

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Transactions Subject to FPA Section 203 | Docket No. RM05-34-000

**COMMENTS OF THE
TRANSMISSION ACCESS POLICY STUDY GROUP**

The Transmission Access Policy Study Group (“TAPS”) respectfully submits these comments in the above-captioned Notice of Proposed Rulemaking (hereafter “203 NOPR” or “NOPR”) issued on October 3, 2005.¹ TAPS commends the Commission for its fast start in implementing the numerous mandates of the Energy Policy Act of 2005 (“EPAAct”). The present NOPR addresses one of the most important – expansion and reinforcement of Federal Power Act (“FPA”) Section 203’s consumer protection provisions. TAPS comments on the proposed rules for valuation for purposes of amended Section 203’s \$10 million threshold, generation facility definition, assessment of encumbrances and cross-subsidization, and procedures to meet EPAAct’s new deadlines for Section 203 reviews. TAPS also comments on rules the Commission should propose as part of this proceeding (or a companion one commenced as soon as possible) to update its tools for analyzing Section 203 transactions in light of industry developments that have occurred since it issued its Merger Policy Statement nearly a decade ago and are likely to materialize as a result of EPAAct’s repeal of the Public Utility Holding Company Act of 1935 (“PUHCA”).

¹ The NOPR appeared in the Federal Register on October 7, 2005, which established a November 7, 2005 deadline for comments. 70 Fed. Reg. 58,636.

When the Commission issued its Merger Policy Statement in 1996,² it recognized the need for application of Section 203's standards to keep pace with industry developments.³ The Commission adopted the Department of Justice/Federal Trade Commission Merger Guidelines as its analytical framework to analyze the effect on competition.⁴ While the Guidelines prescribe analysis of five primary areas – concentration, competitive effects, entry, efficiencies, and potential exit of assets, the Commission's application of the Guidelines, at least as evidenced by recent orders in specific cases, has effectively devolved into a static exercise that begins and ends with the measurement of concentration using the Herfindahl-Hirschman Index ("HHI"). As shown by its unreceptiveness to intervenor claims that do not involve or are not corroborated by HHI calculations, *see generally Exelon Corp., Public Service Enterprise Corp.*, 112 F.E.R.C. ¶ 61,011 (2005) ("*Exelon-PSEG*"), the Commission appears unwilling to look beyond HHI to examine the competitive effects of a transaction. The need to do so, however, is underscored by the near consensus that HHI, standing alone, is not sufficient for analyzing competitive effects in most electricity markets. Further, the Commission's rote application of HHI bears little resemblance to the antitrust agencies' use of the Merger Guidelines to analyze market power in electricity markets. The Commission's continued, virtually exclusive reliance on HHI as its primary analytical tool for assessing competition in the Section 203 context, without giving genuine

² *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (Dec. 30, 1996), [1996-2000 Regs. Preambles] FERC Stat. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 62 Fed. Reg. 33,340 (June 19, 1997), 79 F.E.R.C. ¶ 61,321 (1997).

³ 61 Fed. Reg. at 68,596.

⁴ *Id.*

consideration to other kinds of evidence, will not satisfy the consumer protection goals of amended Section 203. The answer, however, is not necessarily to discard the Merger Policy Statement, but rather to update it (or at least the Commission's application of it) so that a broader array of evidence informs Commission decisions under Section 203.

As detailed below, TAPS comments as follows:

- While TAPS generally agrees with the NOPR's approach to determining value for purposes of the \$10 million transaction threshold, the Commission should refine the approach to (1) use a higher of fair market value or original depreciated costs for affiliated asset transactions, (2) regarding power supply contracts, use expected revenues over the life of a contract and add to those revenues any option value, and (3) make clear that applicants' misrepresentations regarding valuation could subject them to penalties.
- The proposed definition of "existing generation facility" should (1) be clarified to include mothballed facilities, (2) have a high standard for demonstrating that a facility is used solely for retail sales, and (3) include QFs.
- To effectively police for harmful encumbrances and cross-subsidization, the Commission should be pro-active, including by requiring that the proposed Exhibit M be supported through the submission of contracts, agreements or other arrangements that relate to a pledge or encumbrance, as well as documents related to a transaction that discuss pledges, encumbrances or cross-subsidies.
- The Commission should use its conditioning authority to (1) require applicants to disclose future pledges, encumbrances or cross-subsidization involving the assets or businesses subject to a Section 203 application, (2) impose structural conditions that limit the combining or commingling of utility and non-utility businesses and operations, and (3) require, in appropriate cases, "ring-fences" to protect utility assets and revenues from non-utility activities.
- The Commission should not prejudge, in the absence of experience applying amended Section 203, which categories of transactions should receive expedited treatment.
- The Commission should ensure that intervenors have sufficient time and information to assess a Section 203 application, and should adhere to its policy of not providing less than a full 60-day notice period where a competitive analysis is submitted.
- The Commission must update its Section 203 reviews to reflect changes in the industry as well as amended Section 203's new time limits, which will put more pressure on the Commission to avoid hearings. Needed tools include:

- Submission of data and documents, beyond those needed to perform the Appendix A analysis, that shed light on the true reasons for and impacts of a transaction, including the kinds of information submitted as part of Hart-Scott-Rodino (“HSR”) notifications.⁵
- Submission of data considered but not used in developing the Appendix A analysis.
- Limited, early discovery during the 60-day notice period to obtain information needed to analyze a transaction.
- Consideration of, and giving weight to, evidence other than HHI results.
- Analyses of supply curves, which Appendix A’s HHI calculations do not provide.

I. INTERESTS OF TAPS

TAPS is an informal association of transmission-dependent utilities in more than 30 states, promoting open and non-discriminatory transmission access.⁶ As entities entirely or predominantly dependent on transmission facilities owned and controlled by others, TAPS members have long been concerned about structural changes in the electricity and natural gas industries that could adversely affect competition, rates or regulation, or could expose consumers to harms from cross-subsidization. TAPS has commented on nearly all of the Commission’s major rulemakings and policy inquiries involving the electricity industry over the past decade, including those that led to the

⁵ As explained below, the HSR notification is a far more limited submission required of all utilities subject to the HSR filing requirements and is not the response to a “Second Request” that the antitrust agencies use to obtain more information in a small minority of cases.

⁶ TAPS is chaired by Roy Thilly, CEO of Wisconsin Public Power Inc. Current members of the TAPS Executive Committee include, in addition to WPPI, representatives of: American Municipal Power-Ohio; Blue Ridge Power Agency; Clarksdale, Mississippi; ElectriCities of North Carolina, Inc.; Florida Municipal Power Agency; Geneva, Illinois; Illinois Municipal Electric Agency; Indiana Municipal Power Agency; Madison Gas & Electric Co.; Missouri River Energy Services; Municipal Energy Agency of Nebraska; Northern California Power Agency; Oklahoma Municipal Power Authority; Southern Minnesota Municipal Power Agency; and Vermont Public Power Supply Authority.

1996 Merger Policy Statement and the Revised Filing Requirements for Section 203 Transactions issued in 2000.⁷

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II. THE COMMISSION SHOULD ENSURE THAT ITS PROPOSED RULES FULFILL CONGRESSIONAL INTENT TO PROTECT CONSUMERS FROM HARMFUL TRANSACTIONS

A. While the NOPR is Generally on the Right Track for Purposes of Determining Transaction Value, Some Refinements are Needed

As the NOPR spells out, amended Section 203(a) increases the previously applicable \$50,000 value threshold to \$10 million and expands its application to transactions involving securities, existing generation facilities, and certain holding company transactions. With certain exceptions, the Commission proposes to determine value based upon market value. NOPR PP 27, 29. TAPS generally supports the NOPR's approach and suggests the following refinements.

⁷ Revised Filing Requirements Under Part 33 of the Commission's Regulations, Order No. 642, 65 Fed. Reg. 70,983 (Nov. 28, 2000), [1996-2000 Regs. Preambles] FERC Stat. & Regs., ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 66 Fed. Reg. 16,121 (Mar. 23, 2001), 94 F.E.R.C. ¶ 61,289 (2001) (codified at 18 CFR Part 33 (2005) (Filing Requirements Rule)).

The NOPR properly observes that “for a transaction between affiliates, it cannot be readily assumed that the market value will be reflected in the transaction price, since the buyer and seller do not bargain at arm’s length.” NOPR P 30. The Commission has long-recognized risks associated with potential affiliate abuse,⁸ and appropriately proposes provisions to address such risks in the Section 203 context. For affiliate transactions other than those involving securities, the NOPR suggests using original undepreciated costs to measure value, though asks for suggestions regarding other appropriate approaches. NOPR P 30. Transactions between affiliates should not escape review where the original undepreciated cost is less than \$10 million but the fair market value is higher. Thus, TAPS suggests that the value be determined based upon the higher of fair market value (not the acquisition price) or original undepreciated costs. For securities, market value, not acquisition price, should be used, as suggested by the NOPR (P 33). Where affiliated applicants use the market value measure, the NOPR’s suggestion that they submit *Edgar*-type evidence is reasonable.⁹ The *Edgar* standards provide more than one means to show value based upon available evidence.

⁸ For example, the absence of affiliate abuse or favoritism is one of the criteria for the approval of market-based rate (“MBR”) authorization under Section 205 of the FPA. *Market-Based Rates for Public Utilities*, 107 F.E.R.C. ¶ 61,019, at P 1 (2004). THE COMMISSION has also recently explored affiliate abuse issues in the context of public utility purchases of power from affiliated sellers and purchases of the assets of affiliated sellers. *See generally Solicitation Processes for Public Utilities*, Docket No. PL04-6-000; *Allegheny Energy Supply Co.*, 108 F.E.R.C. ¶ 61,082 (2004); *Acquisition and Disposition of Merchant Generation Assets by Public Utilities*, Docket No. PL04-9-000; *Ameren Energy Generating Co.*, 108 F.E.R.C. ¶ 61,081 (2004).

⁹ As recited in the NOPR, under *Boston Edison Company Re: Edgar Electric Energy Company*, 55 F.E.R.C. ¶ 61,382 (1991), the buyer can present evidence (1) “of direct head-to-head competition either through a formal solicitation or an informal negotiation process;” (2) “of the prices that non-affiliated buyers were willing to pay for similar services to the proposed affiliate sale,” or (3) “showing the terms, prices and conditions of sales of similar services made by non-affiliated sellers in the relevant market.” NOPR P 33 n.25.

With respect to wholesale contract value, TAPS supports the NOPR's use of expected revenues over the remaining life of the contract. NOPR P 32. From the perspective of assessing a transaction's effect on competition, the quantity and price of power and energy supplied are clearly relevant. Further, the expected revenues approach should avoid valuation issues where affiliates are involved. TAPS also supports adding to the expected revenue stream the value of any options (*see* NOPR P 32).¹⁰

Finally, the Commission should make clear that the applicants' representation of value could be subject to the FPA's recently enhanced penalty authority in cases where they understate value in order to avoid a Section 203 review.¹¹ While the threat of penalties is particularly important in the case of affiliate transactions where there is no arm's-length verification of value, even non-affiliated parties may be tempted to try to avoid FERC review by under-valuing the transaction.¹² Penalties should thus be available in both affiliated and non-affiliated transactions.

B. The Definition of Existing Generation Facility Used for Jurisdictional Sales Should Not Let Reviewable Transactions Slip Through the Cracks

1. Existing Facilities Should Include Mothballed Units

Amended Section 203(a)(1) provides for Commission review of purchases, leases, or other acquisitions of "an existing generation facility: (i) that has a value in excess of \$10 million; and (ii) that is used for interstate wholesale sales and over which the

¹⁰ Whether options value is determinative would seem to arise where the revenues stream is less than \$10 million or the contract's only value is its options value.

¹¹ *Cf.* 15 U.S.C. § 18a(g) (providing civil penalty authority for violations of the Hart-Scott-Rodino notification requirements).

¹² For example, they may want to quickly close the transaction and, thus, understate the transaction value to avoid the Commission's review.

Commission has jurisdiction for ratemaking purposes.” NOPR P 14. The NOPR proposes to define “existing generation facility” as one “that is operational at the time the transaction is consummated.” NOPR P 37. It further explains that the Commission believes that a reasonable interpretation of a facility “that ‘is’ used for [interstate] wholesale sales” is one “that ha[s] already been energized at the time the transaction is consummated and [is] intended to be used in whole or in part for wholesale sales in interstate commerce by public utilities.” *Id.* TAPS urges the Commission to clearly state that mothballed generation facilities are included in its proposed definition of an “existing generation facility.”

In amending Section 203, Congress sought to give the Commission the authority to assess the competitive and other impacts of existing generation facility transfers. A fair reading of the statutory language should be understood to include any existing generation facility the transfer of which could affect competition or one of the other elements of the Commission’s standards. To limit the statutory language to just a “snapshot,” for example, whether the facility is injecting energy into the grid on the day a transaction is consummated, would be nonsensical; if a facility has value it is only because it is intended to be used for wholesale sales or because it is desired to prevent someone else from using it for wholesale sales. Newly constructed, energized facilities qualify for such treatment, as the Commission proposes. Mothballed facilities should as well.

Mothballed facilities are clearly “existing” and have the ability to deliver power to the grid on relatively short notice. As a general matter, mothballed plants can be brought back on line in a few months. So long as a mothballed facility can be put back on line, it

is reasonable to rebuttably assume that it is “intended to be used in whole or in part for wholesale sales in interstate commerce by public utilities.” See NOPR P 37.¹³ The Commission should so clarify.

2. The Bar to Prove Use of a Facility Exclusively for Retail Sales Should be Set High

The NOPR notes that “if it can be demonstrated that a facility is used exclusively for retail sales, then amended Section 203(a)(1)(D) is not triggered.” NOPR P 37. The Commission should require an applicant claiming such an exemption to seek a declaratory order in which the Commission disclaims jurisdiction. See, e.g., *Perryville Energy Partners, LLC*, 109 F.E.R.C. ¶ 61,019 (2004), *reh’g denied*, 111 F.E.R.C. ¶ 61,006 (2005). Further, the Commission should set a high bar when assessing such claims. As the record in the proceeding leading to adoption of the interim generation market power screens demonstrated, determining whether a facility is dedicated to retail load, for example, is very difficult. *AEP Power Mktg., Inc.*, 108 F.E.R.C. ¶ 61,026, at PP 61-71 (2004). Vertically integrated utilities generally dispatch their plants economically as fleets, with output sometimes serving retail load, sometimes wholesale load, and usually both simultaneously. Unless a utility operates separate dispatch for retail and wholesale sales, which seems highly unlikely given the attendant inefficiencies, the “retail-only” exception would most likely apply where an industrial with its own generation used solely to serve its own load sells the facility to another industrial.

¹³ Cf. *Devon Power, LLC*, 111 F.E.R.C. ¶ 63,063, at P 634 (2005) (concluding that mothballed plants should be counted as installed capacity for purposes of determining LICAP prices because they continued to affect supply decisions in the market and could be used to exercise market power), *exceptions pending*. However, applicants should be permitted to demonstrate that a mothballed facility will not be used for wholesale sales, for example, if the plant itself is going to be removed and the site used for non-electricity purposes, e.g., construction of a factory or shopping center.

In addition, given incentives to avoid the Commission review of acquisitions, especially controversial ones, the Commission should make clear that it will consider using its expanded penalty authority if an applicant receives an exclusion and subsequently it appears that the facility is, in fact, used for wholesale sales.

3. Existing Facilities Should Include QFs

In Docket No. RM05-36-000,¹⁴ the Commission has proposed rules governing QFs to amend, among other things, the exemptions available to QFs from FPA requirements. Among the exemptions the Commission proposes to eliminate are the Section 205 and 206 exemptions for QFs the sales of which are not governed by Section 210(f) of PURPA. PURPA NOPR P 26. In the rulemaking, the Commission also invites comments on other FPA provisions for which the Commission should eliminate existing exemptions. *Id.* P 30. As TAPS will urge in its comments on the PURPA NOPR, the Commission should eliminate the Section 203 exemption for QFs in its entirety. However, in this Section 203 NOPR proceeding, the Commission should also make clear that existing QFs will be deemed existing generation facilities.

The Commission's reasons articulated in the PURPA NOPR for no longer exempting certain QFs from Section 205 and 206 apply equally to Section 203.

[A] large number of QFs make market-based sales, which are often referred to as "non-PURPA sales". Many QFs are large units and their non-PURPA sales could potentially have a significant market effect. Nevertheless, under our current regulations, these QFs are not required to file for market-based rate authority under section 205 of the FPA. Moreover, if there were allegations of any type of market misconduct by these QFs, the Commission might not be

¹⁴ *Revised Regulations Governing Small Power Production and Cogeneration Facilities*, 113 F.E.R.C. ¶ 61,020 (2005) (hereafter "PURPA NOPR").

able to effectively investigate and remedy the misconduct because our current regulations exempt these QFs from section 206 of the FPA.

Our concern is heightened by the fact that, in section 1253(b) of EAct 2005, Congress has eliminated the ownership requirements for QF status, and, consistent with the new provision, we are proposing to eliminate the ownership requirements currently contained in sections 292.203(a)(3), 292.203(b)(2) and 292.206 of our regulations. Therefore, traditional utilities will now be able to own up to 100 percent of a QF. We believe that QFs, which now may be largely or wholly-owned by traditional utilities, generally should not be exempt from regulation under the FPA.

PURPA NOPR PP 23-24.

The consumer protection concerns that led Congress to expand the Commission's Section 203 authority over generation acquisitions apply equally to existing QFs. While it makes sense to retain the Sections 205 and 206 exemptions for QFs making PURPA avoided-cost sales, such exemption would be inappropriate in the Section 203 context. In the latter context there is the additional concern that with the elimination of the ownership restriction a QF purchased by a public utility in many cases will likely be operated as part of that utility's fleet of generation. Even where a "PURPA sale" contract at avoided-cost rates remains in effect, the Section 203 exemption should be eliminated, because the public utility will be able to dispatch the entirety of its fleet, including the QF, in satisfaction of those sales. The resulting modified dispatch could give the public utility an ability and/or incentive to exercise market power that would not have existed previously.

The Commission should not undermine its new authority by continuing a QF exemption developed under a different statutory regime when the Commission did not have jurisdiction over transfers of generation facilities. Thus, as part of the 203 NOPR, the Commission should make clear that these existing QFs will be treated as existing generation facilities and subject to Section 203 review.

C. The Commission Must Effectively Police for Harmful Encumbrances and Cross-Subsidization

1. The Commission Should Be Pro-Active in Protecting Consumers

As described in the NOPR (P 17), amended Section 203(a)(4) adds to the pre-existing “consistent with the public interest” standard an entirely new requirement that the Commission find that the transaction “will not result in cross-subsidization of a non-utility associate company or pledge or encumbrance of utility assets for the benefit of an associate company, unless the cross-subsidization, pledge, or encumbrance will be consistent with the public interest.” Repeal of PUHCA of 1935 creates a new world of transactions that could put consumers at risk if the Commission only reacts after damage has occurred. Instead, the Commission needs to be pro-active in its policing of increasingly complex transactions, including new varieties of financial derivatives and risk bearing.

The need to be pro-active is underscored by the fact that Section 203 transactions are not like Section 205 rate filings. The FPA does not provide refund authority for approved Section 203 transactions that end up having an adverse effect on rates by allowing the new owner to engage in manipulation of the markets or cross-subsidizing non-utility ventures. The inadequacy of after-the-fact remedies – one cannot unscramble

the egg – puts a premium on having greater assurances up-front that a transaction does not adversely pledge, encumber or produce cross-subsidization. The mechanisms discussed below should help to provide such assurances.

TAPS supports therefore the Commission’s proposal to interpret the term “non-utility associate company” “[t]o provide the broadest cross-subsidization protection.” NOPR P 44. The temptation to lean on the financial security provided by captive customer revenue streams is not limited to businesses not related to generation, transmission, distribution, or sale of electricity. Indeed, given the desire to gain a leg up on one’s competition, and the ability to do so by leaning on the financial strength of a utility with captive customers, the temptation to pledge, encumber or cross-subsidize will be just as great, if not greater, in support of related businesses such as power and gas marketing, merchant generation, or fuel supply.

The Commission’s ability to be pro-active, however, will be limited if it does not have sufficient information on a proposed transaction. The Commission and parties potentially affected by pledges, encumbrances and cross-subsidization can act only to the extent they know about such activities. The NOPR proposes that Section 203 applicants include in a new Exhibit M

an explanation of how applicants are providing assurance that the proposed transaction will not result in cross-subsidization of a non-utility associate company or pledge or encumbrance of utility assets for the benefit of an associate company, with appropriate evidentiary support for such explanation; or, if no such assurance can be provided, an explanation of how such cross-subsidization, pledge, or encumbrance will be consistent with the public interest.

NOPR P 45. An explanation alone will not suffice to provide an accurate picture of the transaction. The Commission should expect that such explanations will be drafted to put the transaction in a favorable light. It should thus require submission of the documentation underlying the transaction and documents discussing it as a means to verify the explanation and to ensure that the explanation does not stray from the truth.

Such evidence should include:

- All contracts, agreements, or other arrangements that relate to the pledge, encumbrance or cross-subsidy, including cost-allocation agreements among affiliates or among divisions of a single affiliate; and
- All documents related to the transaction that discuss pledges, encumbrances or cross-subsidy.

The Commission should periodically assess whether the Exhibit M, with the kind of evidence identified above, is providing sufficient information and should revise the requirements as needed to ensure that the Commission and affected parties can police transactions subject to Section 203 to determine the risk of consumer harm.

2. The Commission Should Not Hesitate to Use Conditioning Authority to Prevent Future Consumer Harm

The NOPR (P 53) also seeks comment on conditions that “should be placed on section 203 approvals to ensure that there is no pledge or encumbrance that harms utility customers.” TAPS supports the Commission’s using its ample conditioning authority under Section 203(b) to protect consumers. While the NOPR appropriately inquires about the kinds of conditions the Commission might consider, at this early stage of its exercising its expanded Section 203 authority, along with the absence of a crystal ball to see what kinds of transactions a post-PUHCA future will produce, the Commission should refrain from limiting its conditioning options. It should put in place mechanisms

that shed light on the future activities of successful Section 203 applicants so that it can act when the need arises. For example, the Commission should use its authority to condition Section 203 approvals with an obligation that applicants disclose future pledges, encumbrances or cross-subsidizations involving the assets or businesses subject to the Section 203 application.¹⁵ It is not inconceivable that applicants would not encumber the asset at the time of the Section 203 application but proceed to do so once the Commission's blessing is received.

With respect to specific conditions, the Commission rightly looks to the experience of its state commission colleagues. NOPR P 52. The kinds of conditions imposed by state commissions should be included in the Commission's quiver, but should not be deemed exhaustive of the options available to the Commission. It should also include, and perhaps favor, structural conditions for the same reason that structural conditions should be favored when addressing market power – once in place, such conditions require far less ongoing monitoring to ensure compliance. Possible structural conditions include (1) limits on the quantity and types of non-utility businesses pursued within a single corporate family; (2) prohibitions on public utility and non-utility businesses being conducted within the same affiliate; (3) separation of utility and non-utility books, records and financial statements; and (4) prohibitions on commingling of utility assets or liabilities with non-utility assets or liabilities.

¹⁵ *Cf.* 18 C.F.R. § 35.27 (“As a condition of obtaining and retaining market-based rate authority, a public utility with market-based rate authority must 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.”)

In some cases, the Commission may also need to consider “ring-fences” around affiliates, such as no common directors or officers, or prohibitions on sharing credit. The industry’s recent experiences with bankruptcies make clear that affiliated companies expressly or impliedly share credit. For example, Enron shell company 223 relies upon the credit of Enron shell company 15, which in turn relies on the credit of the parent. Where the revenues from captive customers are providing the financial security for this credit, consumers are at-risk. The Commission, for example, permitted the PG&E Corporation to ring-fence the assets of PG&E National Energy Group (“NEG”), when it was clear that PG&E Company was heading into bankruptcy. Absent that ring-fencing, it feared that creditors of PG&E Company might be able to reach the assets of PG&E NEG through the powers of the bankruptcy court. That was indeed a legitimate concern. By the same token, however, creditors of any subsidiary have the potential in bankruptcy of reaching the assets of any other subsidiary. This is a demonstration of the fact that cross-subsidies do take place at the credit level unless ring-fences are in place. At the very least, the Commission should act to protect the customers of any energy subsidiary from being forced to pay for losses associated with the bankruptcy of another subsidiary.

D. Proposed Standards for Expedited Applications and Notice Periods Can be Reasonable so Long as Interested Parties Have Timely Access to Needed Information

Amended Section 203(a)(5) requires the Commission to “adopt procedures for the expeditious consideration of applications for the approval of dispositions, consolidations, or acquisitions.” NOPR P 55. The NOPR proposes “expeditious consideration of completed section 203 applications that are not contested, are not mergers, and are consistent with Commission precedent, because they should typically meet the standards

established in section 203(a)(4).” NOPR P 57. TAPS finds the proposed criteria for expedited consideration reasonable. TAPS further agrees with the Commission’s decision not to provide a comprehensive description of the classes or types of transactions that would fall into the expedited review category. NOPR P 59. The Commission should gain experience applying its expanded Section 203 authority. An attempt now to codify certain types of transactions as eligible for expedited consideration would not be supported by substantial evidence, because there is no track record on which to base such determinations, and would encourage entities to structure their transactions so that they appear to comply, even if the real transaction is something else.

The NOPR also asks for comment on safeguards or conditions that the Commission might adopt to expedite review of acquisitions of foreign utilities by U.S. holding companies, even where the U.S. company has captive customers in the U.S. NOPR P 60. While the Commission is correct not to want to impede investment in the U.S. or abroad, it should not decide in the abstract how reviews of such transactions can be expedited. If, as the Commission envisions, such transactions can be structured to safeguard captive customers, the absence of risk should be apparent from the application and approval should occur quickly. After gaining experience with such transactions, the Commission may be in a position to identify procedures or safeguards that permit expeditious consideration of similar transactions in the future.

In response to the NOPR’s discussion of notice periods (PP 63-65), TAPS notes that the new 180/360-day deadlines on the Commission’s review of Section 203 applications is likely to put even more pressure on the Commission to avoid hearings. Such hearings, which are already rare, will become more so. TAPS fears that the

Commission will ask even more of intervenors in terms of supporting their concerns in cases upfront, particularly in cases where hearings are sought. However, intervenors will stand no chance if the Commission does not provide sufficient time or, as discussed below, access to needed information to analyze a transaction. It is vital that other than in non-complicated cases the Commission provide a full 60 days notice. Further, while the Commission can issue early deficiency letters, it should not deem an application complete until after it has reviewed any interventions or protests, which may identify deficiencies in an application.

III. THE COMMISSION MUST UPDATE ITS REVIEW OF SECTION 203 APPLICATIONS TO MEET THE CHALLENGES PRESENTED BY A CHANGING ENERGY INDUSTRY

When issuing its Merger Policy Statement nearly 10 years ago, the Commission said that it “believe[s] that the Commission has broad flexibility in determining what is in the public interest, particularly in light of changing conditions in the industry.”¹⁶ Much has changed since then. Significant portions of the U.S. have RTOs with increasingly complicated markets, which can make predicting a merger’s effects more difficult, and locational pricing, which creates new opportunities to exercise market power by accentuating the price effects of market power exercise made possible by transmission constraints. The recently initiated Notice of Inquiry on the adequacy of Order 888’s OATT evidences concerns that the OATT is not sufficient to mitigate transmission market power.¹⁷ Congress has repealed PUHCA, opening the door to mergers that

¹⁶ 61 Fed. Reg. at 68,598.

¹⁷ *Preventing Undue Discrimination and Preferences in Transmission Services*, Notice of Inquiry, Docket No. RM05-25-000, 70 Fed. Reg. 55,796 (Sept. 23, 2005), IV F.E.R.C. Stat. & Regs. ¶ 35,553 (2005).

straddle large geographic regions of the country. Congress has also beefed up the Commission's Section 203 authority. Given these changes, it is time for the Commission to update its tools for analyzing transactions.

A. The Commission Should Require Submission of Documents and Data that Shed Light on the Transaction

Amended Section 203 puts the Commission on relatively short deadlines of up to 360 days to approve jurisdictional transactions. The resulting pressure to minimize or expedite already scarce hearings means that the Commission and intervenors will not have traditional discovery tools to better understand a transaction. While the data and documents required by the Merger Policy Statement and associated filing requirements provide some useful information, it is information that applicants have scoured and packaged to sell their deal to the Commission. It and intervenors also need the documents and information used to sell the deal to the applicants themselves. It defies common sense that the Commission continues to apply an analytical framework based on the one used by the antitrust agencies but without requiring submission of the kinds of evidence those agencies routinely review. The Commission thus should revise the existing Section 203 filing requirement to include the kinds of documents submitted to the antitrust agencies as part of the initial HSR filing,¹⁸ as well as data sets examined by applicants but not used in their Appendix A analysis.¹⁹

¹⁸ The antitrust agencies also have deadlines imposed on their HSR reviews.

¹⁹ While the Commission rejected proposals along these lines in its Revised Filing Requirements rulemaking, Docket No. RM98-4-000, 94 F.E.R.C. ¶ 61,289, at 62,033-34, the case for adopting the proposal now is even more compelling, particularly given changes to Section 203 and in the electricity industry.

The documentary requirements for HSR initial notification are described at 16 C.F.R. pt. 803. Because utility HSR filings often follow a Section 203 filing, the Commission will need to adopt rules that require the submission of the same kinds of information required as part of the HSR filing, rather than the submission of the HSR notification itself.²⁰ Among the kinds of relevant information the Commission should receive are (1) documents filed with the Securities and Exchange Commission, (2) annual reports, annual audit reports, and regularly prepared balance sheets, and (3) studies, surveys, analyses, and reports. The HSR rules refer to the latter category as 4(c) documents, which according to the HSR instructions should include:

all studies, surveys, analyses and reports which were prepared by or for any officer(s) or director(s) (or, in the case of unincorporated entities, individuals exercising similar functions) for the purpose of evaluating or analyzing the acquisition with respect to market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets, and indicate (if not contained in the document itself) the date of preparation, and the name and title of each individual who prepared each such document.

Antitrust Improvements Act Notification and Report Form for Certain Mergers and Acquisitions, Instructions, Item 4.²¹ In the Commission context, the 4(c)-type documents would relate not only to competitive effects, but also to the other elements of the Commission's review – effects on rates and regulation and, now, pledges, encumbrances and cross-subsidies.

²⁰ To the extent there is overlap between the HSR notification and the Commission's existing requirements, the HSR requirements would obviously not need to be repeated.

²¹ Available at <http://www.ftc.gov/bc/hsr/050407InstructRpt.pdf> (last viewed November 1, 2005).

The Commission must understand that this proposal would not require applicants to submit a “Second Request”-type response. The documents required for the HSR notification generally should already exist. The HSR notification is required for *all* transactions subject to HSR. By contrast, the antitrust agencies send the Second Request to a small subset of the companies that must make an HSR notification. A response to a Second Request is also far more voluminous than an HSR notification, often involving hundreds of boxes of documents and countless electronic files. The entirety of an HSR notification is often no more than a single box of documents and frequently less.

TAPS appreciates that some of the documents required by a Commission equivalent to an HSR initial submission could be deemed competitively sensitive or proprietary. However, that information may be sensitive does not (and should not) prevent the Commission from requesting it.²² Rather, the applicants can indicate which documents should be protected,²³ and provide such documents to intervenors upon execution of an appropriate protective agreement.²⁴ The Commission’s Administrative Law Judges use a standard protective order that the Commission could adopt for purposes of Section 203 materials. Recent versions of that protective order include provisions that preclude access by “competitive duty personnel” to certain competitively sensitive

²² For example, the Revised Filing Requirements for Section 203 transactions contain provisions for supplying documents required by the Commission pursuant to a protective order. 18 C.F.R. § 33.9, § 388.112.

²³ *Id.*

²⁴ The Commission should consider requiring a requesting party to have filed a motion to intervene prior to executing the protective agreement so that the applicants can assess whether the requesting party has a legitimate interest in the documents.

documents.²⁵ In addition, such orders limit use of materials to the proceeding in which they are submitted.²⁶ To ensure compliance with the protective order, the Commission can subject violations to its penalty authority.²⁷

The Commission should also require submission of all data sets examined but not used by applicants in preparing their Appendix A analysis. Merger applicants will ordinarily have put their economic teams together well in advance of the filings with the Commission, and will have spent months examining various iterations of the potential data available, in order to create the most favorable picture. The rejected data are clearly relevant to the Commission's and intervenors' assessment of the transaction.²⁸

While these proposed revisions to the Section 203 submission will ameliorate somewhat the great information advantage enjoyed by applicants and improve the evidentiary record upon which the Commission makes its decisions, the revisions should not appreciably add to the applicants' burden. Unlike most of the materials that must be prepared for the Appendix A analysis, the documents and data described are largely pre-existing. Applicants need only produce them.

²⁵ "Competitive duties" are defined as "(i) the marketing or sale of electric power at wholesale, (ii) the purchase or sale of electric power at wholesale, (iii) the direct supervision of any employee with such responsibilities, or (iv) the provision of electricity marketing consulting services to entities engaged in the sale or purchase of electric power at wholesale." *See, e.g.*, Protective Order, ¶ 3(d), adopted by the Presiding Administrative Law Judge in *Devon Power, LLC*, Docket No. ER03-563-030 (August 6, 2004), available at <http://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=10217740>.

²⁶ *Id.* at P 7 ("Protected Materials shall not be used except as necessary for the conduct of this proceeding, nor shall they be disclosed in any manner to any person except a Reviewing Representative who is engaged in the conduct of this proceeding and who needs to know the information in order to carry out that person's responsibilities in this proceeding.").

²⁷ Applicants who in other circumstances will likely claim that the Commission's penalty authority suffices to encourage compliance with its rules should not be heard to claim otherwise in this context.

²⁸ *Cf.* Fed. R. Civ. P. 26(a)(2)(B) and Advisory Committee Note to the 1993 Amendments (expert reports must include data or other information considered by a witness, whether or not ultimately relied upon).

Particularly if the Commission does not expand the kinds of information that it requires applicants to submit, consideration should be given to a limited right to discovery during the initial notice period. Discovery should be available only to parties that have filed a motion to intervene so that applicants can determine whether the requesting party would have a legitimate interest in using the discovery for purposes of the Commission's review of the transaction. Reasonable limitations to prevent discovery from being unduly burdensome could be considered. Discovery requests and responses should also be filed with the Commission so that its staff has access to the information.²⁹

The foregoing measures are necessary so that intervenors and the Commission have an opportunity to properly assess a transaction given the new time limits. By having more information available early in the process, the Commission should increase its ability to act on many transactions within the first 180 days. For those transactions requiring more than the initial 180 days, especially any set for hearing, the early-produced information should give a head-start to such further review, thereby facilitating completion within the 360-day period.

B. The Commission Should Examine and Give Weight to a Broader Range of Evidence

1. The Commission Must Go Beyond HHIs in Assessing Transactions

With the predicted increase in merger activity resulting from PUHCA's repeal, combined with amended Section 203's time limits, TAPS fears that there will be great pressure on the Commission to mechanize its review of Section 203 transactions,

²⁹ While the Commission has in the past rejected proposals for early, limited discovery, Revised Filing Requirements rulemaking, Docket No. RM98-4-000, 94 F.E.R.C. ¶ 61,289, at 62,033-34, the new time limits create a new need.

especially mergers. Currently, merger review under the Appendix A analysis often boils down to a number-crunching exercise that gives dispositive and disproportionate weight to HHI results. The recent *Exelon-PSEG* order epitomizes this tendency. While agreeing with intervenors that it should analyze competitive effects, not just HHI results, the Commission's conclusion that Applicants' proposed divestiture mitigated merger-related harms because it restored HHIs to remove screen violations in effect focused only on HHI results. *Exelon*, 112 F.E.R.C. ¶ 61,011, at P 132. There was no analysis in the order of the competitive effects associated with the increases in concentration and thus no discussion about how the merger-related competitive harm was addressed by the proposed divestitures. The Commission stated:

Applicants' proposal to divest sufficient capacity to reduce market concentration to within the screening tolerance for increases from the pre-merger concentration level is one reasonable way to mitigate the merger-related harm to competition. As stated above, the HHI conveys information about the likelihood of both the coordinated and unilateral exercise of market power. By restoring the HHI to near pre-merger levels, Applicants will restore competition to the pre-merger level, and meet their burden to show that the merger, as mitigated, will not harm competition in wholesale energy markets.

Id. Other than reciting economic theory underlying HHIs, the *Exelon-PSEG* order does not discuss the facts on the ground and how the HHI results led to the Commission's conclusion that the merger will not adversely affect competition in light of those facts.

The Commission's mechanistic approach is in marked contrast to the way the antitrust agencies apply their Merger Guidelines. The Guidelines treat HHI statistics as evidence relevant to whether a merger will harm competition, but the statistics are not the only evidence examined. "[M]arket share and concentration data provide only the

starting point for analyzing the competitive impact of a merger.” Merger Guidelines § 2.0. The Guidelines further note that “Although the Guidelines should improve the predictability of the Agency’s merger enforcement policy, it is not possible to remove the exercise of judgment from the evaluation of mergers under the antitrust laws,” and warns that “mechanical application of [the standards set forth in the Guidelines] may provide misleading answers to the economic questions raised under the antitrust laws.” *Id.* § 0.0. Later, the Guidelines note that the “factors contemplated in the Guidelines neither dictate nor exhaust the range of evidence that the Agency must or may introduce in litigation.” *Id.* § 0.1.

Admittedly, the Commission’s merger filing requirements, 18 C.F.R. Part 33, require submission of more than just the HHI statistics. However, much of the data requested supports calculation of HHIs, and the Commission relies on the HHI results in response to intervenor concerns, even when those concerns are not stated in terms of, or cannot be corroborated by, HHI statistics. Typical HHI analyses do not capture competitive concerns associated with supply curve harm theories, for example, because under such theories sellers with market shares below those considered problematic from an HHI perspective may still have the ability and incentive to raise prices above competitive levels. The concern in a supply curve harm theory is less the amount of capacity owned and more the kind of capacity owned, including the location and characteristics of specific units.³⁰

³⁰ See Part III.B.2. below.

For example, in the *Exelon* proceeding, protestors raised concerns about strategic bidding and withholding output along key parts of the supply curve. *Exelon*, 112 F.E.R.C. ¶ 61,011, at P 44. While reciting protestors' concerns about supply curve harms and strategic bidding, *id.* at P 44, the *Exelon* order contained no specific discussion addressing why the concerns were invalid, other than noting that HHI measures risks of unilateral market power exercise. *Id.* at 131. The Commission's reliance on HHI results and its observation that "Applicants have proposed divesting units with a range of operational and cost characteristics, including the types of units that protestors argue could be used to engage in strategic bidding or withholding in order to exercise unilateral market power" (*id.*) has little value given the inability of the HHI calculation performed under Appendix A to predict supply curve-related harms. Based upon the order, one can only conclude that the Commission did not examine whether the divestitures would be the right ones to address supply curve harms.

It is evident from a review of the typical competitive impact statement used by the Antitrust Division to explain a settlement of a merger investigation that HHIs tell only part of the competitive harm story. Through interviews of market participants and review of documents produced by them and the merging parties, the agencies develop a picture of the market and its workings. This evidence, along with HHI, informs the antitrust agencies' conclusion about whether a particular transaction will lessen competition. While the Commission is not set up to interview market participants, many do intervene and protest merger filings, telling their stories often through sworn testimony. However, such evidence seems not to carry much weight with the Commission if not accompanied by HHI statistics that corroborate the evidence or challenge the applicants' HHI results.

At a minimum, the Commission should try to reconcile, on the one hand, intervenor concerns that are not amenable to support using HHIs and, on the other, the HHI evidence itself. If the concerns are not corroborated by HHI, the problem may be that the HHI is not capturing the potential harm.³¹

In sum, the Commission's obligations under the FPA, as well as under the Administrative Procedures Act, require that it not limit the kind of evidence to which it gives dispositive weight in its Section 203 reviews. The Commission should demonstrate that it considers and gives weight to other kinds of evidence, including evidence that challenges the conclusions suggested by HHIs or that captures competitive harms missed by HHI. With this revised approach, the Commission will be better equipped to fulfill its consumer protection mission.

2. The Commission Should Require Applicants to Submit Supply Curve Evidence

As noted above, HHIs generally are not useful at indicating competitive harms associated with applicants' ownership of strategic assets on a market's supply curve where even a relatively small market share can translate into considerable market power. Thus, the Commission should also require applicants to submit supply curve analyses for each relevant geographic market. In its August 2002 Strawman on Market Metrics, Commission Staff explained the need for

some measure of structural incentives for withholding, where firms with units near the market clearing price (typically peaking units) hold large amounts of lower

³¹ There are many reasons why complaints of real harm do not register on the HHI calculations used by applicants, most obviously a choice of geographic application of the HHI calculations without looking at real submarkets. *See also American Elec. Power Co. and Central and Southwest Corp.*, 85 F.E.R.C. ¶ 61,201, at 61,819 (1998) (recognizing that applicants' merger "screen analysis may not fully capture the effects of the merger on competition").

priced (typically baseload) capacity that could profit from economic withholding of the marginal units, or from physical withholding of small amounts of baseload capacity that would force the peaking units to set the marginal price.³²

In his article, *Analyzing Gas and Electricity Convergence Mergers: A Supply Curve is Worth a Thousand Words*, Commission OMTR Staffer David Hunger explained that “[e]stimating supply curves for the downstream electricity market gives analysts an additional tool for predicting future market outcomes.”³³ In his affidavit attached to TAPS’s (and APPA’s) comments on the Commission’s generation market power screens, Professor Darren Bush noted that “[a] straight-up counting of capacity may not detect market power arising from a fuel curve problem.”³⁴ Paul Joskow and Edward Kahn, when examining withholding behavior in California markets, recognized the importance of supply curves.³⁵

whether withdrawing capacity is in the self-interest of a portfolio generator will depend critically upon the slope of the supply curve. It must be steep enough to result in MCPs sufficiently high so that the increase in profit on generation still tendered to the market more than offsets the profits lost on the capacity withdrawn.

³² See “Strawman” Staff Discussion Paper on Market Metrics SMD Staff Conference on Market Monitoring, Docket No. RM01-12, *Remedying Undue Discrimination Through Open-Access Transmission Service and Standard Electricity Market Design*, at 12, available at <http://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=9567029> (last viewed March 11, 2005).

³³ David Hunger, *Analyzing Gas and Electric Convergence Mergers: A Supply Curve is Worth a Thousand Words*, 24:2 JOURNAL OF REGULATORY ECONOMICS 161 (2003).

³⁴ Affidavit of Professor Darren Bush, ¶ 22, attached to March 14, 2005 Comments of the American Public Power Association and Transmission Access Policy Study Group in *Market Based Rates for Public Utilities*, Docket No. RM04-7-000, available at <http://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=10446555>.

³⁵ Paul Joskow and Edward Kahn, *A Quantitative Analysis of Pricing Behavior in California’s Wholesale Electricity Market During Summer 2000: The Final Word*, at 20 (February 4, 2002), available at <http://www.ksg.harvard.edu/hepg/Papers/Joskow-Kahn%20Final%20Word%20Feb2002.pdf> (last viewed March 10, 2005).

Consider the simplified example of a buyer with a baseload unit in a load pocket with LMP that purchases another company's peaking unit in the same load pocket. Assume also that the next peaking unit to the right on the supply curve has marginal costs 30% higher than the peaking unit subject to acquisition. Before the transaction, the buyer with the baseload unit would likely not have withheld from that unit because the forgone infra-marginal rents associated with the withholding likely would not have been recovered with the added profit on the unit's remaining output. The seller of the peaking unit likely would not have withheld the unit, because it would not have infra-marginal capacity on which to earn extra profits from the price increase. However, once the owner of the baseload unit acquires the peaking unit, it will have the ability to withhold at a far lower loss of infra-marginal revenue, and will earn added profits on the output of its baseload unit. Even if the buyer's total market share, post-acquisition were less than, say, 20%, and the market had an HHI below 1800, the fact that the next most expensive peaking unit has marginal costs 30% higher gives the buyer the ability to raise price by that amount through withholding, and its ownership of the baseload unit gives it the incentive to do so.³⁶ Examining the supply curve reveals that the applicant has market power within a portion of the supply curve and has the incentive to exercise it.

The Commission should thus examine whether the addition of a seller's plant(s) to the buyer's fleet gives the buyer an ability and incentive to exercise market power that

³⁶ Let us also assume that the peaking unit has a marginal cost of \$60 per MWh. Such economic withholding would be possible in a number of RTO markets, for example, in ISO-NE where the market's mitigation measures permit offer increases of the lesser of \$25 per MWh or 50 percent, or NYISO and MISO where offers exceeding reference levels by the lesser of \$100 per MWh or 300 percent are tolerated. In contrast, if the example market were in PJM, the unit would presumably be subject to a marginal cost plus 10% bid cap when transmission constraints bind.

it would not have enjoyed prior to the merger or acquisition. The analysis would consider the composition and shape of the supply curve, the elasticity of supply along the curve, and the location of the seller's and buyer's units on the curve. Data needed to construct supply curves should be readily available to most applicants.³⁷ A key piece of information is heat rate data, because the efficiency of a unit gives a good approximation of the likely order in which the units should be dispatched, if the units are bidding based upon marginal (including, if appropriate, opportunity) costs, as the Commission's preferred market design requires in most cases. Sources of this data include the Environmental Protection Agency (because heat rate data is also used to monitor air emissions) and commercial sources, such as RDI and Platt's.

Supply curve analysis is a vital, yet missing, link in the Commission's merger analysis. It should be a standard part of the Commission's filing requirements under Section 203.

³⁷ January 27, 2005 Technical Conference, *Market-Based Rates for Public Utilities*, Docket No. RM04-7-000, Transcript at 60 (Bushnell), available at <http://www.ferc.gov/EventCalendar/Files/20050207080325-rm04-7-01-27-05.pdf>.

CONCLUSION

Many of the Commission's proposals in the Section 203 NOPR merit adoption, including with the changes proposed above. In addition, TAPS urges the Commission to update its Section 203 reviews to reflect changes in the industry, to ensure that relevant evidence is submitted by applicants and provided to interested parties, and to give weight to evidence in addition to the HHI metric.

Respectfully submitted,

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