

169 FERC ¶ 61,204
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Richard Glick and Bernard L. McNamee.

Tucson Electric Power Company

Docket No. EC19-100-000

ORDER CONDITIONALLY AUTHORIZING ACQUISITION OF EXISTING
GENERATION FACILITY

(Issued December 19, 2019)

1. On June 5, 2019, as amended on September 26, 2019, Tucson Electric Power Company (Tucson Electric) requested authorization pursuant to section 203(a)(1) of the FPA¹ and part 33 of the Commission's regulations² for a transaction in which Tucson Electric will exercise a purchase option for all of the assets constituting one of the four 550 megawatt (MW) power blocks (Power Block 2) of the Gila River Power Station (Gila River Station) from the Salt River Project Agricultural Improvement and Power District (SRP) (Proposed Transaction).³

2. We have reviewed the Proposed Transaction under the Commission's Merger Policy Statement.⁴ As discussed below, we authorize the Proposed Transaction as consistent with

¹ 16 U.S.C. § 824b (2018).

² 18 C.F.R. pt. 33 (2019).

³ Application Pursuant to Section 203 of the Federal Power Act and Request for Expedited Consideration, Docket No. EC19-100-000 (filed June 5, 2019) (Application).

⁴ *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996) (Merger Policy Statement) (cross-referenced at 77 FERC ¶ 61,263), reconsideration denied, Order No. 592-A, 79 FERC ¶ 61,321 (1997); *see also FPA Section 203 Supplemental*

the public interest, subject to certain conditions regarding Tucson Electric's proposed mitigation discussed herein.

I. Background

A. Description of Parties

1. Tucson Electric

3. Tucson Electric states that it is a vertically-integrated utility that provides regulated electric service in Arizona. Tucson Electric sells wholesale power to other utilities and power marketers at locations in the southwestern United States.⁵ Tucson Electric owns approximately 2,797 MW of generating capacity and electric transmission facilities to deliver that capacity to its service territory.⁶

4. Tucson Electric is a wholly owned subsidiary of UNS Energy Corporation (UNS Energy) which in turn is a wholly owned indirect subsidiary of Fortis Inc., a publicly traded holding company. Fortis owns regulated electric utilities in nine states, five Canadian provinces, and two Caribbean countries, and natural gas utilities in British Columbia, Canada, Arizona, and New York State.⁷ Through UNS Energy, Tucson Electric is affiliated with UNS Electric, Inc. (UNS Electric), an electric utility operating company that provides retail electric service to customers in Arizona.

Policy Statement, FERC Stats. & Regs. ¶ 31,253 (2007)) (crossed-referenced at 120 FERC ¶ 61,060) (Supplemental Policy Statement), *order on clarification and reconsideration*, 122 FERC ¶ 61,157 (2008); *Transactions Subject to FPA Section 203*, Order No. 669, 113 FERC ¶ 61,315 (2005), *order on reh'g*, Order No. 669-A, 115 FERC ¶ 61,097, *order on reh'g*, Order No. 669-B, 116 FERC ¶ 61,076 (2006); *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000) (cross-referenced at 93 FERC ¶ 61,164), *order on reh'g*, Order No. 642-A, 94 FERC ¶ 61,289 (2001).

⁵ Application at 2.

⁶ *Id.* at 3.

⁷ *Id.* at 3-4.

2. SRP

5. SRP is a political subdivision of the State of Arizona that provides retail electric service to customers in Arizona; open access transmission and power sales services to wholesale customers; and purchases, sells, and transmits power in wholesale power markets.⁸

3. Gila River Power Station

6. Tucson Electric explains that the Gila River Station is a four-block natural gas-fired generation facility jointly owned by SRP, Tucson Electric, and UNS Electric, with SRP owning Power Blocks 1, 2, and 4, and Tucson Electric and UNS Electric jointly owning Power Block 3. SRP, Tucson Electric, and UNS Electric hold interests in common assets of the Gila River Station in proportion to their interests in the power blocks.⁹

B. Description of the Proposed Transaction

7. Tucson Electric states that on May 2, 2018, SRP acquired Power Block 2 of the Gila River Station from CXA Sundevil Power II, Inc., pursuant to a transaction authorized by the Commission (SRP-Sundevil Transaction).¹⁰ Tucson Electric notes that, as part of that transaction, Tucson Electric and SRP entered into the Power Block 2, Tolling Agreement which gives Tucson Electric: (1) rights to the full output of Power Block 2 from May 2, 2018, to May 2, 2038, as well as (2) the right to exercise an option to purchase the unit from SRP during the first three years of the tolling agreement.¹¹

8. Tucson Electric describes the Proposed Transaction as an exercise of the option to purchase Power Block 2. Tucson Electric states that it wants to exercise this option in order to continue the process of rebalancing its generation portfolio away from coal-fired resources and towards natural-gas fired generation and renewable resources. Tucson Electric states that over the next three years, it will retire approximately 500 MW (summer) of generation capacity that will need to be replaced to meet peak summer demand.¹²

⁸ *Id.* at 4.

⁹ *Id.* at 5.

¹⁰ *Id.* (citing *CXA Sundevil Power I, Inc.*, 163 FERC ¶ 62,043 (2018)).

¹¹ *Id.*

¹² *Id.* at 6.

II. Notice of Filing and Responsive Pleadings

9. Notice of the Application was published in the *Federal Register*, 84 Fed. Reg. 27,104 (2019), with interventions and protests due on or before July 22, 2019. SRP filed a motion to intervene.

10. On September 12, 2019, Commission staff issued a letter (Deficiency Letter) informing Tucson Electric that the Application was deficient and requesting additional information regarding certain aspects of Tucson Electric's horizontal market power analysis. On September 26, 2019, Tucson Electric responded to the Deficiency Letter (Response to the Deficiency Letter). This response is discussed in Section III.B.2 below.

11. Notice of the Response to the Deficiency Letter was published in the *Federal Register*, 84 Fed. Reg. 52,882 (2019), with interventions and protests due on or before October 17, 2019. None was filed.

III. Discussion

A. Procedural Matters

12. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2019), the timely, unopposed motion to intervene serves to make SRP a party to this proceeding.

B. Substantive Matters

1. FPA Section 203 Standard of Review

13. FPA section 203(a)(4) requires the Commission to approve proposed dispositions, consolidations, acquisitions, or changes in control if the Commission determines that the proposed transaction will be consistent with the public interest.¹³ 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.¹⁴ 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,

¹³ 16 U.S.C. § 824b(a)(4).

¹⁴ Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,111.

or encumbrance will be consistent with the public interest.”¹⁵ 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.¹⁶

2. Analysis of the Proposed Transaction

a. Effect on Horizontal Competition

i. Tucson Electric’s Analysis

14. Tucson Electric presents two arguments to support its assertion that the Proposed Transaction will result in no change in market concentration. First, Tucson Electric states that it already controls the full output of Power Block 2 through the Power Block 2 Tolling Agreement, which runs from May 2, 2018 until May 2, 2038 and, as a result, the Proposed Transaction does not change the amount of generation capacity that Tucson Electric controls.¹⁷

15. Second, Tucson Electric notes that, after it entered into the Power Block 2 Tolling Agreement, it entered into “back-to-back” sales agreements to sell 475 MW to an unaffiliated third party from the inception date of the Tolling Agreement through January 1, 2020, and 150 MW to an unaffiliated third party from January 2, 2020, through December 31, 2020 (Back-to-Back Agreements). Tucson Electric asserts that these agreements are system sales agreements, and that Tucson Electric already controlled the entire capacity of Power Block 2 notwithstanding the sales made pursuant to these agreements.¹⁸

¹⁵ 16 U.S.C. § 824b(a)(4).

¹⁶ 18 C.F.R. § 33.2(j) (2019).

¹⁷ Application at 9.

¹⁸ *Id.* at 9 n.26.

16. Tucson Electric represents that it faces a number of generation retirements including: Units 1 and 2 at its Sundt Station (combined summer capacity of 162 MW) in late 2019; the Navajo Power Station (approximately 169 MW)¹⁹ in December 2019; and Unit 1 at the San Juan Generating Station (approximately 170 MW) in June 2022. Tucson Electric explains that the Proposed Transaction is part of its long-term plan to replace these retirements.²⁰

17. Tucson Electric performed a Delivered Price Test, also referred to as an Appendix A analysis or Competitive Analysis Screen,²¹ to analyze the effects of the Proposed Transaction on horizontal competition under the assumption that Tucson Electric does not presently control the output of Power Block 2. Tucson Electric states that the results of the Delivered Price Test evaluating the effect of the Proposed Transaction in the Tucson Electric balancing authority area indicate screen failures. Using the available economic capacity²² measure, in four of the 10 season/load periods under base case prices, the increases in HHI range from 689 points in a moderately concentrated market to

¹⁹ The Navajo Power Station was shut down on November 18, 2019. *See* <https://media.srpnet.com/navajo-generating-station-permanently-shuts-down/> (retrieved November 21, 2019).

²⁰ Application at 5-6.

²¹ The Delivered Price Test determines the pre- and post-transaction market shares from which the change in market concentration, or the change in the Herfindahl-Hirschman Index (HHI), due to a proposed transaction can be derived. 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; markets in which the HHI is greater than or equal to 1,800 points are considered to be highly concentrated. In the Merger Policy Statement, the Commission adopted the 1992 Federal Trade Commission/Department of Justice Horizontal Merger Guidelines, which state that 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. ¶ 31,044 at 30,129; *see also Analysis of Horizontal Market Power under the Federal Power Act*, 138 FERC ¶ 61,109 (2012) (affirming the Commission's use of the thresholds adopted in the Merger Policy Statement).

²² Each supplier's Economic Capacity is the amount of capacity that could compete

2,951 points in a highly concentrated market. When base case prices are increased 10 percent, the increases in HHI range from 719 points in a moderately concentrated market to 3,182 points in a highly concentrated market. Finally, when base case prices are reduced by 10 percent, HHI increases range from 738 points in a moderately concentrated market to 1,736 points in a highly concentrated market.²³

18. Tucson Electric notes that the Delivered Price Test does not show any screen failures for the Proposed Transaction using available economic capacity in markets first-tier to the Tucson Electric balancing authority area.²⁴ Tucson Electric's Delivered Price Test shows screen failures under all season/load conditions under base case prices for the economic capacity measure, and when prices are adjusted higher and lower by 10 percent with the exception of when prices are below \$22 per MWh. However, Tucson Electric states that it and its affiliate UNS Electric have significant native load obligations and, thus, the economic capacity failures should not be cause for concern.²⁵

19. Tucson Electric proposes mitigation for horizontal market power arising from the Proposed Transaction indicated by the screen failures. Tucson Electric commits, subject to the consummation of the Proposed Transaction, to sell to an unaffiliated third party at least 75 MW of energy during peak hours in all periods from December 1, 2019 through June 30, 2022, with the exception of Summer 2020 in which it will sell at least 25 MW, all at a price not to exceed the Palo Verde Index (Mitigation Sale). Tucson Electric commits that such third party will have no more than a four percent market share in the Tucson Electric balancing authority area during the season/load periods in which the Proposed Transaction fails the Delivered Price Test. Tucson Electric commits to submit to the Commission, in the present docket, the executed Mitigation Sale agreement within 10 days of its execution.²⁶

20. Tucson Electric explains that the Mitigation Sale eliminates the screen failures, in all but three off-peak periods when assumed prices are increased by 10 percent, because

in the relevant market given market prices, running costs, and transmission availability. Available Economic Capacity is based on the same factors but deducts the supplier's native load obligation from its capacity and adjusts transmission availability accordingly. *Wis. Energy Corp.*, 151 FERC ¶ 61,015, at P 25 (2015).

²³ Application at 11-12.

²⁴ *Id.* at 12.

²⁵ *Id.*

²⁶ *Id.* at 12-13.

the capacity subject to the Mitigation Sale is attributed to another party.²⁷ Tucson Electric explains that the residual screen failures in these periods are not indicative of a market power problem for four reasons: (1) the failures occur in off-peak periods when load levels are very low; (2) revenues from off-system spot sales flow into its retail rate fuel adjustment clause; (3) any increase in market concentration will be transitory because of the aforementioned retirements; and (4) Tucson Electric intends to join the Energy Imbalance Market administered by the California Independent System Operator Corporation.²⁸

ii. Response to Deficiency Letter

21. In the Response to the Deficiency Letter, Tucson Electric states that the Power Block 2 Tolling Agreement was part of a negotiation strategy to obtain the assets with favorable terms in a timely manner with transaction certainty under the prior seller's bankruptcy liquidation process. Tucson Electric states that structuring the Power Block 2 Tolling Agreement with a purchase option enabled it to align its purchase of Power Block 2 with its state regulatory proceedings and its resource needs. Tucson Electric states that it entered the Power Block 2 Tolling Agreement with the expectation that it would exercise the purchase option in the future, subject to regulatory authorization.²⁹

22. Tucson Electric also addresses whether it correctly described the Back-to-Back Agreements as sales of system power when the competition analysis in the SRP-Sundevil Transaction modeled them as sales of capacity of Power Block 2 that had the effect of transferring that capacity to the Arizona Public Service Company balancing authority area under the control of an unaffiliated third party. Tucson Electric argues that it correctly characterized the Back-to-Back Agreements as a system sale, and provides copies of the Sale Confirmations as attachments to the Response to the Deficiency Letter. Tucson Electric also notes that a different modeling would not have materially affected the results of the analysis in the SRP-Sundevil Transaction.³⁰

23. With respect to the Proposed Transaction, Tucson Electric states that it proposes mitigation in the form of the Mitigation Sale, a firm sale to an unaffiliated third party of at least 75 MW during the peak hours in all periods through June 30, 2022. Tucson Electric states that the sale would be in the form of WSPP Schedule C Firm Energy or an

²⁷ *Id.* at 14.

²⁸ *Id.* at 13-14.

²⁹ Response to the Deficiency Letter at 1-2.

³⁰ *Id.* at 4-5.

equivalent product. Tucson Electric states that the unaffiliated third party has not been identified, but commits that the unaffiliated third party will have no more than a four percent market share in the Tucson Electric balancing authority area during the season/load periods in which the addition of Power Block 2 causes Tucson Electric's screen failures, as identified in Tucson Electric's Application. Tucson Electric states that it has not proposed mitigation sales following June 30, 2022, due to the permanent shutdown of the San Juan Generating Station, which will result in a decrease of 170 MW of generating capability.³¹

iii. Commission Determination

24. 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.³²

25. Based on Tucson Electric's representations, we find that, with the implementation of Tucson Electric's proposed mitigation and subject to the condition described below, the Proposed Transaction will not have an adverse effect on horizontal competition in the Tucson Electric balancing authority area. Absent this mitigation, the Proposed Transaction results in screen failures indicating that the Proposed Transaction may adversely affect horizontal competition in the Tucson Electric balancing authority area.

³¹ *Id.* at 6.

³² *Nev. Power Corp.*, 149 FERC ¶ 61,079, at P 28 (2014).

26. As an initial matter, we disagree with Tucson Electric's arguments that the Proposed Transaction should not be deemed to change the amount of generation Tucson Electric controls. Consistent with *Osprey Energy Center, LLC*,³³ we find that it is appropriate to consider the competitive effects of the change in control over Power Block 2 that results from the Proposed Transaction.

27. In *Osprey*, the Commission addressed a transaction in which a utility entered into an agreement with the owner of a generation facility to purchase its capacity and energy for two years under a tolling arrangement and then to purchase the facility. When the utility submitted its section 203 application, it argued that the competition analysis should not consider any increase in the capacity controlled by the utility. The Commission rejected this argument, holding that "[t]he tolling agreement was entered into on or near the same time as the agreement governing the Proposed Transaction and is linked."³⁴

28. Similar to the *Osprey* transaction, Tucson Electric acquired the option to purchase as part of the Power Block 2 Tolling Agreement. Further, Tucson Electric states in its Response to the Deficiency Letter that it intended to purchase Power Block 2 at the time that it entered into the Power Block 2 Tolling Agreement.³⁵ Therefore, we conclude that it is appropriate to consider the Power Block 2 Tolling Agreement as linked to the sale of Power Block 2. Tucson Electric cites to the *Osprey* decision in its Application for other purposes,³⁶ but does not acknowledge *Osprey's* holding with respect to the change in control issue or otherwise argue that the holding in *Osprey* should not apply. Therefore, as in *Osprey*, "we decline to consider the tolling agreement between Applicants as obviating the need for the submission of a horizontal market power analysis."³⁷

29. We also are not persuaded by Tucson Electric's contention that the Back-to-Back Agreements are system sales agreements and that Tucson Electric already controlled Power Block 2. This assertion is inconsistent with the way that the Back-to-Back Agreements were treated in the SRP-Sundevil Transaction competition analysis,³⁸ as well

³³ 152 FERC ¶ 61,066 (2015) (*Osprey*).

³⁴ *Id.* P 31.

³⁵ Response to the Deficiency Letter at 1-2.

³⁶ See Application, Appendix 2 at 6 n.15, 18 n.34, 25 n.49, and 35 n.75.

³⁷ *Osprey*, 152 FERC ¶ 61,066 at P 31.

³⁸ See SRP-Sundevil Transaction Application at 22 ("Tucson Electric has indicated that it plans to re-sell 475 MW of Power Block 2's 515 MW to an unaffiliated third party, and the delivery point for the sale will be the Palo Verde Substation in the [Arizona

as with the terms of the Sales Confirmations submitted by Tucson Electric in the Response to the Deficiency Letter. Although the Sales Confirmations are styled as a system sale, the terms are identical to those of a tolling agreement, and clearly transfer control over Power Block 2 to the third-party seller.

30. Although we disagree with Tucson Electric's arguments regarding the transfer of control as a result of the Power Block 2 Tolling Agreement, we agree with Tucson Electric that our analysis should focus on the effects of the Proposed Transaction on the available economic capacity measure. The native load obligation of Tucson Electric is such that, while economic capacity measures do provide some helpful information, the available economic capacity measure provides needed context to understand competitive supply.³⁹

31. We find that the proposed sale of Power Block 2 raises competitive concerns because the increase in market concentration increases the ability for Tucson Electric to withhold generation for the purpose of increasing marginal prices. While we take into consideration the other factors that Tucson Electric identifies to explain why the Proposed Transaction does not have an adverse effect on competition despite screen failures, we find that these factors are insufficient to overcome the increased market concentration because the screen failures are severe, span multiple season/load periods, and are a result of reduced import capabilities because of the transmission capacity needed to move the capacity of Power Block 2 into the Tucson Electric balancing authority area. Nonetheless, as discussed below, we find that Tucson Electric's proposed mitigation, when considered as part of the Proposed Transaction, is sufficient to mitigate the competition concerns. In making this determination, we consider both the nature of the proposed mitigation as well as the other factors that Tucson Electric identifies to explain why the Proposed Transaction does not have an adverse effect on competition despite minor screen failures in off-peak periods when prices are raised by 10 percent that still arise post-mitigation.⁴⁰

Public Service Company balancing authority area]. Therefore Ms. Solomon's analysis assumes that 475 MW of Power Block 2 will remain in the [Arizona Public Service Company balancing authority area] under the control of the new entrant.").

³⁹ See *Arizona Pub. Serv. Co.*, 141 FERC ¶ 61,154, at P 28 (2012) (citing *Great Plains Energy Inc.*, 121 FERC ¶ 61,069, at P 34 (2007); *Nevada Power Co.*, 113 FERC ¶ 61,265, at P 15 (2005)).

⁴⁰ See *supra* P 20.

32. We note, however, that the Mitigation Sale must give control over the MW to the unidentified buyer in order to sufficiently mitigate horizontal competition concerns.⁴¹ In that regard, Tucson Electric has not yet provided details of the Mitigation Sale agreement terms providing this transfer of control.⁴² Therefore, although we accept this commitment, we condition approval of the Proposed Transaction on Tucson Electric submitting a compliance filing with the contracts implementing the Mitigation Sale with the Commission.⁴³ Each Mitigation Sale should be a firm sales contract that transfers control over the dispatch of the Tucson Electric controlled output to a third party. Further, pricing of the contract should be fixed or tied to a liquid benchmark such that the contracts do not allow for the economic withholding of the capacity if priced above market. Further, should Tucson Electric retain beyond 2022 the capacity due to retire, we require Tucson Electric to extend the Mitigation Sale until such capacity is retired.

b. Effect on Vertical Competition

i. Tucson Electric's Analysis

33. Tucson Electric states that the consolidation of Tucson Electric's electric transmission assets with the assets to be acquired will not enhance vertical market power because the Proposed Transaction will not enhance any ability of Tucson Electric or any of its affiliates to restrict potential downstream competitors' access to upstream supply. Tucson Electric states that access to Tucson Electric's and its affiliates' transmission lines is subject to their respective open access transmission tariffs, and the assets to be acquired will provide neither

⁴¹ See, e.g., *Market-Based Rates for Wholesale Sales of Elec. Energy, Capacity & Ancillary Servs. by Pub. Utils.*, Order No. 697, 119 FERC ¶ 61,295, at PP 174-76, 184, *clarified*, 121 FERC ¶ 61,260 (2007), *order on reh'g*, Order No. 697-A, 123 FERC ¶ 61,055, at P 384, *clarified*, 124 FERC ¶ 61,055, *order on reh'g*, Order No. 697-B, 125 FERC ¶ 61,326 (2008), *order on reh'g*, Order No. 697-C, 127 FERC ¶ 61,284 (2009), *order on reh'g*, Order No. 697-D, 130 FERC ¶ 61,206 (2010), *aff'd sub nom. Mont. Consumer Counsel v. FERC*, 659 F.3d 910 (9th Cir. 2011), *cert. denied sub nom. Pub. Citizen, Inc. v. FERC*, 567 U.S. 934 (2012); *NextEra Energy, Inc.*, 165 FERC ¶ 61,199, at PP 25, 31 (2018).

⁴² In the Response to the Deficiency Letter, Tucson Electric did not provide details of the terms of the proposed Mitigation Sale regarding transfer of control other than stating that the Mitigation Sale would be firm sales "in the form of WSPP Schedule C Firm Energy or an equivalent product." Response to the Deficiency Letter at 6.

⁴³ The compliance filing is subject to notice and Commission action.

Tucson Electric nor its affiliates any enhanced ability to restrict potential downstream competitors' access to upstream supply.⁴⁴

34. Tucson Electric states that it is affiliated with UNS Gas, Inc. (UNS Gas), a natural gas utility serving retail customers in portions of northern and southern Arizona. Tucson Electric states that UNS Gas's limited facilities cannot be used to restrict access to fuel by competitors of UNS Gas's affiliates or otherwise to create barriers to entry because UNS Gas is required by Arizona state law to offer retail gas service on a non-discriminatory basis. Accordingly, following consummation of the Proposed Transaction, Tucson Electric argues that it will have no ability to restrict natural gas deliveries to generating facilities that compete with it.⁴⁵

ii. Commission Determination

35. 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 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.⁴⁶

36. Based on Tucson Electric's representations, we find that the Proposed Transaction will not have an adverse effect on vertical competition. The Proposed Transaction will not enhance any ability of Tucson Electric or any of its affiliates to restrict potential downstream competitors' access to upstream supply. Although Tucson Electric is affiliated with a natural gas utility, that utility's service will not be affected by the Proposed Transaction, nor will the Proposed Transaction allow Tucson Electric or its affiliates to restrict natural gas deliveries to competing generating facilities.

⁴⁴ Application at 15.

⁴⁵ *Id.* at 15-16.

⁴⁶ *Upstate N.Y. Power Producers, Inc.*, 154 FERC ¶ 61,015, at P 15 (2016); *Exelon Corp.*, 138 FERC ¶ 61,167, at P 112 (2012).

c. **Effect on Rates**

i. **Tucson Electric's Analysis**

37. Tucson Electric states that but for energy exchange agreements and emergency energy sales under the Southwest Reserve Sharing Group Participation Agreement, the contracts under which Tucson Electric's current wholesale electricity customers take service were all entered into under market-based rate authority. Accordingly, Tucson Electric states that the Proposed Transaction will not have an adverse effect on the rates of Tucson Electric's wholesale customers. Tucson Electric states that it already controls all of the output of Power Block 2 pursuant to the Power Block 2 Tolling Agreement. Accordingly, Tucson Electric states that it is the only wholesale customer that purchases power from Power Block 2 that will be affected by the Proposed Transaction.⁴⁷ Tucson Electric also argues that the Proposed Transaction will have no adverse effect on its transmission service rates. Tucson Electric states that is unable to pass through costs related to the Proposed Transaction to its transmission customers absent an application with the Commission pursuant to section 205 of the FPA.⁴⁸

38. Tucson Electric pledges to hold harmless all transmission and current wholesale customers from any costs associated with the Proposed Transaction (i.e., transaction costs) for a period of five years to the extent that such costs exceed savings related to the Proposed Transaction. Tucson Electric states that consistent with Commission precedent, "transaction costs" in this context includes all transaction-related costs, not only costs related to consummating the Proposed Transaction.⁴⁹ Tucson Electric states that its hold harmless commitment, however, is not a rate freeze and would not preclude changes in jurisdictional rates attributable to non-Transaction costs or to the costs or value of the assets to be transferred themselves.⁵⁰

⁴⁷ Application at 17.

⁴⁸ *Id.* at 18.

⁴⁹ *Id.* (citing *ITC Midwest LLC*, 142 FERC ¶ 62,106 (2013)).

⁵⁰ *Id.* at 18 n.45.

ii. Commission Determination

39. Based on Tucson Electric's representations, we find that the Proposed Transaction will not have an adverse effect on rates. The Proposed Transaction will not have an adverse effect on wholesale rates for the sale of electricity because the contracts under which Tucson Electric's current wholesale electricity customers take service were all entered into under market-based rate authority.⁵¹

40. Further, we accept Tucson Electric's commitment to hold transmission customers harmless from costs related to the Proposed Transaction. 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 in the five years after the Proposed Transaction's consummation in accordance with the Commission's policy on hold harmless commitments.⁵²

d. Effect on Regulation

i. Tucson Electric's Analysis

41. Tucson Electric states that the Proposed Transaction will not diminish federal regulatory authority over Tucson Electric or Power Block 2. Tucson Electric states that, following the Proposed Transaction, it and its jurisdictional assets and wholesale power sales from Power Block 2 will remain subject to the Commission's jurisdiction under the FPA. Accordingly, Tucson Electric states that the Proposed Transaction will have no adverse effect on federal regulation.

42. Tucson Electric states that Arizona Corporation Commission approval will be required prior to Tucson Electric including Power Block 2 in rate base (although such approval will not be required for consummation of the Proposed Transaction). Accordingly, Tucson Electric argues that the Proposed Transaction will have no adverse effect on state regulation.

⁵¹ See *Union Electric Co.*, 114 FERC ¶ 61,255, at P 45 (2006) (finding wholesale customers will not be adversely affected where applicant provides wholesale service at market-based rates); *NorAm Energy Servs., Inc.*, 80 FERC ¶ 61,120, at 61,382-83 (1997) (stating that the Commission's ratepayer protection concerns do not apply to customers charged market-based rates).

⁵² *Policy Statement on Hold Harmless Commitments*, 155 FERC ¶ 61,189 (2016).

ii. Commission Determination

43. The Commission's review of a transaction's effect on regulation focuses on ensuring that it does not result in a regulatory gap.⁵³ 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.⁵⁴

44. Based on Tucson Electric's representations, we find no evidence that either state or federal regulation will be impaired by the Proposed Transaction. 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.

e. Cross-Subsidization

i. Tucson Electric's Analysis

45. Tucson Electric provides an Exhibit M analysis showing that the Proposed Transaction will not result in proscribed cross-subsidization or the pledge or encumbrance of utility assets. Tucson Electric states that it submits, based on facts and circumstances known to it or that are reasonably foreseeable, that 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.⁵⁵

⁵³ Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,124.

⁵⁴ *Id.*

⁵⁵ Application, Ex. M.

ii. **Commission Determination**

46. 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.

3. **Accounting Analysis**

47. Appendix 3 of the Application includes proposed accounting entries recording Tucson Electric's acquisition of the Gila River Station assets. Tucson Electric proposes to clear the acquisition through Account 102, Electric Plant Purchased or Sold, and record the original cost and related accumulated depreciation on its books. Additionally, Tucson Electric's proposed accounting entries also record a negative acquisition adjustment. However, Tucson Electric did not provide the dollar amounts of the acquisition or the negative acquisition adjustment. We direct Tucson Electric to submit proposed accounting entries within six months of the date that the Proposed Transaction is consummated, providing all the accounting entries and amounts related to the transfer along with narrative explanations describing the basis for the entries.

4. **Other Considerations**

48. 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 215.⁵⁶ 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.

49. 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

⁵⁶ 16 U.S.C. § 824o.

ability. In addition, applicants subject to PUHCA 2005⁵⁷ are subject to the record-keeping and books and records requirements of PUHCA 2005.

50. Section 35.42 of the Commission's regulations 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.⁵⁸ 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.

The Commission orders:

(A) The Proposed Transaction is hereby conditionally authorized, subject to acceptable Mitigation Sale contracts, as discussed in the body of this order.

(B) Tucson Electric is required to make a compliance filing prior to closing of the Proposed Transaction submitting the contracts implementing the Mitigation Sale, 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.

⁵⁷ 42 U.S.C. §§ 16451-63 (2018).

⁵⁸ 18 C.F.R. § 35.42 (2019); *see also Reporting Requirement for Changes in Status for Public Utilities with Market-Based Rate Authority*, Order No. 652, 110 FERC ¶ 61,097, *order on reh'g*, 111 FERC ¶ 61,413 (2005).

(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; and

(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 proposed accounting entries within six months of the date that the Proposed Transaction is consummated, and the accounting submission shall provide all the accounting entries and amounts related to the transfer along with narrative explanations describing the basis for the entries.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.