

156 FERC ¶ 61,170  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;  
Cheryl A. LaFleur, Tony Clark,  
and Colette D. Honorable.

Tucson Electric Power Company

Docket No. EC16-96-000

ORDER CONDITIONALLY AUTHORIZING  
ACQUISITION OF JURISDICTIONAL FACILITIES

(Issued September 12, 2016)

1. On March 29, 2016, pursuant to section 203(a)(1) of the Federal Power Act (FPA)<sup>1</sup> and Part 33 of the Commission's regulations,<sup>2</sup> Tucson Electric Power Company (Tucson Electric) submitted an application seeking all authorizations necessary to permit Tucson Electric to acquire, through a series of related transactions, the 50.495 percent fee interest that it does not already own in Springerville Generating Station Unit 1 (Springerville 1), as well as certain associated interests in non-jurisdictional common facilities of the Springerville Generating Station (Proposed Transaction).
2. We have reviewed the Proposed Transaction under the Commission's Merger Policy Statement.<sup>3</sup> As discussed below, we conditionally authorize the Proposed Transaction as consistent with the public interest.

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<sup>1</sup> 16 U.S.C. § 824b(a) (2012).

<sup>2</sup> 18 C.F.R. pt. 33 (2016).

<sup>3</sup> See *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) (1996 Merger Policy Statement); see also *FPA Section 203 Supplemental Policy Statement*, FERC Stats. & Regs. ¶ 31,253 (2007) (Supplemental Policy Statement). See also *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 94 FERC ¶ 61,289

(continued...)

## I. Background

### A. Description of the Parties

3. Tucson Electric states that it is an indirect, wholly owned subsidiary of Fortis, Inc., and a vertically-integrated utility with a service territory in the greater Tucson, Arizona metropolitan area.<sup>4</sup> Tucson Electric states that it sells electricity at wholesale to other utilities and power marketers throughout the southwestern United States.<sup>5</sup> Tucson Electric owns approximately 2,763 megawatts (MW) of generating capacity including, as is relevant here, approximately 210 MW as a result of its 49.505 percent fee interests in Springerville 1.<sup>6</sup> Tucson Electric explains that it also owns transmission facilities that are primarily used to transmit power to Tucson Electric's service territory for use of its customers.<sup>7</sup> Tucson Electric states that open access is provided pursuant to its Open Access Transmission Tariff (Tucson Electric OATT). Tucson Electric also states that it has market-based rate authority.<sup>8</sup>

4. Tucson Electric states that the interests in Springerville 1 and its common facilities are held in trust by Wilmington Trust Company (Wilmington) and William J. Wade (Wade) for the benefit of Alterna Springerville LLC (Alterna) and LDVF1 TEP LLC (LDVF1).<sup>9</sup> Tucson Electric states that Alterna holds, through a passive grantor trust, a 43.0693 percent undivided interest in Springerville 1 and 21.53465 percent undivided interest in certain non-jurisdictional common facilities at the Springerville Generating Station.<sup>10</sup> Tucson Electric states that LVDF1 holds, through a passive grantor trust,

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(2001). *See also Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006).

<sup>4</sup> Application at 2-3.

<sup>5</sup> *Id.* at 2.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 2-3.

<sup>8</sup> *Id.* at 3.

<sup>9</sup> *Id.* at 4.

<sup>10</sup> *Id.*

a 7.4257 percent undivided interest in Springerville 1 and 3.72635 percent undivided interest in certain non-jurisdictional common facilities at the Springerville Generating Station.<sup>11</sup> Tucson Electric also states that Alterna and LDVF1 are both exempt wholesale generators and have market-based rate tariffs on file with the Commission.<sup>12</sup>

**B. Description of the Assets and the Proposed Transaction**

5. Tucson Electric states that Springerville 1 is a 424.8 MW electric generating unit that forms part of the approximately 1,755 MW Springerville Generating Station, which is located near Springerville, Arizona.<sup>13</sup> Tucson Electric explains that, prior to December 30, 2014, it held an approximately 14.14 percent fee interest in Springerville 1 and leased the balance of the unit under the terms of several lease agreements with Wilmington and Wade (collectively, Leases).<sup>14</sup> Tucson Electric states that it acquired an additional 35.35 percent of the fee interest in Springerville 1 on December 30, 2014 and January 1, 2015, and that the remaining Leases expired on January 1, 2015.<sup>15</sup>

6. Tucson Electric also explains that on November 7, 2014, Alterna, LDVF1, Wilmington, and Wade filed a complaint with the Commission in anticipation of the expiration of the Leases.<sup>16</sup> Tucson Electric states that the Commission denied the complaint and rehearing,<sup>17</sup> and the complainants subsequently filed a petition for review with the U.S. Court of Appeals for the Ninth Circuit (Ninth Circuit). According to Tucson Electric, the appeal has been stayed at the request of the complainants and

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<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 2.

<sup>14</sup> *Id.* at 5.

<sup>15</sup> *Id.* (citing *Tucson Electric Power Co.*, 143 FERC ¶ 62,120 (2013)).

<sup>16</sup> *Id.* See *Alterna Springerville LLC*, Complaint, Docket No. EL15-17-000 (filed Nov. 7, 2014).

<sup>17</sup> See *Alterna Springerville LLC v. Tucson Elec. Power Co.*, 150 FERC ¶ 61,094, *order denying reh'g*, 153 FERC ¶ 61,125 (2015).

Tucson Electric so they could pursue settlement, which has resulted in the Proposed Transaction.<sup>18</sup>

7. Tucson Electric states that pursuant to the Agreement for Settlement of Claims Including Releases and Purchase and Sale of Beneficial Interests (Purchase and Sale Agreement) by and among Tucson Electric, Alterna, LDVF1, Wilmington, and Wade dated February 29, 2016, Tucson Electric intends to acquire the interests in Springerville 1 and its common facilities. Specifically, Tucson Electric states that under the terms of the Purchase and Sale Agreement it will: (1) purchase all interests in the trust holding Alterna's 43.0693 percent fee interest in Springerville 1 and Alterna's 21.53465 percent interest in certain non-jurisdictional common plant of the Springerville Generating Station (Springerville Common Plant); and (2) purchase all interests in the trust holding LDVF1's 7.4257 percent fee interest in Springerville 1 and LDVF1's 3.72635 percent interest in the Springerville Common Plant. Tucson Electric states that following the transfer of these interests, Tucson Electric will dissolve the trusts and directly hold all of the fee interests in Springerville 1, and an undivided 50 percent interest in the Springerville Common Plant.<sup>19</sup>

8. Finally, Tucson Electric states that following consummation of the Proposed Transaction, the parties will seek dismissal of their various adversarial proceedings, including the appeal before the Ninth Circuit.<sup>20</sup>

## **II. Notice of Filing**

9. Notice of the application was published in the *Federal Register*, 81 Fed. Reg. 19,963 (2016), with interventions and protests due on or before May 31, 2016. None was filed.

## **III. Discussion**

### **A. FPA Section 203 Standard of Review**

10. FPA section 203(a)(4) requires the Commission to approve proposed dispositions, consolidations, acquisitions, or changes in control if the Commission determines that the

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<sup>18</sup> Application at 6 (citing Order Staying Proceedings for Mediation, *Alterna Springerville LLC, et al. v. FERC*, Case No. 15-73844 (9th Cir. Feb. 4, 2016)).

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 6-7.

proposed transaction will be consistent with the public interest.<sup>21</sup> The Commission's analysis of whether a proposed transaction is consistent with the public interest generally involves consideration of three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.<sup>22</sup> FPA section 203(a)(4) also requires the Commission to find that the proposed transaction "will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest."<sup>23</sup> The Commission's regulations establish verification and informational requirements for entities that seek a determination that a proposed transaction will not result in inappropriate cross-subsidization or pledge or encumbrance of utility assets.<sup>24</sup>

**B. Analysis of the Proposed Transaction**

**1. Effect on Horizontal Competition**

**a. Tucson Electric's Analysis**

11. Tucson Electric states that the Proposed Transaction will not have an adverse effect on competition and does not raise any horizontal market power concerns. Springerville 1 is located within the Tucson Electric Balancing Authority Area (BAA). Accordingly, Tucson Electric performed a Delivered Price Test analysis of the effect of the Proposed Transaction on competition in the Tucson Electric BAA, as well as the six BAAs directly interconnected to the Tucson Electric BAA, namely: Arizona Public Service Company, El Paso Electric Company, Public Service Company of New Mexico, Salt River Project Agricultural Improvement and Power District, and Western Area Power Administration-Lower Colorado. Tucson Electric used the Herfindahl Hirschman Index (HHI)<sup>25</sup> to measure the Proposed Transaction's impact on horizontal market power.

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<sup>21</sup> 16 U.S.C. § 824b(a)(4) (2012).

<sup>22</sup> 1996 Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,111.

<sup>23</sup> 16 U.S.C. § 824b(a)(4).

<sup>24</sup> 18 C.F.R. § 33.2(j) (2016).

<sup>25</sup> Applicants performed an Appendix A analysis, also referred to as a Delivered Price Test or Competitive Analysis Screen, to determine the pre- and post-transaction market shares from which the market concentration or HHI change can be derived. The HHI is a widely accepted measure of market concentration, calculated by squaring the

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12. Tucson Electric states that the Proposed Transaction passes the Commission's competitive analysis screen thresholds under the available economic capacity measure for the Tucson Electric BAA in all season/load periods under base-case prices and sensitivity analyses except the winter super peak period under base-case prices and the sensitivity analysis that reflects a 10 percent increase in prices. Tucson Electric states that, in the winter super peak season/load period, there are screen failures of 543 points and 691 points under the base-case and sensitivity analysis, respectively, thus constituting a screen failure in a moderately concentrated market.<sup>26</sup> In addition, Tucson Electric states that the Proposed Transaction passes the thresholds under the available economic capacity measure in all periods for all six markets first-tier to the Tucson Electric BAA.

13. Tucson Electric argues that the winter super peak screen failures for the Tucson Electric BAA should not cause the Commission concern because they are limited and discrete failures that do not indicate an ability of Tucson Electric to exercise generation market power following the Proposed Transaction.<sup>27</sup> Tucson Electric advances several arguments in support of this assertion. First, Tucson Electric explains that the winter season is a low load period in the whole Southwest and, as a result, it is difficult if not impossible for an entity to exercise market power during the winter.<sup>28</sup> Second, Tucson Electric states that Springerville 1 is a baseload generating facility, which does not lend itself to the exercise of market power through a withholding

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market share of each firm competing in the market and summing the results. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases. Markets in which the HHI is less than 1,000 points are considered to be unconcentrated; markets in which the HHI is greater than or equal to 1,000 but less than 1,800 points are considered to be moderately concentrated; and markets in which the HHI is greater than or equal to 1,800 points are considered to be highly concentrated. In a horizontal merger, an increase of more than 50 HHI points in a highly concentrated market or an increase of 100 HHI points in a moderately concentrated market fails the relevant screen and warrants further review. 1996 Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,129; *see also Analysis of Horizontal Market Power under the Federal Power Act, Order Reaffirming Commission Policy and Terminating Proceeding*, 138 FERC ¶ 61,109 (2012) (affirming the Commission's use of the thresholds adopted in the Merger Policy Statement).

<sup>26</sup> Application at 10; Appendix 2 – Affidavit of Matthew Arenchild at 11, 26.

<sup>27</sup> Application at 10.

<sup>28</sup> *Id.* (citing *Ariz. Pub. Serv. Co.*, 141 FERC ¶ 61,154, at P 18 (2012)).

strategy.<sup>29</sup> Third, Tucson Electric states that all of its revenues from off-system spot sales flow into its retail rate fuel adjustment clause, and thus Tucson Electric lacks any incentive to exercise market power.<sup>30</sup> Fourth, Tucson Electric argues that the Proposed Transaction will not eliminate a competitor within the Tucson Electric BAA because Alterna and LDVF1 have not made any sales from Springerville 1 since they acquired control of that output on January 1, 2015 when the Leases expired.<sup>31</sup> Fifth, Tucson Electric maintains that any increase in market concentration will be transitory because, by December 31, 2017, the San Juan Generating Station Unit 2 (San Juan 2) will be retired from service, resulting in the loss to Tucson Electric of 170 MW of baseload generating capacity.<sup>32</sup> Tucson Electric states that this reduction in its generating capacity, with all other factors being equal, will eliminate the winter super peak screen failure.<sup>33</sup> Sixth, Tucson Electric states that it did not include the costs of the “final wheel” of power within the destination market in its analysis, which it asserts would remove the screen failures if added.

14. Tucson Electric states that to the extent the Commission determines that mitigation is necessary in light of the winter super peak screen failure, and directs mitigation, it proposes the following mitigation. Tucson Electric commits to enter into a firm power sales agreement for at least 125 MW of capacity and energy from its existing system resources during all winter peak period hours between the date of consummation of the Proposed Transaction and the date of retirement of San Juan 2 for sales to an entity that currently has no market presence in the Tucson Electric BAA.<sup>34</sup> Tucson Electric states the sale would be in effect for all peak hours from December 1, 2016, through February 28, 2017, and December 1, 2017, through December 31, 2017.<sup>35</sup> Tucson Electric states that the sale will be priced such that it is “in the money” during the

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<sup>29</sup> *Id.* (citing *Osprey Energy Center, LLC*, 152 FERC ¶ 61,066, at P 18 (2015) (*Osprey*); *Ariz. Pub. Serv. Co.*, 141 FERC ¶ 61,154 at P 33).

<sup>30</sup> *Id.* at 11 (citing *Ariz. Pub. Serv. Co.*, 141 FERC ¶ 61,154 at P 33).

<sup>31</sup> *Id.* (citing *Osprey*, 152 FERC ¶ 61,066 at P 21; *Ariz. Pub. Serv. Co.*, 141 FERC ¶ 61,154 at P 34).

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 12.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at 12-13.

relevant hours and the product will be WSPP Schedule C firm with a point of delivery at the Palo Verde Hub (which is at the border of the Tucson Electric BAA).<sup>36</sup>

15. Tucson Electric states that to the extent the Commission conditions its approval of the Proposed Transaction on such an agreement, Tucson Electric commits to submit the agreement to the Commission as an informational filing within 30 days of its execution. Tucson Electric states that such an agreement will reduce market concentration during the winter peak period to levels that do not result in any screen failure under base-case prices or sensitivity analyses.<sup>37</sup> Accordingly, Tucson Electric argues that this commitment to mitigation should result in the Commission finding that the Proposed Transaction, as mitigated, will have no adverse impact on horizontal market competition.

**b. Commission Determination**

16. In analyzing whether a proposed transaction will adversely affect horizontal competition, the Commission examines the effects on concentration in the generation markets and whether the proposed transaction otherwise creates the incentive and ability to engage in behavior harmful to competition, such as withholding of generation.<sup>38</sup>

17. Based on Tucson Electric's representations, we find that, with the implementation of Tucson Electric's proposed mitigation, the Proposed Transaction will not have an adverse effect on horizontal competition in the Tucson Electric BAA. In making this finding, we note that without mitigation, the Proposed Transaction results in a substantial screen failure in the winter super peak season, raising concerns that the Proposed Transaction will adversely affect horizontal competition in the Tucson Electric BAA.

18. In Order No. 642, the Commission stated it would look beyond the HHI screens if a transaction proposed under section 203 does not meet the HHI thresholds set forth in the Merger Policy Statement. The Commission clarified that applicants with screen failures could address market conditions beyond the change in HHI "such as demand and supply elasticity, ease of entry and market rules, as well as technical conditions, such as the types of generation involved."<sup>39</sup> In the Supplemental Policy Statement, the Commission stated that "in horizontal mergers, if an applicant fails the Competitive

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<sup>36</sup> *Id.* at 13.

<sup>37</sup> *Id.*

<sup>38</sup> *Nev. Power Corp.*, 149 FERC ¶ 61,079, at P 28 (2014).

<sup>39</sup> Order No. 642, FERC Stats. & Regs. ¶ 31,111 at 31,897.

Analysis Screen (one piece of the Appendix A analysis), the Commission's analysis focuses on the merger's effects on the merged firm's ability and incentive to withhold output in order to drive up the market price."<sup>40</sup>

19. Tucson Electric asserts that based on the timing of the screen failure, the characteristics of the facility, the lack of elimination of a competitor, its lack of incentive to exercise market power, and the future retirement of San Juan 2, the Commission should find that the Proposed Transaction will not adversely affect horizontal competition. However, given the severity of the winter super peak screen failure and Tucson Electric's market share in that period, we find that the instant proceeding is distinguishable from the cases on which Tucson Electric relies in support of these arguments. In the instant case, on balance, given the severity of the winter super peak screen failure (543 points in the base case and 691 points in the sensitivity analysis) and Tucson Electric's market share in that period (33 percent), we find that the analysis shows that the Proposed Transaction will have an adverse effect on horizontal competition, and we will require the mitigation proposed by Tucson Electric. Tucson Electric's mitigation proposal to enter into a firm power sales agreement for at least 125 MW of capacity and energy from its existing system resources during all Winter peak period hours from December 1, 2016, through February 28, 2017, and December 1, 2017, through December 31, 2017, removes this sizable screen failure until such a time as the San Juan 2 unit will be removed from service. Accordingly, we find that Tucson Electric's mitigation proposal addresses our concerns regarding the impact of the Proposed Transaction on horizontal competition. Therefore, we will authorize the Proposed Transaction, subject to the condition that Tucson Electric enter into a firm power sales agreement as described above and submit that agreement to the Commission as an informational filing within 30 days of its execution, as offered in the Application. This finding is consistent with the 1996 Merger Policy Statement, where the Commission noted that the merger guidelines "contemplate using remedies to mitigate any harm to competition."<sup>41</sup> The Commission explained that "[t]here could be mergers where, at the end of an analysis, market power concerns persist but that could be made acceptable with measures to mitigate potential market power problems."<sup>42</sup>

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<sup>40</sup> Supplemental Policy Statement, FERC Stats. & Regs. ¶ 31,253 at P 60 (emphasis in original).

<sup>41</sup> 1996 Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,118.

<sup>42</sup> *Id.*

## 2. Effect on Vertical Competition

### a. Tucson Electric's Analysis

20. Tucson Electric states that the Proposed Transaction will not have an adverse impact on vertical competition. Tucson Electric maintains that the consolidation of Tucson Electric's electric transmission assets with the interests in Springerville Unit 1 and the Springerville Common Plant will not enhance vertical market power because it will not enhance any ability of Tucson Electric or any of its affiliates to restrict potential downstream competitors' access to upstream supply.<sup>43</sup> Tucson Electric states that access to its transmission lines is subject to the Tucson Electric OATT, and it asserts that the Commission has found that open access to transmission facilities provides sufficient assurance that the applicants could not use their control of transmission facilities in a manner that could harm competition.<sup>44</sup>

21. Tucson Electric states that the Proposed Transaction will not provide Tucson Electric with any ability to erect barriers to entry. Tucson Electric states that, other than limited natural gas assets at generation stations, it owns no natural gas assets. Tucson Electric submits that while its affiliate UNS Gas owns and operates a natural gas distribution network, it cannot use this system to restrict market entry because, among other reasons, UNS Gas is required by Arizona state law to offer retail gas service on a non-discriminatory basis.<sup>45</sup> Additionally, Tucson Electric states that neither itself nor any of its affiliates own or control sites for new potential generation in such quantities that the siting and construction of new generation is foreclosed or harmed in any meaningful way.<sup>46</sup>

### b. Commission Determination

22. In analyzing whether a proposed transaction presents vertical market power concerns, the Commission considers the vertical combination of upstream inputs, such as transmission or natural gas, with downstream generating capacity. As the Commission has previously found, transactions that combine electric generation assets with inputs to generating power (such as natural gas, transmission, or fuel) can harm competition if the transaction increases an entity's ability or incentive to exercise vertical market power in

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<sup>43</sup> Application at 14.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at 15.

<sup>46</sup> *Id.*

wholesale electricity markets. For example, by denying rival entities access to inputs or by raising their input costs, an entity created by a transaction could impede entry of new competitors or inhibit existing competitors' ability to undercut an attempted price increase in the downstream wholesale electricity market.<sup>47</sup>

23. Based on Tucson Electric's representations, we find that the Proposed Transaction will not have an adverse effect on vertical competition. Tucson Electric owns limited natural gas assets, and its affiliate's system cannot be used to restrict market entry. Additionally, Tucson Electric's transmission facilities will continue to be subject to the Tucson Electric OATT.

### **3. Effect on Rates**

#### **a. Tucson Electric's Analysis**

24. Tucson Electric states that the Proposed Transaction will not have an adverse impact on rates. Tucson Electric states that the contracts under which its wholesale electricity customers take service all contain either fixed or formula market-based rates that will be unaffected by the Proposed Transaction.<sup>48</sup> Accordingly, Tucson Electric maintains that these contracts do not allow it to impose any costs of the Proposed Transaction on its customers and, therefore, all of its wholesale customers are shielded from any adverse rate effects of the Proposed Transaction.<sup>49</sup>

25. According to Tucson Electric, the Proposed Transaction will have no adverse effect on its transmission service rates. Pursuant to the Tucson Electric OATT, Tucson Electric has stated rates for transmission service (and thus is unable to automatically pass through the costs related to the Proposed Transaction to its transmission customers), and is unable to change the rates charged for transmission service without filing an application with the Commission pursuant to section 205 of the FPA.<sup>50</sup> Therefore, Tucson Electric states that all of its transmission customers are shielded from any rate effects of the Proposed Transaction.

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<sup>47</sup> *Upstate Power Producers*, 154 FERC ¶ 61,015, at P 15 (2016); *Exelon Corp.*, 138 FERC ¶ 61,167, at P 112 (2012).

<sup>48</sup> Application at 15.

<sup>49</sup> *Id.* at 15-16.

<sup>50</sup> *Id.* at 16.

26. Tucson Electric pledges generally to hold harmless all wholesale power and transmission customers from any costs associated with the Proposed Transaction (e.g., transaction costs) for a period of five years, to the extent that such costs exceed savings related to the Proposed Transaction.<sup>51</sup> Tucson Electric states that, for purposes of this pledge, consistent with prior Commission orders, “transaction costs” in this context includes all transaction-related costs, including costs related to consummating the Proposed Transaction, incurred prior to the consummation of the Proposed Transaction, or in the five years after the Proposed Transaction’s consummation. Tucson Electric states the Commission has found similar commitments by applicants under FPA section 203 sufficient to alleviate any concerns regarding the impact of a proposed transaction on jurisdictional rates and that it should do the same here.<sup>52</sup>

**b. Commission Determination**

27. Based on Tucson Electric’s representations, we find that the Proposed Transaction will not have an adverse effect on rates. The contracts under which Tucson Electric’s wholesale electricity customers take service all contain either fixed or formula market-based rates that will be unaffected by the Proposed Transaction. Similarly, Tucson Electric’s transmission customers are served at stated rates that will be unaffected by the Proposed Transaction.

28. We accept Tucson Electric’s hold harmless commitment. We interpret Tucson Electric’s hold harmless commitment to apply to all transaction-related costs, including costs related to consummating the Proposed Transaction, incurred prior to the consummation of the Proposed Transaction, or during the five years after the Proposed Transaction’s consummation.

29. The Commission has established that, where applicants make hold-harmless commitments in the context of FPA section 203 transactions, in order to recover transaction-related costs, applicants must demonstrate offsetting benefits at the time they apply to recover those costs. The Commission has clarified its procedures for recovery of such costs under FPA sections 203 and 205.<sup>53</sup> Consistent with those clarifications, and given the commitment by Tucson Electric to hold transmission customers harmless from transaction-related costs, if Tucson Electric seeks to recover transaction-related costs incurred prior to the consummation of the Proposed Transaction or in the five years after

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<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *Exelon Corp.*, 149 FERC ¶ 61,148, at PP 106-109 (2014).

the consummation of the Proposed Transaction, then it must make that filing in a new FPA section 205 docket<sup>54</sup> and submit that same filing as a concurrent informational filing in this FPA section 203 docket.<sup>55</sup> The Commission will notice the new section 205 filing for public comment.

30. In the FPA section 205 proceeding, the Commission will determine first, whether Tucson Electric has demonstrated offsetting savings, supported by sufficient evidence, to customers served under Commission jurisdictional rate schedules such that recovery of transaction-related costs is consistent with the hold-harmless commitment and, second, whether the resulting new rate is just and reasonable in light of all the other factors underlying the proposed new rate. In the FPA section 205 filing, Tucson Electric must: (1) specifically identify the transaction-related costs it is seeking to recover, and (2) demonstrate that those costs are exceeded by the savings produced by the Proposed Transaction. Tucson Electric must show that the proposed rate is just and reasonable in addition to providing appropriate evidentiary support, such as reasonable documentation and estimates of the costs avoided, demonstrating that transaction-related costs have been offset by transaction-related savings in order to recover those transaction-related costs and comply with its hold harmless commitment. Those savings must be realized prior to, or concurrent with, any authorized recovery of transaction-related costs, and cannot be based on estimates or projections of future savings, but must be based on a demonstration of actual transaction-related savings realized by jurisdictional customers.<sup>56</sup> The Commission will consider rates not to be “just and reasonable” if they include recovery of costs subject to a hold-harmless commitment made in connection with an FPA section 203 application and if applicants fail to show offsetting savings due to the transaction.<sup>57</sup>

31. The Commission will be able to monitor Tucson Electric’s hold harmless commitment under its authority under section 301(c) of the FPA<sup>58</sup> and the books and

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<sup>54</sup> The Commission will not authorize the recovery of transaction-related costs in an annual informational filing under existing formula rates.

<sup>55</sup> Upon receipt, the Commission will not act on or notice the concurrent informational filing.

<sup>56</sup> See *Audit Report of National Grid USA*, Docket No. FA09-10-000 (Feb. 11, 2011) at 55; see also *Ameren Corp.*, 140 FERC ¶ 61,034, at PP 36-37 (2012).

<sup>57</sup> *Exelon Corp.*, 149 FERC ¶ 61,148 at P 107.

<sup>58</sup> 16 U.S.C. § 825(c) (2012).

records provision for the Public Utility Holding Company Act of 2005 (PUHCA 2005),<sup>59</sup> if applicable. Moreover, the commitment is fully enforceable based on the Commission's authority under section 203 of the FPA.

#### **4. Effect on Regulation**

##### **a. Tucson Electric's Analysis**

32. Tucson Electric asserts that the Proposed Transaction will not have an adverse effect on regulation. Tucson Electric states that the Proposed Transaction will not diminish federal regulatory authority over Tucson Electric or Springerville 1 because Tucson Electric, as well as its jurisdictional assets and wholesale power sales from Springerville 1, will remain subject to the Commission's jurisdiction under the FPA.<sup>60</sup> Furthermore, Tucson Electric asserts that the Commission's concern that state regulators should not be divested of authority to act on mergers of traditional, vertically-integrated utilities with captive retail (as well as wholesale) customers is not applicable in this case because the Proposed Transaction is not a traditional merger, but rather, the conversion of an existing long-term lease of a generating facility into a fee interest.<sup>61</sup>

##### **b. Commission Determination**

33. The Commission's review of a transaction's effect on regulation focuses on ensuring that it does not result in a regulatory gap.<sup>62</sup> As to whether a proposed transaction will have an effect on state regulation, the Commission explained in the Merger Policy Statement that it ordinarily will not set the issue of the effect of a proposed transaction on state regulatory authority for a trial-type hearing where a state has authority to act on the proposed transaction. However, if the state lacks this authority and raises concerns about the effect on regulation, the Commission may set the issue for hearing and it will address such circumstances on a case-by-case basis.<sup>63</sup> Based on Tucson Electric's representations, we find no evidence that either state or federal regulation will be impaired by the Proposed Transaction. Both before and after the

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<sup>59</sup> 42 U.S.C. § 16452 (2012).

<sup>60</sup> Application at 17.

<sup>61</sup> *Id.*

<sup>62</sup> 1996 Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,124.

<sup>63</sup> *Id.*

Proposed Transaction is consummated, Tucson Electric, as well as its jurisdictional assets and wholesale power sales from Springerville 1, will remain subject to the Commission's jurisdiction under the FPA. Finally, we note that no party alleges that regulation, state or federal, would be impaired by the Proposed Transaction, and no state commission has requested that the Commission address the issue of the effect on state regulation.

## **5. Cross-Subsidization**

### **a. Tucson Electric's Analysis**

34. Tucson Electric states that, based on facts and circumstances known or that are reasonably foreseeable, the Proposed Transaction will not result in, at the time of the Proposed Transaction or in the future, cross-subsidization of a non-utility associate company or pledge or encumbrance of utility assets for the benefit of an associate company. Specifically, Tucson Electric states the following: (1) Tucson Electric's utility assets are not pledged or encumbered except as through general bond issuances such as those routinely used by utilities to raise capital; (2) the Proposed Transaction will not result in any transfer of facilities between a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, and an associate company; (3) Tucson Electric may, in order to effectuate the Proposed Transaction, issue new debt, but such issuance will not benefit any associate company and, therefore, will not result in any new issuance of securities by a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company; (4) Tucson Electric may, in order to effectuate the Proposed Transaction, issue new debt, but such issuance will not benefit any associate company and, therefore, will not result in any new pledge or encumbrance of assets of a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company; and (5) the Proposed Transaction will not result in any new affiliate contract between a non-utility associate company and a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, other than non-power goods and services agreements subject to review under sections 205 and 206 of the Federal Power Act.

35. In light of the foregoing, and the general fact that the Proposed Transaction as a whole is an arm's length deal between unaffiliated entities (which will remain unaffiliated after consummation of the Transaction), Tucson Electric states that there is no need for a further examination of cross subsidization and encumbrance concerns as to the Proposed Transaction.

**b. Commission Determination**

36. Based on Tucson Electric's representations, we find that the Proposed Transaction will not result in the cross-subsidization of a non-utility associate company by a utility company, or in a pledge or encumbrance of utility assets for the benefit of an associate company. We note that no party has argued otherwise.

**C. Other Considerations**

37. Information and/or systems connected to the bulk system involved in this transaction may be subject to reliability and cybersecurity standards approved by the Commission pursuant to FPA section 215. Compliance with these standards is mandatory and enforceable regardless of the physical location of the affiliates or investors, information database, and operating systems. If affiliates, personnel or investors are not authorized for access to such information and/or systems connected to the bulk power system, a public utility is obligated to take the appropriate measures to deny access to this information and/or the equipment/software connected to the bulk power system. The mechanisms that deny access to information, procedures, software, equipment, etc., must comply with all applicable reliability and cybersecurity standards. The Commission, North American Electric Reliability Corporation or the relevant regional entity may audit compliance with reliability and cybersecurity standards.

38. Section 301(c) of the FPA gives the Commission authority to examine the books and records of any person who controls, directly or indirectly, a jurisdictional public utility insofar as the books and records relate to transactions with or the business of such public utility. The approval of the Proposed Transaction is based on such examination ability. In addition, applicants subject to PUHCA 2005 are subject to the record-keeping and books and records requirements of PUHCA 2005.

39. Order No. 652 requires that sellers with market-based rate authority timely report to the Commission any change in status that would reflect a departure from the characteristics the Commission relied upon in granting market-based rate authority.<sup>64</sup> To the extent that a transaction authorized under FPA section 203 results in a change in status, sellers that have market-based rates are advised that they must comply with the requirements of Order No. 652.

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<sup>64</sup> *Reporting Requirement for Changes in Status for Public Utilities with Market-Based Rate Authority*, Order No. 652, FERC Stats. & Regs. ¶ 31,175, *order on reh'g*, 111 FERC ¶ 61,413 (2005). *See* 18 C.F.R. § 35.42 (2016).

The Commission orders:

(A) The Proposed Transaction is hereby conditionally authorized, as discussed in the body of this order.

(B) Tucson Electric is hereby directed to submit its firm power sales agreement to the Commission as an informational filing within 30 days of its execution, as discussed in the body of this order.

(C) Tucson Electric must inform the Commission of any material change in circumstances that departs from the facts or representations that the Commission relied upon in authorizing the Proposed Transaction within 30 days from the date of the material change in circumstances.

(D) 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 not pending or may come before the Commission.

(E) 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.

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

(G) Tucson Electric shall make any appropriate filings under section 205 of the FPA, as necessary, to implement the Proposed Transaction.

(H) Tucson Electric shall notify the Commission within 10 days of the date on which the Proposed Transaction is consummated.

(I) Tucson Electric shall account for the Proposed Transaction in accordance with Electric Plant Instruction No. 5 and Account 102, Electric Plant Purchased or Sold of the Uniform System of Accounts. Tucson Electric shall submit its final accounting entries within six months of the date that the transaction is consummated, and the accounting submissions shall provide all the accounting entries and amounts related to the transfer along with narrative explanations describing the basis for the entries.

(J) If Tucson Electric seeks to recover transaction-related costs through its transmission or wholesale requirements rates, it must make a new FPA section 205 filing and submit concurrently an informational filing in the instant FPA section 203 docket.

In the FPA section 205 filing, Tucson Electric must: (1) specifically identify the transaction-related costs it is seeking to recover; and (2) demonstrate that those costs are exceeded by the savings produced by the Proposed Transaction.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.