

161 FERC ¶ 61,009
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Cheryl A. LaFleur, and Robert F. Powelson.

Nogales Transmission, L.L.C.
Nogales Frontier Operations, L.L.C.

Docket No. EL17-30-000

ORDER GRANTING PETITION FOR DECLARATORY ORDER

(Issued October 4, 2017)

1. On December 21, 2016, as amended on April 25, 2017, and June 30, 2017, Nogales Transmission, L.L.C. (Nogales Transmission) and Nogales Frontier Operations, L.L.C. (Nogales Operations) (together, Applicants) filed a petition for declaratory order requesting that the Commission: (1) find that Nogales Transmission is a passive entity and therefore not a public utility within the meaning of the Federal Power Act (FPA)¹ or an electric utility company under the Public Holding Company Act of 2005 (PUHCA 2005);² (2) grant Nogales Operations negotiated rate authority; (3) approve Nogales Operations' capacity allocation methodology; and (4) grant certain waivers of Commission regulations. As discussed below, we will grant Applicants' petition.³

¹ 18 U.S.C. § 824(e) (2012).

² 42 U.S.C. §§ 16451 *et seq.* (2006).

³ In this order, the Commission, acting pursuant to its statutory authority, is also acting pursuant to authority delegated to the Commission by the Secretary of Energy (DOE) pursuant to DOE's authority under section 202(e) of the FPA. 16 U.S.C. § 824a(e) (2000); Delegation Order No. 00-004.00 *to the Federal Energy Regulatory Commission, Department of Energy*, 67 Fed. Reg. 8946 (Feb. 27, 2002), FERC Stats. & Regs. ¶ 9918 (2002). Pursuant to section 1.3 of this delegation order, the Secretary delegated to the Commission authority to:

Carry out such functions as are necessary to implement and enforce the Secretary's policy requiring holders of Presidential permits authorizing the construction, operation, maintenance, or connection of facilities for the

I. Background

2. Applicants state that Nogales Transmission proposes to construct a high-voltage, direct current (HVDC) interconnection between the UNS Electric, Inc. (UNS Electric) system near Nogales, Arizona and the Mexican National Electric System in Sonora, Mexico (Project). According to Applicants, the Project will consist of a new 150 megawatt (MW) HVDC converter at a new substation located on property owned by Tucson Electric Power Company (Tucson Electric) (Gateway Substation); a three-mile double-circuit 138 kilovolt (kV) transmission line between the Gateway Substation and an existing pole 1,900 feet west of UNS Electric's existing Valencia substation in Nogales, Arizona;⁴ and a two-mile 230 kV transmission line that will extend from the Gateway Substation to the United States-Mexico border, where it will interconnect with a transmission line to be constructed in Mexico. Applicants describe this as the first phase of the project; the second phase will expand the HVDC converter capacity to 300 MW.⁵
3. Applicants state that the first phase of the Project will cost approximately \$60 million to \$80 million, with construction planned to begin in 2017 for commercial

transmission of electric energy between the United States and foreign countries to provide non-discriminatory open access transmission services. In exercising this authority, the Commission is specifically authorized to utilize the authority of the Secretary under Executive Order No. 10485, dated September 3, 1953, as amended by Executive Order No. 12038, dated February 3, 1978, and section 202(e) of the [FPA] and such other sections of the FPA vested in the Secretary as may be relevant, to regulate access to, and the rates, terms and conditions for transmission services over permitted international electric transmission facilities to the extent the Commission finds it necessary and appropriate to the public interest. This authority is delegated to the Commission for the sole purpose of authorizing the Commission to take actions necessary to implement and enforce non-discriminatory open access transmission lines required by the Secretary to provide such service. Nothing in this delegation shall allow the Commission to revoke, amend, or otherwise modify Presidential permits or electricity export authorizations issued by the Secretary.

⁴ The June 30 Amendment supplemented Applicants' initial Petition to reflect an electrical reconfiguration of the Project. Applicants state that, among other things, the reconfiguration converts the existing Vail-to-Valencia transmission line to a new Vail-to-Gateway transmission line. June 30 Amendment at 1-2.

⁵ Petition at 1-2.

operation in mid-2019. Applicants note, however, that the timing and cost of the Project's second phase have not yet been determined.⁶

4. Applicants assert that Nogales Transmission and Nogales Operations are legally distinct entities whose upstream ownership chains are owned by different entities within the Hunt family.⁷ Applicants state that Nogales Transmission is a Delaware limited liability company that does not own or operate any existing electrical generation, transmission, or distribution facilities. Applicants continue that Nogales Holdings, L.L.C. (Nogales Holdings) will own 75 percent of Nogales Transmission and MEH Equities Management Company (MEH Management) will own the remaining 25 percent. Applicants explain that Nogales Holdings is an indirect, wholly-owned subsidiary of Hunt Power, L.P., which is part of a larger, privately-owned group of companies managed by the Hunt family.⁸ Applicants assert that MEH Management is a holding company that does not own or operate any existing electric generation, transmission, or distribution facilities. Applicants also state that MEH Management is a subsidiary of Millennium Energy Holdings, Inc. (Millennium Energy), which is a subsidiary of UNS Energy Corporation; UNS Energy Corporation is the ultimate corporate parent company of UNS Electric and Tucson Electric, which are Commission-jurisdictional public utilities, and Millennium Energy.⁹

5. Applicants assert that Nogales Operations is a Texas limited liability company that does not currently own or operate any Commission-jurisdictional electric generation, transmission, or distribution facilities.¹⁰ Applicants also state that Nogales Operations is a wholly-owned subsidiary of Shary Holdings, L.L.C. (Shary Holdings), which is owned by "Hunter L. Hunt and members of his family."¹¹ Applicants indicate that Shary

⁶ *Id.*

⁷ The April 25 Amendment supplemented Applicants' initial Petition, providing more information about their request for negotiated rate authority for Nogales Operations. April 25 Amendment at 2.

⁸ Petition at 4.

⁹ *Id.*

¹⁰ Applicants state that Nogales Operations is affiliated, via common upstream ownership by SU Investments, with Sharyland Utilities, L.P., an electric utility serving retail and wholesale customers in the Electric Reliability Council of Texas region. April 25 Amendment at 4.

¹¹ *Id.* at 2.

Holdings wholly owns SU FERC, L.L.C., which is a Commission-jurisdictional entity with negotiated rate authority that will operate 240 miles of new 345 kV double-circuit electric transmission facilities in southern New Mexico and southern Arizona (the Southline Transmission Project (Southline Project)).¹²

6. Applicants state that Nogales Transmission will bear the full cost to develop the Project and will hold legal title to the Project land and transmission facilities. According to Applicants, Nogales Transmission will lease the right to use the Project facilities, along with the associated capacity rights, to Nogales Operations. Applicants assert that the lease will be an arm's length transaction negotiated between Nogales Operations and Nogales Transmission where Nogales Operations will make annual rent payments to Nogales Transmission in exchange for the exclusive right to operate and manage the Project. The payments will consist of both fixed and variable portions.¹³ Applicants continue that, under the lease, Nogales Operations will also have sole responsibility for operating and maintaining the Project and complying with all regulatory and reliability requirements. Applicants assert that, as a result, neither MEH Management nor any of its affiliates, through their shared upstream ownership with Nogales Transmission, will have operational control over Nogales Operations or the Project.¹⁴

7. Applicants explain that, by receiving an appropriate portion of income in the form of rent for the Project facilities, Nogales Transmission would qualify as an asset to be held by a real estate investment trust (REIT) entity at an appropriate time in the future. As such, Applicants assert that they anticipate that Nogales Holdings' 75 percent ownership in Nogales Transmission will ultimately be owned by an entity or entities in a REIT structure. Applicants explain that the REIT structure is an investment vehicle that allows Nogales Transmission to access efficient sources of capital needed to finance the Project while Nogales Operations will reserve full operational control of the Project's jurisdictional services and facilities.¹⁵

¹² Petition at 4-5 (citing *Southline Transmission, L.L.C.*, 152 FERC ¶ 61,211 (2015) (*Southline*), *order on clarification and reh'g*, 155 FERC ¶ 61,144 (2016)).

¹³ Specifically, Applicants state that, while the terms of the lease have not yet been established, the initial term will be at least four years and the fixed base rent amount will constitute the majority of the rental payments. April 25 Amendment at 2-3.

¹⁴ Petition at 2-3, 5-7.

¹⁵ *Id.* at 6.

II. Notice of Filing

8. Notice of the petition was published in the *Federal Register*, 82 Fed. Reg. 1,334 (2016), with interventions and protests due on or before January 20, 2017. On January 19, 2017, the International Brotherhood of Electrical Workers, Local Unions 769 and 1116 (Brotherhood of Electrical Workers) filed a motion to intervene and comments in support of the Project. Notice of the April 25 Amendment was published in the *Federal Register*, 82 Fed. Reg. 20,478 (2017), with interventions and protests due on or before May 25, 2017. None was filed. Notice of the June 30 Amendment was published in the *Federal Register*, 82 Fed. Reg. 32,694 (2017), with interventions and protests due on or before July 14, 2017. None was filed.

9. Brotherhood of Electrical Workers states that granting the petition is consistent with Commission precedent. Brotherhood of Electrical Workers also states that the Project will provide vital economic opportunities to southern Arizona, increase reliability for Tucson Electric, and allow Tucson Electric and UNS Electric to access diverse energy markets that will improve each company's financial state and facilitate passing along Project benefits in the form of reduced costs to customers.¹⁶

III. Discussion

A. Procedural Matters

10. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2017), the timely, unopposed motion to intervene of Brotherhood of Electrical Workers serves to make it a party to this proceeding.

B. Substantive Matters

1. Request for Disclaimer of Jurisdiction

a. Petition

11. Applicants request that the Commission disclaim jurisdiction over Nogales Transmission. Applicants state that the Commission should find that Nogales Transmission may hold legal title to the Project land rights and facilities but not be considered a "public utility" under section 201(e) of the FPA. Applicants state that the Commission has disclaimed jurisdiction where the party with the ownership interest: (1) will not operate or control the operation of the jurisdictional facilities; and (2) is not otherwise engaged in the business of transmitting, selling, or producing electric power

¹⁶ Brotherhood of Electrical Workers Comments at 1.

and has a principal business activity other than that of a public utility.¹⁷ Applicants also state that the Commission has found that a merchant project developer utilizing a REIT structure can be a passive financing entity with no operational control over jurisdictional facilities and is, therefore, not a public utility.¹⁸

12. Applicants state that Nogales Transmission will function as a developer and passive investor of the Project, will have no operational control over the Project, and will not otherwise engage in the transmission or sale of electricity. Applicants represent that Nogales Transmission will hold legal title to the land and Project facilities and will execute a long-term lease that will give Nogales Operations the exclusive right to operate, maintain, and control Project facilities and associated capacity rights. Applicants continue that Nogales Operations will have sole operational control over the day-to-day management Project facilities and all operating activities.¹⁹ Applicants explain that, although a management committee comprised of representatives of Nogales Holdings and MEH Management will have general oversight of the development, construction, and management of the Project, the limited oversight of the Project through the management committee does not give Nogales Transmission authority to exercise operational control or the ability to control or influence transmission functions of the Project.²⁰

13. Applicants explain that the Commission will have jurisdiction over the Project facilities and capacity rights owned by Nogales Transmission and leased to Nogales Operations. Applicants also explain that, prior to energizing the Project, Nogales Operations will file an Open Access Transmission Tariff (OATT) for service over the Project facilities.²¹

14. Applicants argue that, in addition, the Commission should disclaim jurisdiction over Nogales Transmission as an “electric utility company” and “public-utility company” under PUHCA 2005. Applicants state that the definition of electric utility company under PUHCA 2005 turns on whether an entity “owns or operates” electric facilities. Applicants explain that the meaning of “own or operate” depends on whether an entity controls electric facilities. Applicants assert that the Commission has determined that a

¹⁷ Petition at 9-10 (citing *Pacific Power & Light Co.*, 3 FERC ¶ 61,119 (1978) (*Pacific Power*)).

¹⁸ *Id.* at 11 (citing *Southline*, 152 FERC ¶ 61,211 at P 74).

¹⁹ *Id.* at 12.

²⁰ *Id.* at 13.

²¹ *Id.*

passive owner or lessor of electric facilities will not be considered an owner or operator under this definition.²² Applicants also assert that, under the Commission's rules, the term "public-utility company," which includes an "electric utility company," specifically excludes owner-lessors in lease financing transactions involving utility assets.²³ Applicants conclude that, for the same reasons Nogales Transmission will not be a "public utility" under the FPA, it will also not be an "electric utility company" or "public-utility company" under PUHCA 2005.²⁴

b. Commission Determination

15. We find that Nogales Transmission is a passive entity and therefore not a public utility within the meaning of the FPA or an electric utility company under PUHCA 2005. Section 201(e) of the FPA defines a "public utility" as "any person who owns or operates facilities subject to the jurisdiction of the Commission."²⁵ In cases involving passive investors, the Commission determines whether the passive investor: (1) will operate or control the operations of the jurisdictional facilities; and (2) is otherwise in the business of transmitting, selling, or producing electric power and has a principal business activity other than that of a public utility.²⁶ In *Pacific Power*, a case involving a passive lease financing transaction, the Commission stated that the threshold question is whether the interest of the lessor and other participants in the lease financing constitutes ownership as contemplated by section 201(e). The Commission found that, although the lessor and other participants would hold either equitable or legal title to the jurisdictional facility, they would not operate the facility. The Commission also found that none of the parties were involved in the business of producing or selling electrical power, and therefore found that they were not public utilities.²⁷ Similarly, in *Southline*, the Commission further found that a merchant transmission project developer utilizing a REIT structure to finance the Southline project and executing a long-term lease of its ownership interest in the Southline project is a passive financing entity with no operational control over

²² *Id.* at 14.

²³ 18 C.F.R. § 366.1 (2017).

²⁴ Petition at 14-15.

²⁵ 16 U.S.C. § 824(e) (2012).

²⁶ *See Pacific Power*, 3 FERC at 61,337.

²⁷ *Id.*

jurisdictional facilities and, therefore, not a public utility.²⁸ Here, although Nogales Transmission will hold legal title to the land and Project facilities, it will not operate or control the Project facilities.²⁹ Nogales Transmission also is not otherwise engaged in the business of transmitting, selling, or producing electric power, and has a principal business activity as a developer and passive investor, which is other than that of a public utility.³⁰ Accordingly, based on Applicants' representations, we find that Nogales Transmission should not by reason of its interest in the Project be considered a public utility under section 201(e) of the FPA.

16. Section 1262(5) of PUHCA 2005 defines an "electric utility company" as "any company that owns or operates facilities used for the generation, transmission, or distribution of electric energy for sale."³¹ This definition is similar, albeit not identical, to the definition of a public utility in section 201(e) of the FPA. The Commission's regulations define a "public-utility company" as an "electric utility company or a gas utility company" and provide that "owner-lessors and owner participants in lease financing transactions involving utility assets shall not be treated as 'public-utility companies'."³² This definition is likewise similar to the Commission's precedent for passive investors under the FPA. Here, Applicants propose to use a REIT structure, which, according to Applicants, is an investment vehicle that allows Nogales Transmission to access efficient sources of capital while the Project is solely operated by Nogales Operations. Applicants state that, under this structure, Nogales Transmission will execute a long-term lease that will give Nogales Operations the exclusive right to operate, maintain, and control the Project facilities and associated capacity rights, and Nogales Operations will have sole responsibility for operations and control over the day-to-day management of the Project.³³ Thus, based on Applicants' representations, we find that Nogales Transmission qualifies as an owner-lessor in a lease-financing transaction

²⁸ *Southline*, 152 FERC ¶ 61,211 at P 74.

²⁹ Applicants state that Nogales Transmission's participation on the Project's management committee does not give it authority to exercise operational control or the ability to control or influence transmission functions of the Project. Petition at 12.

³⁰ *Id.* at 13-14.

³¹ 42 U.S.C. § 16451(5) (2012).

³² 18 C.F.R. § 366.1 (2017).

³³ Petition at 6-7, 14-15.

involving utility assets and should not be considered an electric utility company or public-utility company under PUHCA 2005.

2. Request for Negotiated Rate Authority

17. In addressing requests for negotiated rate authority from merchant transmission providers, the Commission is committed to fostering the development of such projects, but it requires that reasonable and meaningful protections be in place to preserve open access principles and to ensure that the resulting rates for transmission service are just and reasonable.³⁴ The Commission's analysis for evaluating negotiated rate applications focuses on four areas: (1) justness and reasonableness of the rates; (2) potential for undue discrimination; (3) potential for undue preference, including affiliate preference; and (4) regional reliability and operational efficiency requirements.³⁵

18. The Commission also issued a Policy Statement to clarify and refine its policies governing the allocation of capacity for new merchant transmission projects and new nonincumbent, cost-based, participant-funded transmission projects.³⁶ The Commission allows the developer of a new merchant transmission project to select a subset of customers, based on not unduly discriminatory or preferential criteria, and to negotiate directly with those customers to reach agreement for procuring up to 100 percent of transmission capacity. In order for this to occur, the merchant transmission developer must: (1) broadly solicit interest in the project from potential customers; and (2) demonstrate to the Commission that the developer has satisfied the solicitation, selection, and negotiation process set forth in the Policy Statement.³⁷ To the extent the developer complies with these requirements, the Commission will find that the developer has satisfied the second (undue discrimination) and third (undue preference) factors of the four-factor *Chinook* analysis.³⁸

³⁴ See, e.g., *Western Spirit Clean Line LLC*, 155 FERC ¶ 61,252 (2016) (*Western Spirit*); *Tres Amigas, LLC*, 153 FERC ¶ 61,287 (2015).

³⁵ *Chinook Power Transmission, LLC*, 126 FERC ¶ 61,134, at P 37 (*Chinook*), order on reh'g, 128 FERC ¶ 61,074 (2009).

³⁶ *Allocation of Capacity on New Merchant Transmission Projects and New Cost-Based, Participant-Funded Transmission Projects; Priority Rights to New Participant-Funded Transmission*, 142 FERC ¶ 61,038, at P 1 (2013) (Policy Statement).

³⁷ *Id.* P 16.

³⁸ *Id.* P 15.

19. Under the Policy Statement, once a developer has identified a subset of customers through the open solicitation process, the Commission will allow the developer to engage in bilateral negotiations with each potential customer. In these negotiations, the Commission will allow for distinctions among prospective customers based on transparent and not unduly discriminatory or preferential criteria, with the potential result that a single customer, including an affiliate, may be awarded up to 100 percent of the transmission capacity.³⁹

a. Factor One: Just and Reasonable Rates

20. To approve negotiated rates for a transmission project, the Commission must find that the rates are just and reasonable.⁴⁰ To do this, the Commission must determine whether the merchant transmission owner has assumed the full market risk for the cost of constructing its proposed transmission project. Additionally, the Commission considers whether the project is being built within the footprint of the merchant transmission owner's (or an affiliate's) traditionally regulated transmission system; if so, the Commission must determine that there are no captive customers that would be required to pay the costs of the project. The Commission also considers whether the merchant transmission owner or an affiliate already owns transmission facilities in the particular region where the project is to be located; what alternatives customers have; whether the merchant transmission owner is capable of erecting any barriers to entry among competitors; and whether the merchant transmission owner would have any incentive to withhold capacity.⁴¹

i. Petition

21. Applicants state that Nogales Operations will lease from Nogales Transmission the Project facilities and associated capacity rights in the Project. Applicants explain that, under the Internal Revenue Service's REIT regulations, the anticipated lease will transfer operational control over the Project from Nogales Transmission to Nogales Operations; in exchange, the lease will provide Nogales Operations with an opportunity to earn a profit or suffer a loss from its operation of the Project. Applicants explain that the lease will initially be four years in length, with automatic renewal options, and will require Nogales Operations to pay a fixed base rent amount, which will constitute a majority of the rental payments, as well as a variable rent component, which will be based on

³⁹ *Id.* P 28.

⁴⁰ See, e.g., *Champlain Hudson Power Express, Inc.*, 132 FERC ¶ 61,006, at P 17 (2010) (*Champlain Hudson*).

⁴¹ *Chinook*, 126 FERC ¶ 61,134 at P 38.

specified financial performance metrics for Nogales Operations. Applicants explain that the lease will not permit Nogales Operations to transfer, assign, or surrender operation of the Project, or otherwise cease to operate it, without prior Commission approval.⁴²

22. Applicants assert that Nogales Operations will assume the full market risk associated with the Project as a result of Nogales Operations leasing the Project facilities and associated capacity rights from Nogales Transmission. Applicants explain that this is because Nogales Operations does not own or control a traditionally regulated transmission system or a franchised service territory, and therefore does not have captive customers that could be required to take transmission service on, or pay the costs of, the Project.⁴³ According to Applicants, although UNS Electric and Tucson Electric are affiliated with Nogales Transmission via common upstream ownership interests held by MEH Management, they are not affiliated with Nogales Operations and have no ability to control Nogales Operations.⁴⁴ Applicants assert that the Project's costs cannot be shifted to captive customers of UNS Electric or Tucson Electric absent approval by the Arizona Corporation Commission or this Commission.⁴⁵ Applicants also note that UNS Electric and Tucson Electric operate under Commission-approved OATTs and that customers of UNS Electric or Tucson Electric are not required to take service on, or pay the costs of, the Project; they will do so only if it is economical, as determined by Nogales Operations' open solicitation process.⁴⁶

23. Applicants state that Nogales Operations' books and records will comply with the Uniform System of Accounts in part 101 of the Commission's regulations⁴⁷ and will be subject to examination as required in part 41 of the Commission's regulations.⁴⁸ Applicants assert that such accounting and audit requirements will further ensure that the

⁴² April 25 Amendment at 2-3.

⁴³ *Id.* at 3-4.

⁴⁴ Petition at 17.

⁴⁵ April 25 Amendment at 4.

⁴⁶ Petition at 17.

⁴⁷ 18 C.F.R. pt. 101 (2017).

⁴⁸ 18 C.F.R. pt. 41 (2017).

Project's costs are recovered only from those customers that voluntarily enter into contracts with Nogales Operations for service on the Project.⁴⁹

24. Applicants assert that Nogales Operations' affiliation with SU FERC, the entity that is operating the Southline Project, is immaterial because the projects are fundamentally different. According to Applicants, the Southline Project is a domestic, east-west 240-mile transmission line that will provide approximately 1,000 MW of bi-directional transmission capacity in southern New Mexico and southern Arizona, whereas the Nogales Project involves a back-to-back HVDC converter station that allows transfers of power between two asynchronous, cross-border power grids. Therefore, Applicants assert that capacity on one project is not a substitute for capacity on the other.⁵⁰

25. Applicants also assert that Nogales Operations, Nogales Transmission, and none of their affiliates own or control any barriers to market entry or have any incentive to withhold capacity. Applicants state that, to the contrary, Nogales Operations has every incentive to make Project capacity available to potential customers because it bears the full market risk of the Project. Applicants further state that, because potential customers can pursue alternative transmission service from incumbent transmission owners at cost-of-service rates, potential customers will purchase transmission service from Nogales Operations only to the extent that it is cost-effective to do so.⁵¹ Further, Applicants state that Nogales Operations is not capable of erecting barriers to entry because the Project will operate under a Presidential Permit that requires open access transmission.

ii. Commission Determination

26. Based upon the information provided in the petition, we find that Nogales Operations meets the first of the *Chinook* factors, that is, Nogales Operations' rates will be just and reasonable. Nogales Operations is assuming full market risk for the Project and has no captive customers from which to recover the costs of the Project. Additionally, potential customers are not required to purchase transmission service from Nogales Operations and have the option of purchasing transmission from incumbent transmission owners in the region. Although Nogales Operations is affiliated with SU FERC, which operates the Southline Project, Nogales Operations and SU FERC cannot erect any barriers to entry given the fundamental differences in transmission service provided by each of the two projects because the Project involves a back-to-back HVDC converter station to allow transfers of power between two asynchronous, cross-border

⁴⁹ April 25 Amendment at 4.

⁵⁰ *Id.* at 5-6.

⁵¹ Petition at 18.

power grids and the Southline project is a domestic east-west transmission line extending 240 miles.⁵² Nogales Operations also does not have any incentive to withhold capacity because it must secure customers to use the Project in order to pay its long-term lease obligation. Therefore, we find that the negotiated rate authority requested by Nogales Operations will result in just and reasonable rates for service on the Project.

b. Factor Two: Undue Discrimination

27. As explained in *Chinook*, the Commission has in the past primarily looked at two factors to ensure that applicants cannot exercise undue discrimination when approving negotiated rate authority: (1) the terms and conditions of a merchant developer's open solicitation process; and (2) its OATT commitments (or, in the Regional Transmission Organization (RTO) or Independent System Operator (ISO) context, its commitment to turn operational control over to the RTO or ISO).⁵³

28. Pursuant to the Policy Statement, a developer may demonstrate no undue discrimination or preference by conducting an open solicitation that broadly solicits interest in the project from potential customers and, following the solicitation process, demonstrating to the Commission that it has satisfied the solicitation, selection, and negotiation process criteria set forth in the Policy Statement.⁵⁴

29. In addition, applicants must issue broad notice of the project in a way that ensures that all potential and interested customers are informed of the proposed project, such as by placing notice in trade magazines or regional energy publications.⁵⁵ The notice should include developer points of contact, pertinent project dates, and sufficient technical specifications and contract information to inform interested customers of the nature of the project, including the following: (1) project size/capacity; (2) end points of the line; (3) projected construction and/or in-service dates; (4) type of line; (5) precedent agreement (if developed); and (6) other capacity allocation arrangements (including how the developer will address potential oversubscription of capacity).⁵⁶ The developer should also specify in the notice the criteria it plans to use to select transmission customers. The developer may also adopt a specific set of objective criteria that it will

⁵² April 25 Amendment at 5.

⁵³ *Chinook*, 126 FERC ¶ 61,134 at P 40.

⁵⁴ Policy Statement, 142 FERC ¶ 61,038 at P 16.

⁵⁵ *Id.* P 23.

⁵⁶ *Id.* P 20.

use to rank prospective customers, provided it can justify why such criteria are appropriate. Finally, the Commission expects the developer to update its notice if there are any material changes to the nature of the project or the status of the capacity allocation process, in particular to ensure that interested entities are informed of any remaining available capacity.⁵⁷

30. In the Policy Statement, the Commission stated that merchant developers must disclose the results of their capacity allocation process for approval under section 205 of the FPA.⁵⁸ Developers must demonstrate that the processes that led to identifying transmission customers and executing the relevant contractual arrangements are consistent with the Policy Statement and the Commission's open access principles. Specifically, the developer should describe the criteria that were used to select customers, any price terms, and any risk-sharing terms and conditions that served as the basis for identifying transmission customers selected versus those that were not, as well as provide certain information listed in the Policy Statement in order to provide transparency to the Commission and interested parties.⁵⁹

31. The Commission emphasized in the Policy Statement that the information in the post-selection demonstration is an essential part of a merchant transmission developer's request for approval of a capacity allocation process, and that the developer will have the burden to demonstrate that its process was in fact not unduly discriminatory or preferential, and resulted in rates, terms, and conditions that are just and reasonable.⁶⁰ The Commission allows merchant transmission developers discretion in the timing of requests for approval of capacity allocation processes, and provided two examples. First, a developer can seek approval of its capacity allocation approach after having completed the process of selecting customers in accordance with Commission policies. Alternatively, a developer can first seek approval of its capacity allocation approach and then can demonstrate in a subsequent filing filed in response to the Commission's order approving that approach that the developer's selection of customers was consistent with the approved selection process.⁶¹

⁵⁷ *Id.* PP 24-27.

⁵⁸ 16 U.S.C. § 824d (2012).

⁵⁹ Policy Statement, 142 FERC ¶ 61,038 at P 30.

⁶⁰ *Id.* P 32.

⁶¹ *Id.* P 31.

i. **Petition**

32. As part of its open solicitation process, Nogales Operations requests approval to allocate up to 100 percent of the Project's initial capacity rights to one or more anchor customers.⁶² Applicants state that they will use an open solicitation process in which they will issue a broad notice to ensure that all potential and interested customers are informed of the Project. Applicants assert that, while they have been conducting outreach efforts for the Project since 2015, they also plan to post a notice of the Project on the Project's website, widely distribute the notice through industry and stakeholder outlets, and publish the notice in regional news outlets and energy publications. Applicants explain that the notice will include the types of information identified in the Policy Statement including appropriate points of contact, pertinent Project dates, sufficient technical specifications, and contract information to inform interested parties of the nature of the Project. Applicants also state that the notice will include information addressing customer selection screening factors and ranking criteria that will be used by Nogales Operations to identify and rank prospective customers.⁶³ Applicants also explain that the notice will provide interested parties with the option to request a meeting with Nogales Operations' representatives and other stakeholders to discuss bid considerations and will include a commitment by Nogales Operations to host a conference to address questions from interested parties. Applicants continue that Nogales Operations will also provide a password-protected website to provide additional information requested by potential customers. Applicants state that any material changes to the nature of the Project or the status of the capacity allocation process will be reflected in an updated notice and prominently displayed on the Project's website in a timely manner to ensure that interested parties are informed of any remaining available capacity.⁶⁴

33. Applicants state that they have developed objective criteria to select and rank potential customers seeking Project capacity through negotiated agreements. According to Applicants, Nogales Operations will use the following initial customer screening criteria to establish preferred minimum standards for potential customers that are identified through the open selection process: (1) first-mover status; (2) investment-grade credit rating or alternative evidence of creditworthiness; (3) firm transmission service reservation request for at least 10 years; and (4) firm transmission service

⁶² Petition at 21.

⁶³ *Id.* at 22-23.

⁶⁴ *Id.* at 23.

reservation request for at least 50 MW of capacity. Applicants state that these screening criteria are designed to ensure that the Project is economically viable.⁶⁵

34. In support, first, Applicants assert that first-mover status would give potential customers the incentive to submit timely proposals and thus to allow the Project to move forward. Second, Applicants state that creditworthiness is a typical customer screening criterion and is necessary to secure financing for the construction of the Project; potential customers would be allowed to demonstrate creditworthiness with an investment-grade credit rating, or, alternatively, by other commercially reasonable means. Finally, Applicants state that the third and fourth criteria, requirements for minimum terms and minimum capacity reservations, respectively, are necessary as a practical matter to reduce costs, increase efficiency, and help to reduce the overall risk of the Project—all of which support construction financing. Applicants state that it may be necessary to refine these criteria based on market circumstances and that Nogales Operations would provide public notice of any changes and apply the revised criteria equally to all potential customers.⁶⁶

35. Applicants state that, after applying the initial customer selection criteria, Nogales Operations will rank potential customers based on the following measures: (1) price terms contained in the customer's offer; (2) level of creditworthiness; (3) early commitment in the Project's development cycle; (4) Project risk-sharing through phased deposits or financial commitments during the Project's development cycle; (5) ability of the potential customer to assist with the Project's development needs, including obtaining necessary siting approvals and governmental authorizations; (6) length of term-of-service; (7) size of capacity reservation; (8) ability to access the Project to deliver or receive power, (e.g., proximity of generation resource to the line, transmission service queue positions on adjacent systems); (9) for generation customers, completion of generation development milestones, including site control, equipment commitments, off-take commitments, and a commercial operation date for generation; and (10) for customers without generation, such as power marketers or load-serving utilities, evidence of need for Project capacity and timing of their transmission service commencement date.⁶⁷

36. Applicants note that, prior to submitting bids, potential customers would be able to access the Project's development and construction cost information, and may request a preliminary meeting with Nogales Operations to discuss bid considerations. Applicants explain that, after receiving bids, Nogales Operations will apply the ranking measures to

⁶⁵ *Id.* at 24.

⁶⁶ *Id.*

⁶⁷ *Id.* at 25-26.

customers that satisfy the initial screening criteria to identify a subset of one or more customers eligible for the initial phase of bilateral negotiations for transmission service rights. If the full capacity of the Project is not reserved through the initial solicitation process, Applicants state that Nogales Operations will use the same ranking criteria to develop additional subsets of customers for subsequent phases of bilateral negotiations.⁶⁸

37. Applicants assert that these criteria are designed to minimize the Project's commercial risk and, thus, facilitate reasonable construction financing terms. Applicants also assert that minimizing these costs through appropriately ranking initial customers would benefit not only the initial customers, but also later customers taking service under Nogales Operations' OATT and secondary market customers. Furthermore, Applicants state that these criteria would improve the Project's long-term viability insofar as they give customers an incentive to share in the Project's risk and development costs.⁶⁹

38. Applicants commit that Nogales Operations would disclose the results of its customer selection and ranking process and bilateral negotiations in one or more post-allocation filings submitted to the Commission pursuant to FPA section 205 and the Policy Statement.⁷⁰ Applicants explain that, if the Project is oversubscribed, the post-allocation filing(s) of Nogales Operations would describe its decision whether to prorate capacity among eligible customers and provide notice of further processes to address requests for more capacity than the Project is initially able to accommodate. For these reasons, Applicants assert that Nogales Operations' proposed capacity allocation process, including both its customer selection and ranking criteria, will not lead to undue discrimination and is consistent with both the Policy Statement and the process approved in *Southline*.⁷¹

39. Applicants state that Nogales Operations commits to file and obtain Commission approval of an OATT prior to commencing service.⁷² Applicants continue that, if the

⁶⁸ *Id.* at 26.

⁶⁹ *Id.*

⁷⁰ *Id.* at 26-27.

⁷¹ *Id.* at 22-24.

⁷² April 25 Amendment at 7.

Commission approves an RTO or ISO for the region in which the Project will operate, Nogales Operations commits to join such an organization if reasonable to do so.⁷³

40. Finally, Applicants state that, as an additional protective measure, Nogales Operations commits to the following conditions customarily imposed on merchant transmission owners following commercial operation: (1) Nogales Operations' books and records will comply with the Uniform System of Accounts in part 101 of the Commission's regulations and will be subject to examination as required in part 41 of the Commission's regulations; (2) Nogales Operations will file reports in accordance with sections 141.14 and 141.15 of the Commission's regulations, to the extent applicable; and (3) Nogales Operations' books and records will be audited by independent auditors. Applicants state that these commitments ensure that the Commission may effectively exercise oversight over Nogales Operations⁷⁴ and that Project costs are only recovered from those customers that voluntarily enter into contracts with Nogales Operations for service on the Project.⁷⁵

ii. Commission Determination

41. In its Petition, Applicants describe how Nogales Operations plans to broadly solicit interest from potential customers. In addition to committing to engage in an open solicitation process, Applicants state that Nogales Operations will file an applicable OATT prior to the commencement of service, and one or more detailed post-allocation reports with the Commission disclosing the results of the capacity allocation process and describing the process in sufficient detail to demonstrate consistency with its Commission-approved process. As described above, the Policy Statement provides a merchant transmission developer with discretion as to the timing of its request for approval of the selection process. We find that Nogales Operations' conditionally satisfies the undue discrimination factor for negotiated rate authority based on its commitment to file an applicable OATT prior to the commencement of service, and to engage in an open solicitation and capacity allocation process consistent with the Policy Statement. However, we will reserve final judgment on whether that OATT and open solicitation and capacity allocation process are not unduly discriminatory, pending Nogales Operations' subsequent section 205 filing providing the details necessary to judge the OATT, and open solicitation and capacity allocation process. We also acknowledge Nogales Operation's voluntary commitment to join an RTO or ISO should

⁷³ Petition at 18.

⁷⁴ *Id.* at 20.

⁷⁵ April 25 Amendment at 4.

the Commission approve such an organization for the region in which the Project will operate.

42. Nogales Operations also commits that, upon Project commencement, Nogales Operations will maintain books and records for the Project that comply with the Uniform System of Accounts found in part 101 of the Commission's regulations, subject to examination as required in part 41 of the Commission's regulations, and to ensure that its books and records are audited by an independent auditor.⁷⁶ We rely on these commitments in our finding that Nogales Operations conditionally satisfies this factor, as these commitments will assist the Commission in carrying out its oversight role.

c. Factor Three: Undue Preference and Affiliate Concerns

43. In the context of merchant transmission, Commission concerns regarding the potential for affiliate abuse arise when the merchant transmission owner is affiliated with the anchor customer, participants in the open season or solicitation, or customers that subsequently take service on the merchant transmission line. The Commission expects an affirmative showing that the affiliate is not afforded an undue preference, and the developer bears a high burden to demonstrate that the assignment of capacity to its affiliate and the corresponding treatment of nonaffiliated potential customers is just, reasonable, and not unduly discriminatory or preferential.⁷⁷

i. Petition

44. Applicants state that no affiliates of Nogales Operations plan to participate in the open solicitation process for transmission service on the Project.⁷⁸ Thus, Applicants conclude that there is no possibility of undue preference or affiliate concerns. Applicants note that MEH Management's affiliates UNS Electric and Tucson Electric, which are both jurisdictional public utilities, could participate in the open solicitation process. However, Applicants assert that Nogales Operations' exclusive operational control over the Project and management of the open solicitation process mitigates any concern regarding possible undue discrimination or preference in favor of UNS Electric or Tucson Electric. In addition, Applicants note that the Commission allows a merchant transmission developer to conduct a solicitation, selection, and negotiation process that complies with the requirements of the Policy Statement and file a post-allocation filing to

⁷⁶ See *Chinook*, 126 FERC ¶ 61,134 at P 62; *Champlain Hudson*, 132 FERC ¶ 61,006 at P 48; *Tres Amigas LLC*, 130 FERC ¶ 61,207, at P 90 (2010) (*Tres Amigas*).

⁷⁷ Policy Statement, 142 FERC ¶ 61,038 at P 34.

⁷⁸ Petition at 20.

demonstrate a lack of undue preference in the assignment of capacity. Applicants further state that Nogales Operations will disclose the results of its customer selection and ranking processes and bilateral negotiations to the Commission in one or more detailed post-allocation filings submitted pursuant to FPA section 205 and the Policy Statement.⁷⁹ Applicants state that Nogales Operations' open solicitation and capacity allocation processes comply with the Policy Statement and Commission precedent and, therefore, Nogales Operations' proposal to allocate up to 100 percent of the Project's transmission capacity through bilateral negotiations would not result in any undue preference.⁸⁰

ii. Commission Determination

45. Nogales Operations commits to engage in an open solicitation process and make a future filing with the Commission disclosing the results of the capacity allocation process, and making an affirmative showing in sufficient detail to demonstrate that no affiliate has been afforded undue preference. We find that Nogales Operations conditionally satisfies the undue preference factor for negotiated rate authority based on these commitments. However, we will reserve final judgment on whether our affiliate preference concerns are addressed pending Nogales Operations' subsequent section 205 filing demonstrating that the assignment of capacity to any affiliate and the corresponding treatment of nonaffiliated potential customers is just, reasonable, and not unduly discriminatory or preferential.⁸¹

d. Factor Four: Regional Reliability and Operational Efficiency

46. In order to ensure regional reliability and operational efficiency, the Commission expects that any merchant transmission projects connected to an RTO or ISO turn over operational control to the RTO or ISO.⁸² Merchant transmission projects, like cost-based transmission projects, are subject to mandatory reliability requirements.⁸³ Merchant

⁷⁹ *Id.* at 26-27.

⁸⁰ *Id.* at 20-21.

⁸¹ *See, e.g., Southline*, 152 FERC ¶ 61,211 at P 67; *Western Spirit*, 155 FERC ¶ 61,252 at P 32.

⁸² *Empire State Connector Corp.*, 155 FERC ¶ 61,305, at P 28 (2016).

⁸³ *See, e.g., Rules Concerning Certification of the Electric Reliability Organization; and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards*, Order No. 672, FERC Stats. & Regs. ¶ 31,204, *order on*

transmission developers are required to comport with all applicable North American Electric Reliability Corporation (NERC) requirements and those of any regional reliability council in which they are located.

i. Petition

47. Applicants explain that the Project is not located in a region with an RTO or ISO. However, Applicants state that Nogales Operations will comply with all applicable NERC and Western Electricity Coordinating Council reliability requirements and participate in regional transmission planning to develop coordinated and efficient operations. Applicants state that, prior to energization, Nogales Operations will assume transmission planning responsibility for the Project; therefore, the Project would meet applicable regional reliability requirements and will operate in a coordinated and efficient manner.⁸⁴

ii. Commission Determination

48. Nogales Operations commits to comply with all applicable reliability requirements and to participate in a regional transmission planning process. We rely on these commitments and find that, based on these commitments, Nogales Operations has met the regional reliability and operational efficiency requirements.

49. In summary, our conditional grant of negotiated rate authority is based on an expectation that Applicants will follow through on their commitments summarized above, and we will use the subsequent section 205 filing and post-allocation reports to verify that Applicants have done so.

3. Waiver Requests

a. Petition

50. Applicants request certain waivers that will otherwise become effective when Nogales Operations becomes a public utility under the FPA. Specifically, Applicants request that the Commission waive the following requirements: (1) the full reporting requirements of subparts B and C of part 35, except for sections 35.12(a), 35.13(b), 35.15 and 35.16;⁸⁵ (2) part 141, relating to forms and reports, with the exception of sections

reh'g, Order No. 672-A, FERC Stats. & Regs. ¶ 31,212 (2006).

⁸⁴ Petition at 21.

⁸⁵ 18 C.F.R. § 35.12 (2017).

141.14 and 141.15;⁸⁶ and (3) the Form No. 1, Annual Report of Major Electric Utilities, Licenses, and Others filing requirement.⁸⁷ Applicants state that Nogales Operations requests waiver of these requirements because it would not sell transmission service at cost-based rates and does not have captive customers. Applicants state that the Commission typically has granted similar waiver requests to merchant transmission projects seeking negotiated rate authority.⁸⁸

b. Commission Determination

51. Because Applicants are proposing a merchant transmission project in which Nogales Operations will bear the full market risk associated with the Project, will not have any captive customers, and will be charging negotiated rates, the regulations requiring the filing of cost-based data are not applicable. Consistent with our prior orders, we will grant waiver of the filing requirements of subparts B and C of part 35 of the Commission's regulations, except sections 35.12(a), 35.13(b), 35.15, and 35.16.⁸⁹

52. We also will grant waiver of part 141 of the Commission's regulations, except sections 141.14 and 141.15, as well as the Form No. 1 filing requirement. The Commission previously granted waiver of the Form No. 1 filing requirement to other merchant transmission owners.⁹⁰

The Commission orders:

(A) Applicants' request for disclaimer of jurisdiction over Nogales Transmission is hereby granted, as discussed in the body of this order.

(B) Applicants' request to grant Nogales Operations negotiated rate authority is hereby granted, subject to the Commission's approval of a subsequent section 205 filing, as discussed in the body of this order.

⁸⁶ 18 C.F.R § 141 (2017).

⁸⁷ 18 C.F.R. § 141.1 (2017).

⁸⁸ Petition at 27-28.

⁸⁹ See, e.g., *Southline*, 152 FERC ¶ 61,211 at P 77; *Plains and Eastern Clean Line, LLC*, 148 FERC ¶ 61,122, at P 33 (2014) (*Plains and Eastern*); *Hudson Transmission Partners, LLC*, 135 FERC ¶ 61,104, at P 42 (2011); *Tres Amigas*, 130 FERC ¶ 61,207 at P 103.

⁹⁰ See, e.g., *Southline*, 152 FERC ¶ 61,211 at P 78; *Plains and Eastern*, 148 FERC ¶ 61,122 at P 34.

(C) Applicants' request for waiver of the provisions of subparts B and C of part 35 of the Commission's regulations, with the exception of sections 35.12(a), 35.13(b), 35.15, and 35.16, is hereby granted, as discussed in the body of this order.

(D) Applicants' request for waiver of part 141 of the Commission's regulations, with the exception of sections 141.14 and 141.15, and the FERC Form No. 1 filing requirement is hereby granted, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.