UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

REQUESTS FOR CLARIFICATION AND/OR REHEARING OF THE TRANSMISSION ACCESS POLICY STUDY GROUP

On December 23, 2005, the Commission issued final rules amending 18 C.F.R. § 2.26 and 18 C.F.R. Part 33 to implement amended section 203 of the Federal Power Act.[1] *Transactions Subject to FPA Section 203*, 113 F.E.R.C. ¶ 61,315 (2005) ("Order 669"). Pursuant to Commission Rule 713, 18 C.F.R. § 385.713, the Transmission Access Policy Study Group ("TAPS") requests clarification and/or rehearing on a limited set of issues raised by Order 669. While TAPS supports many of the rulings in Order 669, in a few instances Order 669 either may be construed to unnecessarily narrow important consumer protections against the anticompetitive impacts of transactions or failed to adopt TAPS-recommended measures needed to provide the Commission with the tools to protect consumers from unlawful cross-subsidization and the adverse competitive impacts of mergers and acquisitions.

I. SPECIFICATION OF ERRORS

Pursuant to Rule 713(c), 18 C.F.R. § 385.713(c), TAPS specifies the following errors:

1. The Commission should clarify that cross-subsidization also concerns the effect of a transaction on competition. If the Commission does not so clarify, it should grant rehearing.

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[1] 16 U.S.C. § 824b, as amended by the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005).

2. The Commission erred by not adopting as a standard section 203 condition an ongoing requirement that applicants disclose future pledges, encumbrances or cross-subsidization involving the assets or businesses that are the subject of a section 203 application.

3. The Commission erred by not taking steps to update its section 203 reviews to reflect changes in the electricity industry as well as new time constraints under which the Commission must operate.

II. STATEMENT OF ISSUES

Pursuant to Order 663, 112 F.E.R.C. ¶ 61,297 (2005), TAPS identifies the following issues for Commission decision:

1. Whether the Commission should clarify or, in the alternative, grant rehearing that cross-subsidization concerns a transaction's effect on competition, in addition to its effect on rates? Yes. Interaffiliate transfers of financial benefits, including through cross-subsidization, are relevant to the Commission's section 203 public interest determination. *Ameren Energy Generating Co.*, 108 F.E.R.C. ¶ 61,081 (2004).

2. Whether the Commission should adopt as a standard section 203 condition an ongoing requirement that applicants disclose future pledges, encumbrances or cross-subsidization involving the assets or businesses that are the subject of a section 203 application? Yes. Section 203(b) gives the Commission the responsibility and authority to so condition application approvals and the Commission's adopting of a similar reporting requirement in the market-based rate context (18 C.F.R. § 35.27) demonstrates the reasonableness of doing so.

3. Whether the Commission should update its merger reviews to account for significant changes in the electricity industry and to expand the evidentiary basis for its section 203 determinations, including by:

    a) Requiring submission of data and documents that shed light on the true reasons for and impacts of a transaction, including the kinds of notifications submitted as part of Hart-Scott-Rodino notifications (16 C.F.R. pt. 801)?

    b) Requiring submission of data considered but not used in developing the Appendix A analysis?

    c) Allowing limited, early discovery by parties during the 60-day notice period to obtain information needed to analyze a transaction?

    d) Giving consideration of and weight to relevant evidence other than Herfindahl-Hirschman Index ("HHI") results?

    e) Analyzing supply curves that provide evidence of strategic bidding risks not generally revealed by HHIs?

Yes. The Commission's obligations under section 203, 16 U.S.C. § 824b, to ensure that a transaction is consistent with the public interest does not permit it to ignore clearly relevant and probative evidence needed to understand section 203 transactions given changes in the industry since the Commission adopted its Merger Policy Statement nearly 10 years ago.

4. Whether the Commission should at least examine its merger review policy as part of the technical conference to be held within the year on section 203 regulation? Yes, if the Commission does not initiate a review sooner.

III. ARGUMENT

A. The Commission Should Clarify that It Remains Concerned About the Effect of Cross-Subsidization on Competition

The Commission's section 203 reviews assess a transaction's effects on competition, rates and regulations. Order 669 at P 7. Discussing amended section 203(a)(4)'s new requirement that a transaction not result in unlawful cross-subsidization, the Commission observed that "the concern about cross-subsidization is principally a concern over the effect of a transaction on rates." *Id.* at P 167. Because its statement could be construed to limit cross-subsidization concerns to rates, the Commission should clarify that it will consider, and will not ignore, adverse competitive effects associated with cross-subsidization.

Cross-subsidization harms not only the ratepayers who bear its expense, but also can injure competition in the market where the cross-subsidized company sells, which a commitment by a utility to hold captive customers harmless from increased costs associated with a section 203 transaction will not address. The utility's parent may still take revenues earned on jurisdictional operations and use them to capitalize the operations of an affiliated generator making sales at market-based rates. The

capitalization transaction would not necessarily be the subject of a section 203 review.[2] Even if the utility's rates to captive customers did not technically violate a hold harmless provision, for example, because no increased costs were passed through to ratepayers, the jurisdictional rate could produce significant profits available to cross-subsidize affiliate activities.[3] The cross-subsidized sales could make the affiliate appear more efficient than it actually is, allowing it to make sales that should be made by competitors.[4]

Using regulated revenue streams to subsidize an affiliate's rates is little different in effect from a utility's rescuing an affiliated merchant generator by purchasing it at an inflated price. In both cases, the affiliate is propped up by the regulated utility's revenues. As described by the Federal Trade Commission ("FTC"), affiliate acquisitions at inflated prices not only harm customers directly through higher rates but also indirectly through efficiency losses, including the exit of more efficient generators and the retention of less efficient ones, which can lead to overall production cost increases and the loss of innovation.[5] Such acquisitions can also discourage entry by more efficient competitors. FTC Comments at 11. Further, these adverse efficiency effects can reduce the number of

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[2] *See* Order 669 at P 141, which provides a blanket exemption for "routine cash management transactions and intra-holding company system financing transactions."

[3] Such profits could be particularly excessive if many years had passed since the utility's prior rate case and reductions in costs and increases in loads meant that the rates produced far more than a just and reasonable rate of return.

[4] *See* Comments of the Staff of the Bureau of Economics and the Office of the General Counsel of the Federal Trade Commission, *Standards of Conduct for Transmission Providers*, Docket No. RM01-10-000, at 3 (Dec. 20, 2001) ("Second, the transmission utility could engage in anticompetitive cross-subsidization in favor of its unregulated affiliates. This conduct adversely affects competition and economic efficiency. For example, cross-subsidization of an affiliate may allow a less-efficient affiliate to expand at the expense of more efficient non-affiliates. The result will be high average costs for the market served by the affiliate and its displaced competitors."), *available at* http://elibrary.ferc.gov/idmws/common/OpenNat.asp?fileID=8912560.

[5] Comment of the Federal Trade Commission, *Solicitation Processes for Public Utilities*, Docket No. PL04-6-000, *Acquisition and Disposition of Merchant Generation Assets by Public Utilities*, Docket No. PL04-9-000, at 10-11 (Jul. 14, 2004).

competitors in the market, increasing concentration and the risk of anticompetitive prices, including through coordinated interaction. *Id.* at 11 n.19.

The Commission itself has characterized the foregoing harms as competitive harms about which it must be concerned in the section 203 context. *Ameren Energy Generating Co.*, 108 F.E.R.C. ¶ 61,081 (2004). While the Commission expressed its concerns about these harms in the context of affiliate acquisitions, as described above, the transfer of benefits to the affiliate, funded by the regulated utility's operations, is little different from the cross-subsidization concerns now part of the section 203 inquiry. In *Ameren*, the Commission stated:

> In determining that [affiliate] acquisitions are consistent with the public interest, as section 203 requires, the Commission must assure that a public utility's acquisition of a plant from an affiliate is free from preferential treatment. The public interest requires policies that do not harm the development of vibrant, fully competitive generation markets.

Id. at P 59. Echoing the FTC Comments, the Commission noted that preferential procurement of affiliates can harm competition by "raising entry barriers, increasing market power and impeding market efficiency." *Id.* at P 60. The Commission continued, "'utilities may have both incentives and the ability to exercise market power and harm consumers by discriminating in favor of their own affiliates and against independent suppliers.'" *Id.* (quoting FTC Comments at 1).

The need for the Commission to concern itself with the effect of cross-subsidization on competition is underscored by the unique opportunity presented by the section 203 review to address competitive effects:

> While after-the-fact prudence reviews by regulators may insulate ratepayers from the effects of a purchase price that

> is too high, they will not remedy the foreclosure of additional competitors from the market. The Commission must decide at the time of a section 203 application whether an acquisition will adversely affect competition or the public interest. Our responsibility under section 203 is to protect the public interest, and Congress intended us to take action *before* the disposition of facilities is consummated.

Id. at P 61 (emphasis in original).

The link between affiliate preference and competitive effects is seen as well in the Commission's standards for market-based rates ("MBR"), which require, among other things, examination of affiliate abuse and self-dealing. *Heartland Energy Servs., Inc.*, 68 F.E.R.C. ¶ 61,223, at 62,062 (1994). "Affiliate abuse takes place when the affiliated public utility and the affiliated power marketer transact in ways that result in a transfer of benefits from the affiliated public utility (and its ratepayers) to the affiliated power marketer (and its shareholders)." *Id.* As shown above, such benefit transfers adversely affect competition and should also be among the principal Commission cross-subsidization concerns.

In sum, the Commission should clarify that cross-subsidization concerns a transaction's effect on competition, in addition to its rate effect. If the Commission does not so clarify, TAPS requests rehearing for the reasons set forth above.

B. The Commission Should Condition Section 203 Approvals With a Requirement to Report Future Pledges, Encumbrances or Cross-Subsidizations Involving the Assets or Businesses in the Application

Last year, the Commission adopted the sensible requirement that holders of MBR authority make timely reports of any change in status "that would reflect a departure from the characteristics the Commission relied upon in granting market-based rate authority."

18 C.F.R. § 35.27. TAPS made a similar proposal in its comments on the section 203 NOPR, namely, that section 203 approvals be conditioned on an ongoing requirement that the applicant be required to report any future pledge, encumbrance or cross-subsidy involving the assets or businesses that were the subject of the section 203 application. While the Commission mentioned TAPS's proposal in Order 669 (at P 160), it neither adopted it nor provided reasons for not doing so. Order 669 at PP 164-71. TAPS urges the Commission to adopt the proposal on rehearing.

As TAPS pointed out in its comments, particularly if the rule is focused narrowly on encumbrances at the outset, it would not be surprising that applicants would not encumber the asset or business at the time of a section 203 application but proceed to do so once the Commission blessed a transaction. Such a change in status should trigger reporting to the Commission. In the MBR context, the Commission concluded that "[t]o carry out its statutory duty under the FPA to ensure that market-based rates are just and reasonable, the Commission must rely on market-based rate sellers to provide accurate, up-to-date information regarding any relevant changes in status, such as ownership or control of generation or transmission facilities and affiliate relationships." Order 652, 110 F.E.R.C. ¶ 61,097, P 9 (2005). Similarly, in the section 203 context, the Commission's obligation to find that a transaction is consistent with the public interest includes a responsibility to ensure that the conditions under which it approved a transaction do not change in the future such that the public interest determination is no longer valid. The reporting condition proposed by TAPS would provide the mechanism for the Commission to know whether the assets or businesses for which it provided section 203 approval subsequently became pledged or encumbered.

Section 203 clearly provides the authority to require future reporting as a condition:

> The Commission may grant any application for an order under this section in whole or in part and upon such terms and conditions as it finds necessary or appropriate to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission. The Commission may from time to time for good cause shown make such orders supplemental to any order made under this section as it may find necessary or appropriate.

16 U.S.C. § 824b(b). Indeed, the Commission already routinely reserves in section 203 orders its authority under sections 203(b) and 309 of the FPA "to issue supplemental orders as appropriate." *See, e.g.*, *Duke Energy Corp.*, 113 F.E.R.C. ¶ 61,297, Ordering Paragraph (D) (2005). It would be a necessary and appropriate exercise of its FPA authority to condition all section 203 approvals with the obligation to report changes in the encumbrance or pledge status of the assets or businesses subject to a section 203 application.

C. The Commission Should Not Wait to Revise Its Merger Reviews

TAPS's comments in this proceeding also urged the Commission to update its Merger Policy Statement and merger review process so that a broader array of evidence informs Commission decisions under section 203. The Final Rule rejected all recommendations for revising the Commission's approach to merger review, stating:

> With respect to commenters' specific concerns regarding the Commission's merger policy, we are not persuaded at this time to change our current policies. Our standard of review is flexible enough to consider any changes in market structure that ultimately result from the EPAct 2005 and the repeal of PUHCA 1935. However, once the Commission has gained more experience in evaluating

> section 203 applications under the new statute, we may consider reevaluating our merger policy in general.

Order 669 at P 202. TAPS is concerned that by the time the Commission decides it has gained enough experience looking at the trees in the forest by applying amended section 203 in specific cases, the forest will have been cleared, or at least thinned beyond recognition. As TAPS pointed out in its comments (at 18-19), the Commission adopted its current merger policy nearly ten years ago, and much has changed since then, including the development of RTOs with their complicated markets and LMP pricing, an Order 888 OATT that does not suffice to remedy transmission market power, repeal of PUHCA 1935, and new time constraints on Commission merger review that necessitate a fuller evidentiary record early on in the review process. The issue, thus, is not whether the Commission should re-examine how it reviews mergers but whether it will do so before it is too late.

TAPS attaches relevant portions of its earlier comments as an Attachment hereto in support of the recommendations set forth below. Those comments urged the following changes to merger review policy, particularly in light of time limits on Commission consideration of section 203 applications, which puts even more pressure on the Commission to avoid hearings in section 203 proceedings:

- The Commission should require section 203 applications that include Appendix A analyses to also include the data and documents that shed let on the true reasons for and impact of a transaction. Such materials include the kinds of information submitted as part of a Hart-Scott-Rodino ("HSR") notification. TAPS pointed out that the HSR notification required under 16 C.F.R. Part 803 is a limited submission required of all utilities subject to HSR reporting and is not the far more burdensome response to a "Second Request" that the antitrust agencies use to obtain more information about a transaction in a small minority of cases. Among the information the Commission should require are so-called "4(c)" materials representing the studies, surveys, analyses and reports used to sell a deal to the applicants' boards of directors and officers. The antitrust agencies routinely receive and review these materials. For

the Commission not to is like an ostrich sticking its head in the sand. TAPS Comments at 19-22.

- The Commission should require submission of all data sets examined but not used by applicants in preparing their Appendix A analysis. TAPS Comments at 22.

- TAPS noted that the additional information requirements would not appreciably increase the burden an applicants because the documents are usually existing and many of them will need to be submitted to the antitrust agencies in any event. TAPS Comments at 22.

- Particularly if the Commission did not beef up the information included in section 203 application, TAPS urged a limited discovery opportunity for parties that filed motions to intervene in order to obtain information necessary to assess and respond to the application. TAPS Comments at 23.

- The Commission should also give weight to evidence beyond the HHI results produced by the Appendix A analysis. TAPS is concerned that the Commission's merger analyses have become mechanistic, number-crunching exercises that ignore competitive harms that are not or cannot be readily illustrated by HHIs. Indeed, in its recent order approving MidAmerican's acquisition of PacifiCorp, the Commission ignored – indeed, never even mentioned – a sworn affidavit submitted by TAPS member Municipal Energy Agency of Nebraska ("MEAN") that described factual circumstances where price competition between MidAmerican and PacifiCorp could become particularly relevant and how MEAN could be harmed by the transaction. *MidAmerican Energy Holdings Co.*, 113 F.E.R.C. ¶ 61,298, P 31 (2005). The antitrust agencies routinely examine evidence other than HHIs. So should the Commission. TAPS Comments at 23-27.

- The Commission should examine evidence that reveals risks of strategic bidding resulting from the combination of the buyer's and seller's assets, in particular supply curve evidence. A range of industry observers, from the Commission's own staff to professional economists and antitrust professors, have described the need to consider this kind of evidence in order to assess competitive effects. TAPS Comments at 27-30.

TAPS does not seek a delay in the implementation of the new section 203 regulations. Rather, the Commission can initiate now or in the near future an examination of its merger review practices in light of the significant changes in the industry and already clear shortcomings in the current approach, as discussed above.

At minimum, TAPS urges the Commission to make a commitment to include review of current merger policy as part of the technical conference it says it will hold

within the year to address issues raised in this proceeding. *See* Section 203 Final Rule at P 4. Taking stock of the effectiveness of the Commission section 203 analyses must be a part of any review of the post-PUHCA regulatory framework to ensure there are no gaps that leave consumers vulnerable to competitive or other injuries associated with mergers.

CONCLUSION

The Commission should clarify and/or grant rehearing of Order 669 as set forth above.

Respectfully submitted,

/s/ Mark S. Hegedus

Robert C. McDiarmid
Cynthia S. Bogorad
Mark S. Hegedus

Attorneys for
Transmission Access Policy Study Group

Law Offices of:
Spiegel & McDiarmid
1333 New Hampshire Avenue, NW
Washington, DC 20036
(202) 879-4000

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ATTACHMENT

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 ("EPAct"). 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 EPAct'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 EPAct'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

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[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.

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 affects 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

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[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]

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[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.

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[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

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[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.

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[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,

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[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]

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[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

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[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.

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[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 Electricty 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

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[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.

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[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,

/s/ Mark S. Hegedus

Robert C. McDiarmid
Cynthia S. Bogorad
Mark S. Hegedus

Attorneys for
the Transmission Access Policy
Study Group

Law Offices of:
Spiegel & McDiarmid
1333 New Hampshire Avenue, NW
Washington, DC 20036
(202) 879-4000

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