

139 FERC ¶ 61,094
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Bluegrass Generation Company, L.L.C.
Louisville Gas and Electric Company
Kentucky Utilities Company

Docket No. EC12-29-000

ORDER CONDITIONALLY AUTHORIZING DISPOSITION AND ACQUISITION
OF JURISDICTIONAL FACILITIES AND ACQUISITION OF GENERATING
FACILITIES

(Issued May 4, 2012)

1. On November 14, 2011, Louisville Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU, and collectively with LG&E, LG&E/KU)¹ and Bluegrass Generation Company, L.L.C. (Bluegrass Generation, and collectively with LG&E/KU, Applicants) filed an application requesting Commission authorization under section 203(a)(1) of the Federal Power Act (FPA)² and Part 33 of the Commission's regulations,³ for LG&E/KU to purchase from Bluegrass Generation an approximately 495 megawatt (MW) gas-fired generating facility (Bluegrass Facility) and certain

¹ LG&E/KU state that they have filed this section 203 application on behalf of themselves and, to the extent necessary, their public utility affiliates in the PPL Corporation family of companies, which include: Electric Energy, Inc., LG&E Energy Marketing, Inc., Midwest Electric Power, Inc., PPL Electric Utilities Corporation, Lower Mount Bethel Energy, LLC, PPL Brunner Island, LLC, PPL Great Works, LLC, PPL Holtwood, LLC, PPL Maine, LLC, PPL Martins Creek, LLC, PPL Montour, LLC, PPL Susquehanna, LLC, PPL EnergyPlus, LLC, PPL New Jersey Solar, LLC, PPL New Jersey Biogas, LLC, PPL Renewable Energy, LLC, PPL Montana, LLC, PPL Colstrip I, LLC, and PPL Colstrip II, LLC.

² 16 U.S.C. § 824b(a)(1) (2006).

³ 18 C.F.R. pt. 33 (2011).

jurisdictional facilities (Proposed Transaction).⁴ The Commission has reviewed the Application under the Commission's Merger Policy Statement.⁵ The Commission finds that the Proposed Transaction results in significant screen failures in the horizontal market power analysis. Therefore, the Commission is unable, at this time, to find that the Proposed Transaction will not have an adverse effect on competition. The Proposed Transaction is thus conditionally authorized, subject to LG&E/KU proposing adequate mitigation to remedy the identified screen failures, as discussed below.

I. Background

A. Description of the Parties

2. LG&E/KU are vertically-integrated electric utilities that are part of the PPL Corporation family. They are indirect, wholly-owned subsidiaries of PPL Corporation, a holding company under the Public Utility Holding Company Act of 2005.⁶ Applicants state that, through various subsidiaries, PPL Corporation delivers electricity to more than 1.4 million customers in Pennsylvania, delivers electricity and natural gas to 1.3 million customers in Kentucky, Virginia and Tennessee, and sells energy in key U.S. markets.

3. LG&E is a public utility that owns and operates electric generation, transmission and distribution facilities, and also natural gas distribution, transmission and storage

⁴ *Application for Approval Pursuant to Section 203 of the Federal Power Act and Request for Expedited Consideration*, Docket No. EC12-29-000 (Nov. 14, 2011) (Application). The jurisdictional facilities associated with the Proposed Transaction include limited generation interconnection facilities and step-up transformers. Bluegrass Generation also states that authorization for termination of the lease for the Bluegrass Facility that it currently has with Oldham County, Kentucky may be required under section 203(a)(1). Application at n.5.

⁵ *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) (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 (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).

⁶ 42 U.S.C. §§ 16,451-16,463 (2006).

facilities in Kentucky, with limited electric transmission and natural gas storage facilities in Indiana. KU is a public utility that owns and operates electric generation, transmission and distribution facilities in Kentucky, Virginia, and Tennessee. Combined, LG&E and KU directly own approximately 8,001 MW of generation capacity and hold minority interests in certain entities that own generation.⁷ Together they serve approximately 941,000 electric customers, and LG&E serves approximately 322,000 natural gas customers. LG&E and KU are authorized to engage in wholesale sales of capacity and energy at market-based rates,⁸ but their market-based rate tariffs are currently limited to sales outside of the joint LG&E/KU balancing authority area (LG&E/KU BAA). KU also supplies power to several wholesale customers within the LG&E/KU BAA under cost-based formula rates.⁹

4. Additionally, Applicants state that LG&E owns and operates approximately 379 miles of natural gas transmission mains and approximately 4,249 miles of natural gas distribution mains, the majority of which are located in Kentucky. LG&E also owns five natural gas storage fields located in Kentucky and Indiana. LG&E/KU jointly own and operate an approximately six-mile natural gas transmission pipeline in Kentucky. KU owns and operates an approximately eleven-mile natural gas transmission pipeline in Kentucky.

5. Applicants state that Bluegrass Generation is a Delaware limited liability company, and a wholly-owned subsidiary of Port River, LLC (Port River). Port River is a Delaware limited liability company owned by LS Power Equity Partners II, L.P. and indirectly owned by LS Power Equity Partners II PIE, L.P. and LS Power Partners II, L.P. Bluegrass Generation is an exempt wholesale generator and has received market-based rate authority from the Commission.

6. The Bluegrass Facility is a three-unit, simple-cycle, gas-fired combustion turbine peaking generating facility with a combined summer rating of 495 MW located in

⁷ Applicants list the energy subsidiaries and energy affiliates of LG&E/KU in Exhibit B to the Application.

⁸ *Louisville Gas & Elec. Co.*, 85 FERC ¶ 61,215 (1998) (accepting for filing joint market-based rate tariff of LG&E/KU, FERC Electric Tariff, Original Vol. No. 2); *Louisville Gas & Elec. Co.*, Docket No. ER02-1077-000 (Apr. 16, 2002) (delegated letter order accepting “short form” market-based rate tariff of LG&E/KU, FERC Electric Tariff, Original Vol. No. 3).

⁹ *Kentucky Utilities Co.*, 125 FERC ¶ 61,242 (2008).

LaGrange, Kentucky.¹⁰ The Bluegrass Facility is interconnected with LG&E's transmission system and the natural gas lines supplying fuel to the Bluegrass Facility are owned by Texas Gas Transmission. Applicants state that the energy output of the Bluegrass Facility is sold to a variety of parties, including LG&E and KU, on a spot basis.

B. Description of Proposed Transaction

7. Applicants state that, in order to comply with existing and planned Environmental Protection Agency (EPA) regulations for power plant emissions, LG&E/KU intend to retire six coal-fired generating units at three locations. As a result, LG&E/KU's generating capacity will be reduced by approximately 800 MW. Applicants state that these retirements will result in a capacity shortfall in 2016 of 877 MW, creating a significant need for new and additional resources to meet LG&E/KU's current load and projected load growth. After considering various resource alternatives, Applicants state that LG&E/KU have requested approval from the Kentucky Public Service Commission (Kentucky Commission) to build a natural gas combined-cycle generating unit at the existing Cane Run site and purchase the Bluegrass Facility. Applicants also state that they expect to file an application seeking Virginia State Corporation Commission (Virginia Commission) approval for the Proposed Transaction.¹¹

8. Under the terms of the asset purchase agreement between Bluegrass Generation and LG&E/KU, LG&E/KU will pay approximately \$110 million in cash for the Bluegrass Facility, subject to certain adjustments. The facilities to be conveyed include the generating facility itself, generator leads, and step-up transformers. LG&E/KU will acquire the Bluegrass Facility as tenants in common, with LG&E owning a 69 percent interest and KU a 31 percent interest.¹² Applicants state that Bluegrass Generation will retain its market-based rate tariff, as well as contracts and books and records thereunder.

¹⁰ Applicants explain that the Bluegrass Facility is currently subject to a lease with Oldham County, Kentucky, and that immediately prior to the consummation of the Proposed Transaction, the lease will be terminated so that ownership of the Bluegrass Facility will revert to Bluegrass Generation before the sale of the facility to LG&E/KU. Application at 7.

¹¹ Application at 8-10, 29.

¹² *Id.* at 10, 21.

II. Notice of Filing

9. Notice of Applicants' filing was published in the *Federal Register*, 76 Fed. Reg. 72,195 (2011), with interventions and protests due on or before December 5, 2011. The comment date was subsequently extended to January 13, 2012.¹³ No interventions or protests were filed.

III. Discussion

A. Standard of Review Under Section 203

10. Section 203(a)(4) requires the Commission to approve a transaction if it determines that the transaction will be consistent with the public interest.¹⁴ The Commission's analysis of whether a transaction will be 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.¹⁵ Section 203(a)(4) also requires the Commission to find that the 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. The Commission's regulations establish verification and information requirements for applicants that seek a determination that a transaction will not result in inappropriate cross-subsidization or pledge or encumbrance of utility assets.¹⁶

B. Analysis Under Section 203

1. Effect on Competition – Horizontal Market Power

a. Applicants' Analysis

11. Applicants submit that the Proposed Transaction will have no adverse effect on horizontal competition in generation. They identify the following relevant products across relevant geographic markets as: non-firm energy, short-term capacity (firm energy), long-term capacity, and certain ancillary services. In their analysis of non-firm

¹³ Errata Notice Extending Comment Date (Issued November 17, 2011), Docket No. EC12-29-000.

¹⁴ 16 U.S.C. § 824b(a)(4) (2006).

¹⁵ See Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,111.

¹⁶ 18 C.F.R. § 33.2(j) (2011).

energy markets, Applicants argue that the relevant geographic market for analysis of the impact of the Proposed Transaction on horizontal competition in generation is the LG&E/KU BAA, as this is the only market in which the sales of LG&E/KU (and their affiliates) overlap with that of Bluegrass Generation.¹⁷ Applicants explain that the Bluegrass Facility is located in the LG&E/KU BAA, interconnected with the transmission lines owned by LG&E, and the vast majority of sales from the Bluegrass Facility are made to LG&E/KU to serve their customers in the LG&E/KU BAA.¹⁸

12. In their analysis of non-firm energy markets, Applicants use economic capacity (EC) and available economic capacity (AEC) as proxies for a supplier's ability to participate in the market.¹⁹ Applicants performed an Appendix A analysis, which includes a Delivered Price Test, to evaluate the effect on competition in the relevant markets over 10 separate time periods: super peak, peak and off-peak periods for summer, winter and shoulder seasons, along with an extreme summer super peak. Although Applicants' analysis considers all 10 periods, they state that the Bluegrass Facility is economic in only the two summer peak periods (summer super peak 1 and summer super peak 2), the winter super peak period and the shoulder super peak period.²⁰

13. Applicants incorporate prices in their Delivered Price Test analysis ranging from \$26/MWh in the shoulder off-peak period to \$72/MWh in the summer super peak 1 period.²¹ Applicants also examine price sensitivities of base case prices plus 10 percent, with prices ranging from \$28/MWh in the shoulder off-peak period to \$79/MWh in the summer super peak 1 period.²² They also examine a sensitivity with prices 10 percent

¹⁷ Application at 12; and Appendix 2 (Solomon Affidavit) at 9-10.

¹⁸ *Id.* at 12-13. Applicants state that the both LG&E/KU (along with their affiliates) and Bluegrass Generation make sales in the PJM Interconnection, L.L.C. (PJM) BAA, but that such sales are *de minimis*. See Application at nn.28-29.

¹⁹ Each supplier's "economic capacity" is the amount of capacity that could compete in the relevant market given market prices, running costs, and transmission availability. "Available economic capacity" is based on the same factors but subtracts the supplier's native load obligation from its capacity and adjusts transmission availability accordingly. Applicants state that under both measures, capacity that is attributed to a market participant is that capacity controlled by it that can reach the destination market, taking transmission constraints and costs into account, at a price no higher than 105 percent of the destination market price. Appendix 2 (Solomon Affidavit) at 9-10.

²⁰ Application at 13.

²¹ Appendix 2 (Solomon Affidavit) at 21.

²² *Id.* at 24.

less than those in the base case, and an additional sensitivity based on Ventyx forecast prices, with prices ranging from \$29/MWh in the shoulder off-peak period to \$90/MWh in the summer super peak 1 period.²³

14. In explaining the choice of prices used in their Delivered Price Test analysis, Applicants state that data for markets that are not in regional transmission organizations (RTO), such as the LG&E/KU BAA, are derived from data found in Electric Quarterly Reports (EQRs), or based on third-party forecasts. Applicants argue that reliance on EQR data is not without problems in the context of the Proposed Transaction. Among other things, Applicants state that short-term transactions in the LG&E/KU BAA are reported for a very small number of hours (approximately 1,000 hours in 2010). Applicants state that this is far fewer hours, covering far less volume, than the Commission deemed to be statistically reliable in its recent order conditionally approving the merger of Duke Energy Corporation and Progress Energy, Inc.²⁴ Applicants state that observations in the LG&E/KU BAA totaled 11.5 percent per year (i.e., 11.5 percent of 8,760 hours), as compared to 47 percent and 56 percent for the Duke Energy Carolinas and Progress Energy Carolinas East BAAs, respectively, as detailed in the Duke/Progress Merger Order.²⁵

15. Second, Applicants state that the Proposed Transaction involves the acquisition of a single generating asset, which, as a combustion turbine (CT), is expected to operate infrequently. In this regard, Applicants state that the Bluegrass Facility operated only 315 hours in 2010 (3.6 percent), and had an average capacity factor of about 2.5 percent.²⁶ Applicants add that some LG&E/KU CTs have tended to have somewhat higher capacity factors (about 8 percent in 2010), but argue that any price series that infers operation of CTs at significantly higher levels raises serious doubts about the validity of the assumption about destination market prices.²⁷

16. Third, Applicants state that a review of the potential destination market prices drawn from the three available data sources (system lambdas, EQRs, and Ventyx forecast

²³ *Id.* at 25.

²⁴ *Id.* at 14 (quoting *Duke Energy Corp.*, 136 FERC ¶ 61,245, at P 126 (2011) (Duke/Progress Merger Order)).

²⁵ *Id.* at 13-15.

²⁶ *Id.* at 15.

²⁷ *Id.*

prices)²⁸ provided further insight into choosing reasonable market prices for the Delivered Price Test. Applicants state that using system lambdas generates an implied capacity factor of 0.01 percent for the Bluegrass Facility, both Ventyx forecast prices and EQR/system lambdas generate implied capacity factors of 4.7 percent, while EQR average prices generate an implied capacity factor of 28.7 percent. On the basis of implied capacity factors, Applicants argue that the appropriate base case prices to use for this analysis is the combination of system lambdas and EQRs, and therefore used this price series as the base case for their analysis.²⁹

17. Applicants report failures of the Competitive Analysis Screen for AEC in all four seasons/load conditions in which the Bluegrass Facility is economic: super summer peak 1 and 2, winter super peak and shoulder super peak. The screen failures range from 402 to 1,081 points, with post-merger market concentrations ranging from 1,250 to 2,780 on the Herfindahl-Hirschman Index (HHI), with two screen failures occurring in a moderately concentrated market, denoted by an HHI value between 1,000 and 1,800, and two more in highly concentrated markets, denoted by an HHI value above 1,800.³⁰

²⁸ *Id.* at 16. Applicants state that their “system lambdas” price series is based on 2010 LG&E/KU hourly data reported in its FERC Form No. 714, adjusted to reflect 2012 system conditions by adjusting the prices to reflect changes in fuel costs between 2010 and 2012. Likewise, the Ventyx price series is based on Ventyx near-term (18 month) price forecast for 2012, for the LG&E/KU and East Kentucky Power Company BAAs, the EQR Average price series is based on a simple average of EQR short-term energy sales for the LG&E/KU BAA in 2010, also adjusted to reflect changes in fuel costs between 2010 and 2012, and the EQR/system lambda price series is based on a combination of EQR data and system lambdas, by “filling in” missing EQR price observations with system lambda data, with the implication that if there are no short-term sales, system lambdas become a reasonable approximation of the market price.

²⁹ Appendix 2 (Solomon Affidavit) at 16-17.

³⁰ Appendix 2 (Solomon Affidavit) at 8, n.5. The HHI is a widely accepted measure of market concentration, calculated by squaring the 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 its screen and warrants further review. Merger Policy Statement, FERC Stats. & Regs.

(continued...)

Applicants argue that AEC is the appropriate measure by which to evaluate the impact of the Proposed Transaction on competition because there is no retail competition in Kentucky and the Commission has tended to rely on Delivered Price Test results for AEC where there is no retail competition.³¹

18. Applicants note that the Commission has indicated that it considers whether a proposed transaction will remove a competitor from the marketplace.³² Applicants state that in the present case, although the Proposed Transaction will result in Bluegrass Generation and its affiliates no longer controlling generating capacity in the LG&E/KU BAA, that change will not for all intents and purposes remove a competitor from the marketplace.³³

19. Specifically, Applicants note that, in recent years, LG&E/KU have purchased most of the output of the Bluegrass Facility. Applicants state that in 2010 LG&E/KU purchased 88,494 MWh of the 90,180 MWh of energy (including imbalance energy) reportedly sold by Bluegrass Generation, or 98 percent. Additionally, according to Applicants, in the first three quarters of 2011, LG&E/KU purchased all of the 34,172 MWh of energy (including imbalance energy) reportedly sold by Bluegrass Generation. Further, because the facility's capacity factor is low - approximately 2 percent in recent years - the acquisition of the facility by LG&E/KU to serve native load obligations will not, according to Applicants, create a market power problem in energy markets. Applicants state that, in recent years, the few sales not made directly or indirectly to LG&E/KU were made not in the LG&E/KU BAA, but rather in the PJM footprint. Applicants add that KU's wholesale customers are under requirements contracts with five-year termination provisions.³⁴

¶ 31,044 at ¶ 30,129; *see 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).

³¹ Appendix 2 (Solomon Affidavit) at 3 n.1 (citing Duke/Progress Merger Order, among others).

³² Application at 13, n.30. Applicants cite to Order No. 642, in which the Commission stated, at P 38: "Recognizing that energy companies are entering new product markets and that the effect of a merger could be to eliminate one of the merged companies as a perceived potential competitor in such new product markets, we will...require applicants to identify product markets in which they may be reasonably perceived as potential competitors."

³³ Application at 13.

³⁴ *Id.* at 13-14; Appendix 2 (Solomon Affidavit) at 3.

20. Applicants state that, in addition to LG&E/KU, there are only two other entities in the LG&E/KU BAA with a possible need to purchase wholesale energy in the marketplace – Owensboro Municipal Utilities (Owensboro), which generally satisfies its needs from its own generation, and the Kentucky Municipal Power Agency (KMPA), which in the past has been a wholesale customer of the Tennessee Valley Authority (TVA). Applicants further state that, currently, KMPA primarily purchases power from the Midwest Independent System Transmission Operator, Inc. market pending completion of the Prairie State Energy generating facility, of which KMPA owns a 7.82 percent share. Applicants state that, after the Prairie State Energy generating facility begins commercial operation, that facility will be sufficient to serve KMPA’s load. Applicants conclude that, because they already purchase 98 percent of the output of the Bluegrass Facility and for the other reasons outlined above, a change in ownership of the Bluegrass Facility from Bluegrass Generation to LG&E/KU will not “materially remove a competitor from the marketplace.”³⁵

21. Applicants state that because of the time required to retrofit existing units with additional pollution controls and the time required to construct new generating capacity, LG&E/KU had to conduct studies and issue a request for proposals in 2010 so they would have time to implement the least cost alternative determined through the process. Applicants state that the acquisition of the Bluegrass Facility proved to be an element of the least cost solution even though it involves an acquisition in 2012 of capacity that is not expected to be required until 2016 with the retirement of certain coal units. Applicants argue that any increase in market concentration is thus transitory in nature and does not indicate the type of structural market power problem that generally concerns the Commission in the section 203 context.³⁶ Specifically, Applicants state that these retirements will result in a capacity shortfall of 877 MW in 2016.³⁷

22. Applicants further argue that the Commission has approved transactions under FPA section 203 which, like the instant one, involved relatively small quantities of generating capacity where there were Competitive Analysis Screen failures for some periods,³⁸ citing, for example, the Commission’s 2005 approval of the acquisition by Nevada Power Company of a 75 percent interest in a 560 MW generating facility located in the Nevada Power BAA. Applicants note that the application in that case showed

³⁵ *Id.* at 14-15.

³⁶ *Id.* at 15-16.

³⁷ *Id.* at 13-14.

³⁸ *Id.* at 16.

Competitive Analysis Screen failures for one period under the AEC measure and for 11 of 14 periods under the EC measure.³⁹

23. Applicants assert that several facts that the Commission found important in *Nevada Power* are also relevant to the Proposed Transaction. First, Nevada Power Company lacked market-based rate authority in its home BAA. Second, the Nevada Power BAA remained only moderately concentrated following the transaction in the spring peak period, the one period under the AEC measure showing a screen failure. Applicants note that the Commission nevertheless determined in that case that the transaction did not adversely affect competition and urge the Commission to come to the same conclusion with respect to the Proposed Transaction.⁴⁰

b. Commission Determination

24. We find that, based on the record in this proceeding, Applicants have not shown that the Proposed Transaction will not have an adverse effect on horizontal competition in the LG&E/KU BAA. We will, however, afford Applicants the opportunity to propose mitigation measures to address the screen failures identified below. This approach is consistent with the Merger Policy Statement, in which the Commission noted that the merger guidelines “contemplate using remedies to mitigate any harm to competition.”⁴¹ 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.”⁴² We stated that proposing mitigation measures could “avoid the need for a formal hearing on competition issues and thus result in a quicker decision.”⁴³

25. Accordingly, as discussed more fully below, we conditionally authorize the Proposed Transaction, subject to LG&E/KU proposing adequate mitigation to address the existing screen failures in all four seasons/load conditions. Such mitigation measures are necessary to address the screen failures reported by Applicants attributed to the additional capacity that LG&E/KU will have from the date that the Proposed Transaction closes until capacity is removed from the LG&E/KU BAA as a result of all of the coal-fired units ceasing commercial operations. If commercial operation has ceased at all of the

³⁹ *Id.* (citing *Nevada Power Co.*, 113 FERC ¶ 61,265 (2005) (*Nevada Power*)).

⁴⁰ *Id.* at 16-17.

⁴¹ Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,118.

⁴² *Id.*

⁴³ *Id.*

coal-fired units referenced in the Application, but screen failures still exist, LG&E/KU must propose additional mitigation measures to address the screen failures and such measures must be accepted by the Commission. In this way, the Commission will be able to ensure that there is no adverse effect on horizontal competition resulting from the Proposed Transaction either during the interim period or after. In any event, a new Delivered Price Test must be filed no later than December 31, 2016 so the Commission can determine if the mitigation should continue to be necessary.

26. We agree with Applicants that market prices, *supplemented* by system lambdas, provide a more accurate picture of the competitive situation in the LG&E/KU BAA than EQR data alone.⁴⁴ We make this determination based on Applicants' construction of implied capacity factors⁴⁵ and the limited amount of EQR data available for transactions in the LG&E/KU BAA. However, we note that in their plus 10 percent price sensitivity run, Applicants did not include a price range sufficient to cover a full range of possible price conditions, since the maximum price they examined was only \$79/MWh.

27. Applicants' Delivered Price Test results using EQR prices supplemented by system lambda data show that there are screen failures in four of the 10 seasons/load periods in the AEC base case. These failures occur in the summer super peak 1 and summer super peak 2, winter super peak, and shoulder super peak seasons/load periods where LG&E/KU have high market shares involving large HHI increases.⁴⁶ The

⁴⁴ However, as we stated in the Duke/Progress Merger Order, the Commission prefers the use of actual market prices rather than price proxies such as system lambda. *See* Duke/Progress Merger Order, 136 FERC ¶ 61,245 at P 121.

⁴⁵ Applicants construct the price series, "EQR Average," based on a simple average of EQR short-term energy sales for the LG&E/KU BAA in 2010, adjusted to reflect changes in fuel costs between 2010 and 2012. Applicants' analysis using these prices results in a predicted (or "implied") capacity factor of 28.7 percent for the Bluegrass Facility. It is not reasonable to expect a peaking unit, such as the Bluegrass Facility, to operate in this many hours of the year. In contrast, Applicants' price series based on a combination of EQR data and system lambdas (EQR/lambdas), constructed by filling in missing EQR data with system lambdas, results in an implied capacity factor of 4.7 percent. Since this price series generates a much more reasonable capacity factor for the Bluegrass Facility, the Commission accepts it for use in its analysis of the impact of the Proposed Transaction on horizontal competition.

⁴⁶ The post-merger HHI for summer super peak 1 is 1,458 with an increase of 402 points; for summer super peak 2 the post-merger HHI is 2,780 with an increase of 1,081 points; and for winter super peak, the post-merger HHI is 1,954 with an increase of 595 points. LG&E/KU's largest market share in these three periods is 51.5 percent.

sensitivity analysis performed using EQR prices supplemented by system lambda data with a 10 percent price increase results in one additional screen failure, for a total of five screen failures.⁴⁷ The sensitivity analysis performed using EQR prices with a 10 percent decrease results in only three screen failures.⁴⁸ Based on these results, Applicants fail the summer super peak 1, summer super peak 2, and winter super peak seasons/load periods, under both the base case and 10 percent price increase sensitivity analyses.⁴⁹

28. The Commission is normally concerned with cases where there are systematic screen failures, that is, where screen failures “present a consistent pattern across time periods and/or markets.”⁵⁰ The Commission has indicated that systematic screen failures in markets that are highly concentrated and where an entity seeking authorization has a significant share of the market are a cause for concern.⁵¹ We find that the screen failures in the LG&E/KU BAA (as shown in the table below) demonstrate a consistent pattern across various time periods and therefore indicate potential harm to competition. The failures are present in both summer and winter in all three price series (i.e., the base case, and the 10 percent price increase and 10 percent price decrease) as well as in multiple periods in the summer.

⁴⁷ The additional failure is in the summer peak period (post-merger HHI of 3,857, an increase of 1,205 points). LG&E/KU’s market share in this period is 61.5 percent.

⁴⁸ The post-merger HHI for summer super peak 1 is 1,460 with an increase of 400 points; for summer super peak 2 the post-merger HHI is 2,768 with an increase of 1,077 points; for winter super peak, the post-merger HHI is 1,940 with an increase of 592 points. LG&E/KU’s largest market share in these three seasons/load periods is 51.5 percent.

⁴⁹ The post-merger HHI for summer super peak 1 is 1,524 with an increase of 458 points; for summer super peak 2 the post-merger HHI is 2,763 with an increase of 1,074 points; for winter super peak, the post-merger HHI is 1,938 with an increase of 590 points. LG&E/KU’s largest market share in these three seasons/load periods is 51.5 percent.

⁵⁰ *CP&L Holdings, Inc.*, 92 FERC ¶ 61,023, at 61,054 (2000).

⁵¹ *Nevada Power Co.*, 113 FERC ¶ 61,265, at P 15 (2005) (explaining that systematic screen failures would be cause for concern if a market was highly concentrated and post-merger the applicant had a more significant market share).

Table: Applicants' HHI Analysis

Period	Base Case Post Merger			Price Increase 10% Post Merger			Price Decrease 10% Post Merger			Ventyx Prices		
	Mkt Share	HHI	HHI Chg	Mkt Share	HHI	HHI Chg	Mkt Share	HHI	HHI Chg	Mkt Share	HHI	HHI Chg
S_SP1	35.90%	1,458	402	36.9%	1,524	458	35.9%	1,460	400	36.9%	1,524	458
S_SP2	51.50%	2,780	1,081	52.1%	2,835	1,095	51.5%	2,768	1,077	51.5%	2,763	1,074
S_P	23.90%	842	-	61.5%	3,857	1,205	21.1%	743	-	21.1%	741	-
S_OP	33.30%	1,349	-	45.0%	2,197	-	27.8%	1,059	-	33.3%	1,357	-
W_SP	42.70%	1,954	595	42.8%	2,001	595	42.8%	1,940	592	42.7%	1,938	590
W_P	15.30%	499	-	15.3%	482	-	0.8%	373	-	15.3%	500	-
W_OP	10.50%	422	-	21.0%	684	-	5.3%	517	-	10.6%	433	-
SH_SP	33.10%	1,250	418	34.9%	1,371	461	16.2%	526	-	26.0%	881	256
SH_P	3.30%	409	-	15.4%	550	-	0.5%	493	-	21.1%	671	-
SH_OP	20.70%	824	-	20.9%	745	-	19.5%	821	-	21.1%	709	-

Source: Solomon Affidavit at 21, 24, and 25.

29. We reject Applicants' argument that Bluegrass Generation is not a competitor in the wholesale markets in LG&E/KU BAA and, thus, that LG&E/KU's acquisition of the Bluegrass Facility will not materially remove a competitor from the market place. As noted above, Applicants base their argument on two claims: first, that Bluegrass Generation has not made any material sales to any entities other than LG&E/KU in the past few years; and second, that the only other potential wholesale market customers in the LG&E/KU BAA (Owensboro and KMPA) will not need to purchase any generation from the Bluegrass Facility. However, with respect to the first of these claims, Applicants ignore the fact that Bluegrass Generation made a competitive offer in LG&E/KU's request for proposals, indeed, one that LG&E/KU accepted as a least cost resource option. Therefore, the Proposed Transaction does remove a competitor from the marketplace. The latter claim is based on Applicants' unsubstantiated assertion that Owensboro and KMPA have not historically made purchases from Bluegrass Generation and that neither of them will do so in the future because, according to Applicants, Owensboro generally satisfies its needs from its own generation and KMPA will soon do so with the completion of the Prairie State Energy generation facility.

30. We also reject Applicants' argument that the facts presented in this case are similar to those in *Nevada Power*. In *Nevada Power*, there was only one screen failure in

a moderately concentrated market in which Nevada Power's market share was approximately 21 percent. Under these circumstances, the Commission did not find that Nevada Power had an ability to exercise market power.⁵² In contrast, in this proceeding, Applicants have reported a consistent pattern of screen failures across various time periods.

31. In light of the consistent pattern of screen failures discussed above, we find that Applicants have not shown that the Proposed Transaction will not have an adverse effect on horizontal competition in the LG&E/KU BAA. Therefore, the Commission is unable, at this time, to find that the Proposed Transaction will not have an adverse effect on competition. We are not persuaded that the Proposed Transaction will not harm competition, either during the interim period or after commercial operation has ceased at all of the coal-fired units have been. Specifically, the analysis Applicants provide does not demonstrate that the retirement of the coal-fired units will mitigate or address the screen failures that will result from the Proposed Transaction. Accordingly, the Commission is conditionally authorizing the Proposed Transaction subject to LG&E/KU making two compliance filings.

32. Specifically, in the first compliance filing, due within 60 days of the date of this order, LG&E/KU must propose adequate mitigation to address the existing screen failures in all four seasons/load conditions, as well as to demonstrate that they will pass our screens in future years when the coal-fired generating units have been retired. To remedy this concern, LG&E/KU could explore mitigation such as relinquishing operational control (or selling the output under a long-term firm contract) of a sufficient amount of the output of the Bluegrass Facility (or comparable other capacity) as to remedy the screen failures. We note that LG&E/KU are not limited to this mitigation, which is intended to serve as guidance only. LG&E/KU may propose a different mitigation measure to remedy the anticompetitive effects of the Proposed Transaction. LG&E/KU should include in their compliance filing an HHI analysis of the proposed mitigation reflecting a base case scenario of the pre-transaction market. After providing an opportunity for comments from interested parties, the Commission will issue a subsequent order indicating whether the proposed mitigation is sufficient.

33. LG&E/KU are directed to make a second compliance filing after a mitigation plan for LG&E/KU is approved by the Commission and the Proposed Transaction closes, within 60 days of the date on which the last of the six coal-fired units is no longer

⁵² *Nevada Power Co.*, 113 FERC ¶ 61,265 at P 15.

available for commercial operation,⁵³ but in any event, no later than December 31, 2016. In this compliance filing, LG&E/KU are directed to use the pre-transaction market as the base case to analyze the effect on competition. If, prior to December 31, 2016, LG&E/KU determine on the basis of a new Delivered Price Test that the conditions in the LG&E/KU BAA market have changed such that there are no longer any screen failures in the LG&E/KU BAA (i.e., LG&E/KU are able to demonstrate that they have ceased commercial operation of a sufficient amount of MW of capacity such that no horizontal screen failures remain), LG&E/KU may make their second compliance filing at that time.

2. Effect on Competition – Vertical Market Power

a. Applicants’ Analysis

34. Applicants contend that the Proposed Transaction does not raise any vertical market power issues. Applicants argue that the consolidation of LG&E/KU’s electric transmission assets with the Bluegrass Facility will not enhance vertical market power because it will not enhance any ability of LG&E/KU to restrict potential downstream competitors’ access to upstream supply. Applicants further note that LG&E/KU’s transmission lines are subject to an open access transmission tariff (OATT) and the oversight of Southwest Power Pool (SPP)⁵⁴ and TVA, and contend that the facilities to be acquired from Bluegrass Generation will provide LG&E/KU no enhanced ability to restrict potential downstream competitors’ access to upstream supply. Applicants argue that in previous transactions, the Commission has found that open access to transmission

⁵³ We note that Applicants use the terms “retire” and “retirement” to refer to an event or action that will cause the six coal-fired units listed in the Application to reduce LG&E/KU’s generating capacity by approximately 800 MW. We interpret these terms to refer to the point in time when the six plants are no longer available for commercial operation.

⁵⁴ We note that in *Louisville Gas & Elec. Co.*, 137 FERC ¶ 61,195 (2011), the Commission conditionally approved the appointment of TranServ International, Inc. as the Independent Transmission Organization for the LG&E/KU BAA when the contract with SPP expires on August 31, 2012.

facilities provided sufficient assurance that the applicants could not use their control of transmission facilities in a manner that could harm competition.⁵⁵

35. Applicants argue that LG&E's ownership of natural gas distribution systems and storage facilities also does not raise any vertical market power concerns. Applicants state that LG&E's natural gas distribution system and storage facilities are not connected with nor are they used to serve any non-affiliated gas-fired generating facilities. Applicants add that LG&E is authorized to offer firm and interruptible natural gas storage services in interstate commerce at market-based rates.⁵⁶ Applicants also state that Kentucky state law and regulation require LG&E to offer retail gas service on a non-discriminatory basis. Applicants assert that, while LG&E does reserve interstate pipeline capacity primarily to serve its retail customers, LG&E's share of the interstate pipeline capacity in Kentucky was recently estimated at no more than 2.2 percent.⁵⁷

36. Applicants argue that the Proposed Transaction will not provide LG&E/KU any ability to erect barriers to market entry. Applicants state that LG&E/KU's natural gas assets are limited in nature and cannot be used to restrict market entry. Applicants contend that while LG&E/KU own and control an extensive electric transmission system, access to this system – including generator interconnections – is subject to open access pursuant to the LG&E/KU OATT, which is administered by an independent transmission operator. Applicants add that neither LG&E/KU, Bluegrass Generation, nor any of their 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.⁵⁸

b. Commission Determination

37. 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 a firm's ability or incentive to exercise vertical market power in wholesale electricity markets. For example, by denying

⁵⁵ Application at 18 (citing *TECO Wholesale Generation, Inc.*, 107 FERC ¶ 62,208 (2004)).

⁵⁶ *Louisville Gas & Elec. Co.*, 99 FERC ¶ 62,040 (2002); *Louisville Gas & Elec. Co.*, 120 FERC ¶ 62,031 (2007).

⁵⁷ Application at 18-19 (citing *PPL Corp. and E.ON U.S. LLC*, Docket No. EC10-77, section 203 Application, Affidavit of Dr. Joseph P. Kalt and Joseph Cavicchi at P 76).

⁵⁸ Application at 19-20.

rival firms access to inputs or by raising their input costs, a firm created by the transaction could impede entry of new competitors or inhibit existing competitors' ability to undercut an attempted price increase in the downstream wholesale electricity market.

38. The Commission finds that the Proposed Transaction does not raise any vertical market power concerns. As Applicants note, LG&E/KU's transmission lines are subject to an open access transmission tariff and the oversight of SPP and TVA, and the only transmission facilities involved in the Proposed Transaction are limited interconnection facilities associated with the Bluegrass Facility. Likewise, Applicants have stated that LG&E's ownership of a natural gas distribution system and storage facilities also does not raise any vertical market power concerns, and that the Proposed Transaction will not increase Applicants' ability to erect barriers to entry.

3. Effect on Rates

a. Applicants' Analysis

39. Applicants argue that the Proposed Transaction will have no adverse effect on transmission rates or on rates for wholesale requirements customers. Applicants state that KU sells wholesale power to 12 municipal utilities under long-term agreements containing cost-based formula rates on file with the Commission. Applicants add that while the inputs to the formula will likely change as a result of the Proposed Transaction – by reflecting the net book value of the Bluegrass Facility – the formula itself will not change. Applicants state that any change to the formula inputs would likely result in only a small change in the amounts charged by KU to these wholesale customers and any increase may be offset by potential savings in energy rates. Applicants state that because KU will own 31 percent of the facility, that same percentage of the net book value of the facility will be included in the inputs to KU's formula rates, which LG&E/KU estimates will increase capacity charges by 1.16 percent. As to energy rates, Applicants state that KU's cost-based wholesale customers pay an average system charge that in many hours may be unaffected or reduced by the purchase of the Bluegrass Facility. Applicants also argue that if the formula rate produces a slightly higher charge for wholesale requirements customers in a given year compared to existing rate levels following the Proposed Transaction, the Commission has held in the section 203 context that rate increases do not amount to "adverse effects" on rates when there are countervailing benefits that derive from the transaction, including environmental benefits. Applicants explain that although LG&E/KU sell short-term wholesale power to certain entities under agreements entered into under the terms of their cost-based rate tariff for short-term energy sales, the prices for these sales are negotiated, subject to a cap of 110 percent of the LG&E/KU system incremental cost, and therefore customers under these agreements are shielded from any adverse rate effect of the Proposed Transaction. Applicants also add that LG&E/KU's spot energy sales outside of the LG&E/KU BAA are made via

contracts entered into under their market-based rate tariffs, and that these contracts cannot impose any costs related to the Proposed Transaction on their customers.⁵⁹

40. Applicants also argue that the Proposed Transaction will have no adverse effect on LG&E/KU's transmission service rates. Applicants state that all of the assets being acquired by LG&E/KU pursuant to the Proposed Transaction are generation assets and/or limited transmission assets such as generation leads or step-up transformers associated with the Bluegrass Facility. Applicants therefore argue that these assets are not classified as transmission assets for cost-of-service ratemaking purposes.⁶⁰

b. Commission Determination

41. Under the circumstances presented, the Commission finds that the Proposed Transaction will not have an effect on rates that is inconsistent with the public interest. Although Applicants indicate that there may be a small increase in capacity charges under their formula rates for wholesale requirements customers, they represent that such increase may be offset by savings in energy rates. Moreover, under state regulation in Kentucky and Virginia, Applicants will retire coal-fired generation based on existing and planned EPA regulations and they have explained that the Proposed Transaction is part of a least-cost resource procurement process that is intended to satisfy those legal requirements. Likewise, we note that transmission customers will not be affected by the Proposed Transaction since the assets being transferred are not classified as transmission assets for cost-of-service ratemaking purposes. We note that no parties have argued that the Proposed Transaction will adversely affect rates.

4. Effect on Regulation

a. Applicants' Analysis

42. Applicants assert that the Proposed Transaction will not diminish federal regulatory authority over LG&E/KU insofar as, following the Proposed Transaction, LG&E/KU and the Bluegrass Facility will remain subject to the Commission's jurisdiction under the FPA. Applicants submit that the Proposed Transaction will have no adverse impact on state regulation insofar as consummation is conditioned on approval by the Kentucky Commission and the Virginia Commission.⁶¹

⁵⁹ Application at 21-22.

⁶⁰ *Id.* at 23.

⁶¹ *Id.* at 23-24.

b. Commission Determination

43. We find no evidence that either state or federal regulation will be impaired by the Proposed Transaction. The Commission's review of a transaction's effect on regulation focuses on ensuring that it does not result in a regulatory gap at the federal or state level.⁶² We find that the Proposed Transaction will not create a regulatory gap at the federal level because the Commission will retain its regulatory authority over the companies after the Proposed Transaction is consummated. The Commission stated in the Merger Policy Statement that it ordinarily will not set the issue of the effect of a transaction on state regulatory authority for a trial-type hearing where a state has authority to act on the transaction. However, if the state lacks this authority and raises concerns about the effect on regulation, the Commission stated that it may set the issue for hearing, and that it will address such circumstances on a case-by-case basis.⁶³ We note that no state commission has requested that the Commission address the issue of the effect of the Proposed Transaction on state regulation.

5. Cross-subsidization

a. Applicants' Analysis

44. Applicants assert that the Proposed Transaction qualifies for the state review "safe harbor" from cross-subsidization review. Specifically, they state that the Proposed Transaction is subject to review by the Kentucky Commission, and that the Kentucky Commission, by reviewing the Proposed Transaction, will be able to protect against any inappropriate cross-subsidization that could result from the Proposed Transaction. In light of this review, Applicants submit that there is no need for a further examination of cross-subsidization and encumbrance concerns as to the Proposed Transaction.⁶⁴

45. Notwithstanding the application of the state review safe harbor, Applicants state that the Proposed Transaction also satisfies the Commission's four-part test for cross-subsidization.⁶⁵ Applicants contend that based on facts and circumstances known to them 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. Applicants further state that the Proposed Transaction will not result

⁶² Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,124.

⁶³ *Id.* at 30,125.

⁶⁴ Application, Exhibit M at M-1.

⁶⁵ 18 C.F.R. § 33.2(j)(1) (2011).

in, now or in the future: (1) 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; (2) 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; or (3) 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 FPA.⁶⁶

46. With respect to any 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, Applicants note that the assets to be acquired in the Proposed Transaction will automatically become subject to the liens under LG&E/KU's existing first mortgage indentures, which secure existing or future long-term debt issued by LG&E/KU, particularly first mortgage bonds series, including certain series which serve as collateral for pollution control bonds issued by either company. Thus, Applicants explain that the assets to be acquired will be pledged or encumbered in a manner similar to other like property of LG&E/KU, and only in such similar manner. Finally, Applicants disclose LG&E/KU's existing pledges and encumbrances of utility assets, as required under Order No. 669-A and section 33.2(j)(1) of the Commission's regulations.⁶⁷

b. Commission Determination

47. Based on the representations as presented in the Application, we find that the Proposed Transaction will not result in cross-subsidization or the pledge or encumbrance of utility assets for the benefit of an associate company or, where there is a new encumbrance, it is consistent with the public interest.

C. Accounting Matters

48. LG&E/KU propose to account for the purchase of the generating facility in accordance with Electric Plant Instruction (EPI) No. 5 and Account 102, Electric Plant Purchased or Sold. They anticipate a negative acquisition adjustment resulting from the purchase and propose to record the amount as a credit to Account 108, Accumulated

⁶⁶ Application, Exhibit M at M-1 to M-2.

⁶⁷ See Application at Exhibit M at M-2.

Provision for Depreciation of Electric Utility Plant. LG&E/KU must submit their final accounting entries in accordance with EPI No. 5 and Account 102 within six months of the date that the Proposed Transaction is consummated, and the accounting submissions must provide all the accounting entries and amounts related to the purchase along with narrative explanations describing the basis for the entries.

D. Reliability and Cyber Security Standards

49. Information and/or systems connected to the bulk power system involved in this transaction may be subject to reliability and cyber security 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 databases, 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, and the like, must comply with all applicable reliability and cyber security standards. The Commission, North American Electric Reliability Corporation, or the relevant regional entity may audit compliance with reliability and cyber security standards.

The Commission orders:

(A) The Proposed Transaction is hereby conditionally authorized subject to the Commission finding that any mitigation measures proposed by LG&E/KU, in a first compliance filing filed within 60 days of the issuance of this order, address the identified screen failures such that the Proposed Transaction does not have an adverse effect on competition, as discussed in the body of this order.

(B) LG&E/KU are also directed to make a second compliance filing within 60 days of the date that the last of the six coal-fired units ceases commercial operation, but in any event no later than December 31, 2016, to analyze the effect on competition, as discussed in the body of this order.

(C) Applicants must inform the Commission within 30 days of any material change in circumstances that departs from the facts the Commission relied upon in conditionally authorizing the Proposed Transaction.

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

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

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

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

(H) Applicants must notify the Commission within 10 days of the date on which the Proposed Transaction is consummated.

(I) LG&E/KU must account for the Proposed Transaction in accordance with EPI No. 5 and Account 102, of the Uniform System of Accounts. LG&E/KU must submit their final accounting entries within six months of the date that the purchase is consummated, and the accounting submissions must provide all the accounting entries and amounts related to the purchase along with narrative explanations describing the basis for such entries.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.