plant due to state regulatory issues and it now anticipates that the closing will occur no earlier than October 1, 2013. Therefore, APS requests that the Commission accept its notice of cancellation effective on the date that the Four Corners purchase transaction closes. APS states that it will notify the Commission of the actual closing date for the Four Corners purchase transaction within five business days of its occurrence.

II. Notice and Responsive Pleadings

9. Notice of APS's May 2, 2013 filing was published in the *Federal Register*, 78 Fed. Reg. 28,213 (2013), with interventions and protests due on or before May 23, 2013. SoCal Edison filed a timely motion to intervene with comments.

10. SoCal Edison supports APS's notice of cancellation and its associated request to recover the \$40 million termination payment in its rates. SoCal Edison states that recovery of the \$40 million termination payment in APS's transmission rates is both just and reasonable, and provides benefits to transmission customers of both the California Independent System Operator Corporation (CAISO) and APS. Specifically, SoCal Edison asserts that ratepayers will benefit from the additional capacity on the Arizona Transmission Line, while the CAISO ratepayers will benefit from the \$40 million termination payment, which SoCal Edison intends to credit against its formula rate.

11. Notice of APS's June 21, 2013 supplemental filing was published in the *Federal Register*, 78 Fed. Reg. 39,722 (2013) with interventions and protests due on or before July 12, 2013. None were filed.

III. Discussion

A. Procedural Matter

12. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2013), SoCal Edison's timely, unopposed motion to intervene serves to make it a party to this proceeding.

B. Notice of Cancellation

13. As a result of SoCal Edison's sale of its interest in the Four Corners Power Plant, SoCal Edison will no longer need transmission service on APS's transmission line. Therefore, we find good cause to accept APS's notice of cancellation of the Transmission Service Agreement, effective upon the date on which APS's Four Corners purchase transaction closes. We accept APS's proposal to inform us of the closing date within five business days of its occurrence.

C. Proposed Recovery of Termination Fee

14. As discussed below, we find that APS has not adequately supported its proposal to recover the \$40 million termination payment in its jurisdictional cost-based transmission rates.⁹ Therefore, we will deny, without prejudice, APS's request to either defer and amortize over 10 years the proposed \$40 million termination payment with carrying costs, or treat the payment as an immediate miscellaneous transmission expense and include it in APS's next annual transmission formula rate update.

15. APS has failed to provide any justification to support the cost functionalization between generation and transmission in order to include the negotiated \$40 million payment in its wholesale cost-based transmission rates. As APS acknowledges, the agreement to pay a \$40 million termination fee to SoCal Edison in the instant proceeding accommodates the acquisition by APS of SoCal Edison's ownership interests in the Four Corners Power Plant. However, we find the negotiated sums derived by the parties in the comprehensive arrangement and subsequently assigned between transmission and generation cost categories to be vague, imprecise, and without substantiation or evidence.

16. APS argues that the \$40 million payment should be included in wholesale transmission rates because it "appropriately takes into account both the prevailing

⁹ Ratepayers should not be asked to pay unnecessary or imprudent costs, even if management is convinced that those costs are necessary and in its own interest. *New England Power Company*, 31 FERC ¶ 61,047, at 61,083 (1985); *Acker v. U.S.*, 298 U.S. 426, 431 (1936); *Cities Service Gas Company*, 22 FERC ¶ 61,255 at 61,462 & n.5 (1983).

circumstances and the avoidance of potential litigation risk arising under the [Transmission Service Agreement], and satisfies the parties' obligations under the [Transmission Service Agreement]."¹⁰ However, Commission precedent requires that to include expense items as a regulatory asset or as a miscellaneous transmission expense in a cost-based rate, there must be an evidenced-based, quantifiable demonstration of the relevance of those expenses to the provision of a jurisdictional service to those customers from whom cost recovery is sought, and APS makes no such demonstration.¹¹ A general claim of avoidance of litigation risk is not sufficient to quantify costs included in a cost-based rate as just and reasonable. We also note that the transmission facilities associated with the termination agreement are already included in APS's transmission rates at their depreciated original cost value. APS has not provided any cost justification to support a value greater than the depreciated original cost of the facility.¹²

17. In addition to finding that APS has not provided any evidence-based quantifiable cost support for the rate treatment proposed, we also find that APS has not supported its claims of benefits associated with inclusion of the \$40 million payment in its rate base. APS contends that the capacity it acquires from SoCal Edison pursuant to the termination agreement will alleviate transmission constraints on its system and will reduce the rates paid by its native load customers. However, APS has not demonstrated, through the presentation of any historical data or other evidence, that its system faces any transmission constraints, nor does it show how these purported constraints would be alleviated by the acquisition or new construction of transmission. Further, APS has not explained how the transmission constraints or the alleviation of the transmission constraints will benefit its wholesale transmission customers and thereby warrant inclusion in wholesale transmission customers' rates.

18. APS contends that it needs 257 MW of additional transmission capacity to serve the needs of its native load customers. However, APS has not substantiated this purported native load need with any evidence, whether from a state-approved plan or otherwise. To meet the purported native load needs, APS states that paying SoCal Edison

¹⁰ APS Filing at 4.

¹¹ In *ISO New England Inc.*, 109 FERC ¶ 61,314, at P 23 (2004), the Commission rejected tariff revisions that would have allowed the inclusion of unsubstantiated claims and cost levels.

¹² *Missouri Interstate Gas, LLC*, 142 FERC ¶ 61,195, at P 43 (2013) (citing *United Gas Pipe Line Co.*, 25 FPC 26, at 64 (1961)) ("The Commission's general policy is to use original cost principles in establishing the cost of service upon which a pipeline's regulated rates are based. This policy limits a pipeline to including no more than the facilities' depreciated original cost in rate base").

for the transmission capacity on the Arizona Transmission Line is cheaper than acquiring the transmission capacity through new construction or on an alternative path.¹³ However, APS has not provided any estimates of the costs for constructing improvements on its current system or participation by APS in any regional transmission planning effort to reliably transmit 257 MW of additional capacity.¹⁴ Instead, APS merely provides arguments regarding the construction of new facilities comparable to the 500 kV Arizona Transmission Line, significantly in excess of the 257 MW of additional capacity APS claims is needed. Consequently, we find that APS has failed to provide adequate support for its contention that making the termination payment is cheaper than building facilities to accommodate APS's purported native load growth. Further, even if APS demonstrated that the proposed transaction provided benefits to its native load customers, APS has failed to justify recovery of the \$40 million from its wholesale customers.

19. APS also attempts to support its inclusion of the \$40 million payment in its cost-based wholesale transmission rates by arguing that acquiring the transmission capacity on the Arizona Transmission Line would likely result in an overall rate reduction. APS has not supported its assertions that it will be able to sell all the available transmission capacity. Further, although APS states that, based on current load forecasts, APS intends to make 824 MW of firm capacity and 731 MW of conditional firm capacity available to third parties, APS has failed to show supporting documentation to authenticate the load forecasts. Additionally, APS has not supported its assertion that there will be a rate reduction through, for instance, inclusion of rate calculation work papers that demonstrate the purported revenue offset by increased transmission determinants.¹⁵ Finally, APS fails to demonstrate that the \$40 million increase in rates will not be paid for by the same end-use customers that have already paid once for the depreciated value of the assets original cost. Therefore, we find that APS has not only failed to substantiate including the cost of the \$40 million termination payment in its wholesale transmission rates, but APS has also failed to substantiate any benefits to its customers.¹⁶

¹³APS Filing at 9, DeWitt Testimony at 4-7.

¹⁴ DeLizio Testimony at 5-6. APS provides three means of obtaining 257 MW of capacity on alternative paths, and while noting that no alternative is viable, APS estimates that the cost of these alternatives would be between \$3.7 million annually and \$10.6 million annually.

¹⁵ See, e.g., 18 C.F.R. § 35.13, Statement BG- Revenue to Reflect Changed Rates (2013).

¹⁶ We note that an extraordinary miscellaneous transmission expense may require additional support to demonstrate that the cost allocation treatment is appropriate, and here, APS has not explained why a \$40 million allocation to wholesale customers is
(continued...)

20. Finally, we disagree with APS's contention that paragraph 25.3 of the Transmission Service Agreement authorizes recovery of the proposed \$40 million termination payment to SoCal Edison. APS asserts that the \$40 million was agreed upon to avoid potential litigation. However, paragraph 25.3, by its express terms, lays out the lump sum termination payment that *SoCal Edison shall pay APS*; it does not prescribe an equalization of benefits and provides no justification for a termination payment that *APS shall pay SoCal Edison*. Rather, the provision explains that the amount of the lump sum payment made by SoCal Edison to APS is to be calculated as the costs of the investment and removal costs, mitigated by any salvage value, and further mitigated by APS's ability to use the line (and thereby, presumably recoup its losses due to the termination). Nowhere does paragraph 25.3, which applies when there is "termination by [SoCal Edison]," indicate that SoCal Edison is entitled to *receive* payment for terminating the Transmission Service Agreement. Although APS focuses on the language that SoCal Edison "shall be given credit" for any beneficial use APS may retain for the line, "credit" against costs is not a payment *above* costs, especially when this interpretation would conflict with the plain language of "[SoCal Edison] shall pay [APS]."

21. Accordingly, we will deny APS's request for recovery of the \$40 million payment in its wholesale transmission rates, without prejudice to APS making a new filing that is properly supported and substantiated.

The Commission orders:

(A) APS's notice of cancellation of the Transmission Service Agreement is hereby accepted, effective on the date when APS's Four Corners purchase transaction closes, as discussed in the body of this order.

(B) APS is directed to notify the Commission of the closing date of the Four Corners purchase transaction within five days of the date on which the transaction closes, as discussed in the body of this order.

appropriate. For example, the Commission is unable to determine from this record whether \$40 million is the full amount of the termination cost and if so, what allocation of these costs to wholesale customers is appropriate.

(C) APS's request for authorization to recover the \$40 million payment to SoCal Edison through its wholesale transmission rates is hereby denied, without prejudice, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.