

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

5. The authority citation for part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-37, 80a-39 unless otherwise noted;

* * * * *

6. Section 270.24e-2 is amended by revising paragraph (a) to read as follows:

§ 270.24e-2 Computation of fee.

* * * * *

(a) The fee to be paid at the time of filing of such amendment shall be calculated in the manner specified in section 6(b) of the Securities Act of 1933 except that, for the purposes of such calculation, the maximum aggregate price at which the securities are proposed to be offered may be deemed to be the maximum aggregate offering price, as determined by Rule 457(d) (17 CFR 230.457(d)) under the Securities Act of 1933, of:

(1) The amount of securities (number of shares or other units) being registered reduced by;

(2) The amount of securities (number of shares or other units) of the same class redeemed or repurchased by the issuer in its previous fiscal year (which amount of securities must, for purposes of this paragraph (a)(2), be reduced by the amount of any securities used in a reduction made by the issuer with respect to such shares pursuant to paragraph (c) of section 24f-2 of the Act during the current fiscal year) provided that, when more than one such amendment is filed by an issuer in any one fiscal year, the total amount of securities used for such reductions during any fiscal year in which such reductions are made may not exceed the total amount of securities which were redeemed or repurchased by the issuer during its previous fiscal year; and

* * * * *

Dated: December 23, 1996.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

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DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 2

[Docket No. RM96-6-000; Order No. 592]

Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act; Policy Statement

Issued December 18, 1996.

AGENCY: Federal Energy Regulatory Commission.

ACTION: Policy statement.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is amending its regulations to update and clarify the Commission's procedures, criteria and policies concerning public utility mergers in light of dramatic and continuing changes in the electric power industry and the regulation of that industry. The purpose of this Policy Statement is to ensure that mergers are consistent with the public interest and to provide greater certainty and expedition in the Commission's analysis of merger applications.

EFFECTIVE DATE: December 18, 1996.

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- Select the option: [1] FedWorld
- Logon to the FedWorld system
- Type: /go FERC

Policy Statement Establishing Factors the Commission Will Consider in Evaluating Whether a Proposed Merger Is Consistent With the Public Interest

Issued December 18, 1996.

I. Introduction

This Policy Statement updates and clarifies the Federal Energy Regulatory Commission's (Commission) procedures, criteria and policies concerning public utility mergers in light of dramatic and continuing changes in the electric power industry and corresponding changes in the regulation of that industry. The Commission believes it is particularly important to refine and modify its merger policy at this critical juncture for the electric industry. The Commission recognizes that the electric industry now is in the midst of enormous technological, regulatory and economic

changes. At the heart of these changes is the transition to competitive power supply markets, prompted in part by this Commission's open access transmission policies. These changes are fundamental, and mergers and consolidations are among the strategic options available for companies seeking to reposition themselves in response to the emerging competitive business landscape.

In this Policy Statement, the Commission has two broad goals. First, we intend to ensure that future mergers are consistent with the competitive goals of the Energy Policy Act of 1992 (EPA) ¹ and the Commission's recent Open Access Rule.² This means that the Commission, in applying the Federal Power Act standard that mergers must be consistent with the public interest, must account for changing market structures and pay close attention to the possible effect of a merger on competitive bulk power markets and the consequent effects on ratepayers. Second, the Commission believes that as the pace of industry change increases, market participants require greater regulatory certainty and expedition of regulatory action in order to respond quickly to rapidly changing market conditions. Accordingly, this Policy Statement offers procedural innovations and more specific information that we would expect applicants to file to facilitate the Commission acting more quickly on merger requests.³

We will generally take into account three factors in analyzing proposed mergers: the effect on competition, the effect on rates, and the effect on regulation. First, our analysis of the effect on competition will more precisely identify geographic and product markets and will adopt the Department of Justice/Federal Trade Commission Merger Guidelines (Guidelines) as the analytical framework for analyzing the effect on competition. The Guidelines adopt a five-step procedure for analyzing mergers

First, the Agency assesses whether the merger would significantly increase concentration and result in a concentrated market, properly defined

and measured. Second, the Agency assesses whether the merger, in light of market concentration and other factors that characterize the market, raises concern about potential adverse competitive effects. Third, the Agency assesses whether entry would be timely, likely and sufficient either to deter or to counteract the competitive effects of concern. Fourth, the Agency assesses any efficiency gains that reasonably cannot be achieved by the parties through other means. Finally, the Agency assesses whether, but for the merger, either party to the transaction would be likely to fail, causing its assets to exit the market.⁴

By applying an analytic "screen" based on the Guidelines early in the merger review process, the Commission will be able to identify proposed mergers that clearly will not harm competition.

Second, in assessing the effect of a proposed merger on rates, we will no longer require applicants and intervenors to estimate the future costs and benefits of a merger and then litigate the validity of those estimates. Instead, we will require applicants to propose appropriate rate protection for customers. The most promising and expeditious means of addressing this issue is for parties to engage in a pre-filing consensus-building effort that will result in a filing that includes appropriate rate protection. If merger applicants and their affected wholesale customers are able to agree on appropriate ratepayer safeguards, it should not be necessary to set this aspect of the merger for hearing.⁵ Even where the parties have been unable to come to an agreement before the merger is filed, they should continue to attempt to negotiate a settlement. While there are several potential mechanisms available, which we discuss herein, adequate ratepayer protection will necessarily depend on the particular circumstances of the merging utilities and their ratepayers. There is no one-size-fits-all approach, and the Commission strongly encourages parties to resolve this issue without a formal hearing. However, we also recognize the possibility that parties may not be able to reach an agreement on appropriate ratepayer protection and that there may be situations in which the Commission nevertheless would be able to approve a merger. This could occur either after a hearing or on the basis of parties'

filings if we determine that the applicants' proposal sufficiently insulates the ratepayers from harm.

Finally, with regard to the effect of the merger on regulation, we will adopt the approach we have used in recent cases. With respect to shifts of regulatory authority to the Securities and Exchange Commission (SEC) where the applicants will be part of a registered public utility holding company, they may either commit themselves to abide by this Commission's policies with regard to affiliate transactions, or we will set the issue for hearing. With respect to the merger's effect on state regulation, where the state commissions have authority to act on the merger, we intend to rely on the state commissions to exercise their authority to protect state interests.

In order to provide more certainty and expedition in our handling of merger applications, this Policy Statement explains how merger applicants should address each of the three factors as part of their case-in-chief in support of their application. For the effect on competition factor, applicants who demonstrate that their merger passes the market power screen established in this Policy Statement will establish a presumption that the merger raises no market power concerns. In that event, a trial-type hearing on this factor should not be necessary. We are also setting forth guidance on the other two factors and ways to resolve any concerns about these factors without a trial-type hearing.

For mergers that do not pass the market power screen, we will engage in a more detailed analysis, which may include a trial-type hearing. As discussed below, if we find that a merger will have an adverse effect on competition, and if the additional factors examined do not mitigate or counterbalance the adverse competitive effects of the merger, we may impose various remedies where necessary to make a merger consistent with the public interest.

In this Policy Statement, we also provide guidance on what kind of evidence is needed for each factor. Thus, applicants will be able to provide the necessary information at the outset. This should provide more certainty and help focus our review on specific issues that require more scrutiny. We believe that the additional information that we would expect parties to file will expedite the merger review process and enable the Commission to act on section 203 applications more quickly. We intend to process most merger applications within 12-15 months after

¹ Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776, 2905 (1992).

² See Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, (Open Access Rule) 61 FR 21540 (May 10, 1996), III FERC Stats. & Regs. ¶ 31,036 (1996), *reh'g pending*.

³ In the near future, the Commission will also issue a notice of proposed rulemaking to set forth more specific filing requirements consistent with this Policy Statement and additional procedures for improving the merger hearing process.

⁴ U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, issued April 2, 1992, 57 FR 41552 (1992).

⁵ Parties may choose to use alternative dispute resolution or other settlement processes to reach mutually agreeable ratepayer protection resolutions.

the applications are completed, as discussed below under "Procedures."

In general, we expect that a merger approved by the Commission will satisfy each of the three factors that form the basis of our merger review, *i.e.*, post-merger market power must be within acceptable thresholds or be satisfactorily mitigated, acceptable customer protections must be in place, and any adverse effect on regulation must be addressed. However, we recognize that there may be unusual circumstances in which, for example, a merger that raises competitive concerns may nevertheless be in the public interest because customer benefits (such as the need to ensure reliable electricity service from a utility in severe financial distress) may clearly compel approval. Consistent with the Guidelines, the Commission would continue to account for such circumstances and could, in a particular case, conclude that on balance the merger is consistent with the public interest.

Finally, the Commission recognizes that, as the industry evolves to meet the challenges of a more competitive marketplace, new types of mergers and consolidations will be proposed. For example, in addition to mergers between public utilities, market participants already are considering restructuring options that include mergers between public utilities and natural gas distributors and pipelines, consolidations of electric power marketer businesses with other electric or gas marketer businesses, and combinations of jurisdictional electric operations with other energy services.⁶ As a consequence, our merger policy must be sufficiently flexible to accommodate the review of these new and innovative business combinations that are subject to our jurisdiction under section 203 and to determine their implications on competitive markets. We believe that the analytical framework articulated in this Policy Statement provides a suitable methodology for determining whether such mergers will be consistent with the public interest.⁷ However, it will not be necessary for the merger applicants to

⁶ See, for example, among others, the proposed merger of Enron Corporation with Portland General Corporation (Docket No. ER96-36-000) and the proposed acquisition of PanEnergy Corporation by Duke Power Company, announced November 25, 1996.

⁷ We recognize that, as some energy products possibly become more suitable alternatives to others, or as the combination of complementary energy services possibly affects barriers to entry, the focus of our analysis may have to be adjusted to encompass those products, markets, and factors that are relevant to analyzing the exercise of market power in the future business environment.

perform the screen analysis or file the data needed for the screen analysis in cases where the merging firms do not have facilities or sell relevant products in common geographic markets. In these cases, the proposed merger will not have an adverse competitive impact (*i.e.*, there can be no increase in the applicants' market power unless they are selling relevant products in the same geographic markets) so there is no need for a detailed data analysis. If the Commission is unable to conclude that the applicants meet this standard, the Commission will require the applicants to supply the competitive analysis screen data described in Appendix A.

II. Background

Section 203(a) of the Federal Power Act (FPA) provides that no public utility shall sell, lease, or otherwise dispose of the whole of its facilities that are subject to the Commission's jurisdiction, or any part thereof with a value in excess of \$50,000, or by any means whatsoever, directly or indirectly, merge or consolidate such facilities with those of any other person, or purchase, acquire, or take any security of another public utility without first securing the Commission's approval.⁸ Section 203(a) also says that "if the Commission finds that the proposed * * * [merger] will be consistent with the public interest, it shall approve the same."⁹ Under section 203(b), the Commission may approve a proposed merger "in whole or in part and upon such terms and conditions as it finds necessary or appropriate. * * *" This power is to be exercised "to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission."¹⁰

Thirty years ago, in the *Commonwealth* case,¹¹ the Commission set forth six non-exclusive factors for evaluating mergers:

- (1) the effect of the proposed merger on competition;
- (2) the effect of the proposed merger on the applicants' operating costs and rate levels;
- (3) the reasonableness of the purchase price;
- (4) whether the acquiring utility has coerced the to-be-acquired utility into acceptance of the merger;

⁸ While many types of transactions, including relatively minor ones, may require section 203 authorization, this Policy Statement focuses on mergers.

⁹ 16 U.S.C. 824b(a) (1994).

¹⁰ 16 U.S.C. 824b(b) (1994).

¹¹ See *Commonwealth Edison Company (Commonwealth)*, Opinion No. 507, 36 F.P.C. 927, 936-42 (1966), *aff'd sub nom. Utility Users League v. FPC*, 394 F.2d 16 (7th Cir. 1968), *cert. denied*, 393 U.S. 953 (1969).

(5) the impact of the merger on the effectiveness of state and federal regulation; and

(6) the contemplated accounting treatment. Of these factors, the first two—the effect on competition and the effect on costs and rates—have presented the most significant issues in recent merger cases.

Since *Commonwealth*, however, both the electric utility industry and utility regulation have changed dramatically. The Commission's Open Access Rule¹² describes these changes at length. Advances in technology now allow scale economies to be exploited by smaller-size units, thereby allowing smaller new plants to be brought on line at costs below those of the large plants of the 1970s and earlier.¹³ Technological advances in transmission have made possible the economic transmission of electric power over long distances at higher voltages.¹⁴ State public utility commissions have been relying more on competitive contracting as the primary vehicle for adding new generating capacity.¹⁵ This Commission has authorized market-based rates for wholesale electricity sales when it has found that the public utilities lack market power.

In 1992, a landmark change occurred when Congress enacted the EPAct. That statute permitted new power suppliers, called exempt wholesale generators, to enter wholesale power markets, and expanded the Commission's authority to require transmitting utilities to provide eligible third parties with transmission access. In 1996, consistent with the competitive goals of EPAct, the Commission adopted a sweeping regulatory policy change with the promulgation of the Open Access Rule. That rule requires each public utility that owns, operates or controls interstate transmission facilities to file an open access transmission tariff that offers both network and point-to-point service. The rule is designed to remedy the undue discrimination that is inherent when a utility does not offer truly comparable transmission service to others, and to promote competitive bulk power markets. Thus, EPAct and the Commission's Open Access Rule have fundamentally changed federal regulation of the electric utility industry. In addition, many states are contemplating retail access, which may

¹² See Open Access Rule, 61 FR at 21540.

¹³ See *Id.* at 21544.

¹⁴ See *Id.* at 21544-45.

¹⁵ See Paul L. Joskow, *Regulatory Failure, Regulatory Reform, and Structural Change in the Electrical Power Industry*, in *Brookings Papers on Econ. Activity, Microeconomics* 125 (1989).

prompt even more significant changes in the industry.

Because these changes have implications for the Commission's regulation of mergers,¹⁶ we issued a Notice of Inquiry (NOI)¹⁷ soliciting comments on whether our thirty-year-old criteria for evaluating mergers should be revised. While most commenters agree that we should revise our merger policies, there are differences of opinions on the general direction of the change needed. The comments are summarized in Appendix D.¹⁸

III. Discussion

A. General Comments on Revising Merger Policy

1. Direction of Change

As noted above, under section 203, the Commission evaluates mergers to determine whether they are "consistent with the public interest." Congress did not intend the Commission to be hostile to mergers.¹⁹ We have found that the transaction taken as a whole must be consistent with the public interest.²⁰ Thus, even if certain aspects of a proposed merger are detrimental, the merger can still be consistent with the public interest if there are countervailing benefits that derive from the merger.²¹

Almost all commenters argue that we need to revise our merger policies and standards in light of the changes in the industry.²² On one side, many commenters argue that mergers may prevent markets from becoming truly competitive.²³ On the other side, some commenters suggest that the Commission should approve a merger unless harm to the public interest is demonstrated.²⁴ These commenters claim that most mergers are

procompetitive and should be approved unless a problem is identified.

We do not agree either with commenters who argue that we should actively encourage mergers or those who argue that we should discourage them. The statutory standard is that a merger must be "consistent with" the public interest. While we believe that the Commission has broad flexibility in determining what is in the public interest, particularly in light of changing conditions in the industry, we do not read the statutory language as creating a presumption against mergers.²⁵ Nor are we prepared to presume that all mergers are beneficial. It is the applicants' responsibility to demonstrate that the merger is consistent with the public interest.

We believe that if the Commission is to fulfill its statutory responsibilities, it must determine what is consistent with the public interest in light of conditions in the electric industry in general as well as the specific circumstances presented by a proposed merger. In an era of traditional, cost-of-service based regulation, the Commission defined its public interest responsibilities consistent with that structure. Today, we believe that the public interest requires policies that do not impede the development of vibrant, fully competitive generation markets. We are refining our analysis of the effects of proposed mergers on competition in order to protect the public interest in the development of such highly competitive markets, as discussed below.

The Commission's interpretation of the public interest standard has never been static. In the *El Paso* case,²⁶ we explained that our view of what it takes to mitigate market power sufficiently to allow approval of a merger had evolved over time. We pointed out that as the industry had become more competitive, we began examining market power in transmission more closely, and that comparable access was now required. Moreover, we explained in *El Paso* that while in the past we had focused only on *increases* in market power, we no longer believed that we could find any merger to be consistent with the public interest, whether or not the merger created increased market power, unless the merging utilities provided open access. We adopted this revised view of the public interest in light of EPAct's

goal of encouraging greater wholesale competition and the significant increase in actual competition.

2. How to Implement New Policies

We are adopting our new policies through this Policy Statement rather than through other means, such as acting on a case-by-case basis or through a rulemaking. While some commenters suggested other means,²⁷ we believe that a Policy Statement is needed. Proceeding on a case-by-case basis would not give applicants and intervenors the guidance needed to facilitate the presentation of the kinds of well-focused evidence and arguments that will improve and expedite the merger review process. On the other hand, a binding rule would be too rigid at this time. Because the industry continues to change rapidly, we must maintain flexibility in fulfilling our statutory responsibilities.

Commenters disagree on whether we should apply the new policy to pending merger proposals.²⁸ Those proposing mergers have been on notice since we issued the NOI that the Commission is considering revising its criteria for evaluating proposed mergers. In several recent merger hearing orders, we have discussed the NOI and have indicated that we intend to evaluate pending proposals in light of any new criteria we might adopt.²⁹ We do not believe that any applicants will be seriously disadvantaged by application of this policy to pending cases. Our analysis of the effect of a proposed merger on competition has been evolving for some time, particularly since the enactment of EPAct and the issuance of the Open Access Rule. Thus, we are not applying radically new analyses or standards. The same is true of the other two remaining factors, the effects on regulation and on rates. We will address the specific application of the policy to pending cases on a case-by-case basis. If necessary, we will require the parties to supplement the record in any pending case, and we do not expect that this will cause any substantial delay. In fact, if anything, we expect this Policy Statement will make it easier to resolve any remaining issues, because of our clarification of our policies.

¹⁶ Many of the commenters in the Open Access Rule proceeding suggested that the Commission reevaluate its merger policy in concert with the open access rulemaking. See Open Access Rule at 61 FR 21555.

¹⁷ See Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act, Docket No. RM96-6-000, 61 FR 4596 (February 7, 1996), FERC Stats. & Regs. ¶ 35,531.

¹⁸ Appendix C sets forth the full names and acronyms of the commenters.

¹⁹ *Pacific Power & Light Co. v. FPC*, 111 F.2d 1014, 1016 (9th Cir. 1940) (*PP&L*); also see *Northeast Utilities Service Co. v. FERC (NU)*, 993 F.2d 937 (1st Cir. 1993).

²⁰ *Entergy Services Inc. and Gulf States Utilities Company (Entergy)*, Opinion No. 385, 65 FERC ¶ 61,332 at 62,473 (1993), *order on reh'g*, Opinion No. 385-A, 67 FERC ¶ 61,192 (1994), *appeal pending*.

²¹ See *NU*, 993 F.2d at 945.

²² See Appendix D, Section IA.

²³ For example, APPA, NRECA at 7-8; ELCON at 12-13.

²⁴ For example, Utilicorp United at 2, 7, 10.

²⁵ In *NU*, 993 F.2d at 947, the court pointed out that the FPA differs from the Bank Merger Act in that the latter contains an "implicit presumption that mergers are to be disapproved."

²⁶ *El Paso Electric Company and Central and Southwest Services Inc.*, 68 FERC ¶ 61,181 61,914-15 (1994), *dismissed*, 72 FERC ¶ 61,292 (1995).

²⁷ See Appendix D at Section IB.

²⁸ *Id.*

²⁹ *Union Electric Company and Central Illinois Public Service Company (Union Electric)*, 77 FERC ¶ 61,026 (1996), *reh'g pending*; *Public Service Company of Colorado and Southwestern Public Service Company (PS Colorado)*, 75 FERC ¶ 61,325 (1996), *reh'g pending*; *Baltimore Gas & Electric and Potomac Electric Power Company*, 76 FERC ¶ 61,111 (1996).

B. Effect on Competition and Remedies

1. Background

In response to the NOI, we received many comments on our market power analysis. Commenters generally divide into two groups, one recommending stricter scrutiny of the effect of mergers on competition, while the other argues that less concern is warranted in today's more competitive environment.

Those in the first group support more stringent scrutiny because they believe that mergers can cause competitive harm, particularly in a transitional era. Many commenters³⁰ argue that mergers increase generation market power, increase monopsony buying power, encourage self-dealing, discourage alternative suppliers under retail access, and tend to preserve certain competitive advantages associated with vertical integration. These commenters criticize the analysis the Commission has been using to evaluate mergers. They argue that the Commission has not given enough consideration to important factors, including generation dominance, the effect of transmission constraints on competition, the merged company's ability to exercise market power in localized areas and in short-term energy sales, the effects on markets in which little or no effective competition exists, and the significant anticompetitive advantages that vertically integrated utilities possess as a result of the long-existing statutory and regulatory system.

The second broad group of commenters³¹ argues that mergers are procompetitive. These commenters maintain that mergers lower costs, create economies of scale and geographic scope, create large strong competitors, allow rapid movement into new markets, allow diversification to minimize shareholder exposure to business fluctuation, and let the most efficient companies operate facilities, among other reasons.

2. Discussion

a. The role of competition. The electric industry's rapid restructuring, and the Commission's regulatory response to it, have made the effect of mergers on competition, and the way the Commission evaluates that effect, critically important.

The Open Access Rule was a watershed for electric industry regulation. In the Rule, we recognized

that, where it exists, competition has become the best way to protect the public interest and to ensure that electricity consumers pay the lowest possible price for reliable service. Before the Open Access Rule, the Commission took the approach that traditional regulation could cure many market power problems. The size of the company, the territory it covered, and the assets it held did not matter greatly because regulatory oversight could hold market power in check. Indeed, the creation of larger utilities allowed some utilities to take advantage of scale economies and pass the cost savings on to consumers under regulatory supervision.

With the open transmission access resulting from the Open Access Rule and the continuing evolution of competitive wholesale power markets, we believe that competition is now the best tool to discipline wholesale electric markets and thereby protect the public interest. But the competition needed to protect the public interest will not be efficient and deliver lower prices in poorly structured markets. For example, a concentration of generation assets that allows a company to dominate a market will dampen or preclude the benefits of competition. In sum, as customer protection is increasingly dependent upon vibrant competition, it is critically important that mergers be evaluated on the basis of their effect on market structure and performance.

This means that the Commission must find ways to assess more accurately the competitive impact of merger proposals. In doing so, however, we must be sensitive to another pressing concern: the industry's need for more analytic and procedural certainty from the Commission. The increased pace of merger proposals has tested our ability to respond in a timely way. We recognize that merger proposals are business decisions made in response to market pressures and opportunities. Some merger proposals may strengthen weak firms and create stronger competitors. Some, however, may result in firms that will dominate or manipulate electricity markets and thwart competition. In either case, applicants are entitled to timely decisions from this Commission. The policies and procedures adopted in this Policy Statement are intended to promote that goal.

b. Definition of markets. An accurate assessment of the effect on markets depends on an accurate definition of the markets at issue. The Commission's current analytic approach defines geographic markets in a manner that does not always reflect accurately the

economic and physical ability of potential suppliers to access buyers in the market. This approach uses what has come to be known as a hub-and-spoke method. It identifies affected customers as those that are directly interconnected with the merging parties. It then identifies potential suppliers as: (1) those suppliers that are directly interconnected with the customer (the "first-tier" suppliers); and (2) those suppliers that are directly interconnected with the merging parties and that the customer thus can reach through the merging parties' open access transmission tariff (the "second-tier" suppliers).

A drawback of this method of defining geographic markets is that it does not account for the range of parameters that affect the scope of trade: relative generation prices, transmission prices, losses, and transmission constraints. Taking these factors into account, markets could be broader or narrower than the first- or second-tier entities identified under the hub-and-spoke analysis. For example, a supplier that is directly interconnected with a buyer may not be an economic supplier to that buyer if transmission capability across that interconnection is severely constrained or if the transmission charges are greater than the difference between the decremental cost of the buyer and the price at which the supplier is willing to sell. In contrast, a supplier that is three or four "wheels" away from the same buyer may be an economic supplier if the sum of the wheeling charges and the effect of losses is less than the difference between the decremental cost of the buyer and the price at which the supplier is willing to sell. In other words, mere proximity is not always indicative of whether a supplier is an economic alternative.

Another concern with the approach we have used in the past is its analytic inconsistency. It defines the scope of the market to include the directly interconnected utilities that are accessible due to the applicants' open access tariff, but does not expand the market to recognize the access afforded by other utilities' tariffs. This was acceptable before open access was established as an industry-wide requirement for public utilities. Now that virtually all public utilities have open access transmission tariffs on file, it is no longer appropriate to recognize only the effect of certain entities' tariffs on the size of the market.

In modifying our competitive analysis, we are adopting the Guidelines as the basic framework for evaluating the competitive effects of merger proposals. The Guidelines are a well-

³⁰ These include, for example, CA Com, Joint Consumer Advoc., APPA, NRECA, Environmental Action *et al.*, RUS, Salt River, Lubbock, Wisconsin Customers, and TAPS.

³¹ Such as UtiliCorp, Southern, PanEnergy, and Southwestern.

accepted standard approach for evaluating the competitive effects of mergers, and they received substantial support from commenters.

c. Use of the Guidelines. The Guidelines set out five steps for merger analysis: (1) define markets likely to be affected by the merger and measure the concentration and the increase in concentration in those markets; (2) evaluate whether the extent of concentration and other factors that characterize the market raise concerns about potential adverse competitive effects; (3) assess whether entry would be timely, likely, and sufficient to deter or counteract any such concern; (4) assess any efficiency gains that reasonably cannot be achieved by other means; and (5) assess whether either party to the merger would be likely to fail without the merger, causing its assets to exit the market. We note, however, that the Guidelines are just that—guidelines. They provide analytical guidance but do not provide a specific recipe to follow. Indeed, applying the Guidelines to the electric power industry is one of our biggest analytic challenges, both because the industry is evolving very rapidly and because the industry has some unique features, such as very limited opportunities for storage (hence the importance of time-differentiated markets). An analysis that follows the Guidelines still requires many assumptions and judgments to fit specific fact situations.

While this Policy Statement provides guidance on how the Commission intends to more sharply focus its analysis of a merger's effect on competition, we cannot reduce this analysis to a purely mechanized computation of the same data inputs for all merger applications. Rather, the Commission will need to evaluate the relevant product and geographic markets affected by each merger proposal; these markets, in turn, depend on the specific characteristics of the merger applicants and the products and markets in which they potentially trade. Consequently, mergers may require analysis of different product and geographic markets due to factors (such as the existence of constrained transmission paths) that affect the size of a particular market or the hours in which trade of the product is critical to determine whether merger applicants possess market power. Such distinguishing factors will need to be identified and analyzed on a case-by-case basis. Thus, the analytical process explained in this Policy Statement is a framework under which appropriate adjustments may be required to be

incorporated to take account of factors unique to a merger. Furthermore, as noted above, this Policy Statement also is intended to be sufficiently flexible to accommodate the kinds of new merger proposals that will be presented to the Commission as the energy industry evolves to meet the challenges of a more competitive marketplace.

We note that the Guidelines contemplate using remedies to mitigate any harm to competition. There will be mergers where, at the end of an analysis, market power concerns persist but that could be made acceptable with measures to mitigate potential market power problems. We encourage applicants to identify market power problems and to propose remedies for such problems in their merger proposals. In many cases, such a remedy could avoid the need for a formal hearing on competition issues and thus result in a quicker decision. As discussed further in Section III B (2)(e), if a proposed long-term remedy is not capable of being effectuated at the time the merger is consummated, applicants may propose effective interim remedial measures.

d. Analytic screen. It is important to give applicants some certainty about how filings will be analyzed and what will be an adequate showing that the merger would not significantly increase market power. This will allow applicants to avoid or minimize a hearing on this issue. Consequently, we will use an analytic screen (described in Appendix A) that is consistent with the Guidelines. If applicants satisfy this analytic screen in their filings, they typically would be able to avoid a hearing on competition. We would expect applicants to perform the screen analysis as part of their application and to supply the Commission and the public with electronic files of all data used in the analysis as well as other related specified data. The Commission will need this information in order to perform its competitive analysis. If an adequately supported screen analysis shows that the merger would not significantly increase concentration, and there are no interventions raising genuine issues of material fact that cannot be resolved on the basis of the written record, the Commission will not set this issue for hearing. Applicants may, of course, submit an alternative competitive analysis in addition to the screen.

The Commission believes that the screen will be a valuable analytical tool in all cases. It is conservative enough so that parties and the Commission can be confident that an application that clears the screen would have no adverse effect

on competition. The screen also will be valuable in identifying potential competitive problems early in the process. The result will be more narrowly focused issues at hearings when they are necessary. We also note that the screen is intended to be somewhat flexible. It sets out a general method, but we will consider other methods and factors where applicants properly support them.

We believe that the analytic screen will produce a reliable, conservative analysis of the competitive effects of proposed mergers. However, it is not infallible. In some cases, the screen may not detect certain market power problems. There also may be disputes over the data used by applicants or over the way applicants have conducted the screen analysis. These claims may be raised through interventions and by the Commission staff. However, such claims must be substantial and specific. In other words, they should focus on errors in or other factual challenges to the data or assumptions used in the analysis, or whether the analysis has overlooked certain effects of the merger.

Unsupported, general claims of harm are insufficient grounds to warrant further investigation of an otherwise comprehensive analysis developed by the applicants. Intervenor may also file an alternative competitive analysis, accompanied by appropriate data, to support their arguments. The Commission realizes that the need for more rigor in intervention showings could require additional efforts by potential intervenors. We will therefore routinely allow 60 days from filing for intervenors and others to comment on a merger filing.³²

A detailed illustrative description of the analytic screen that we will use is in Appendix A. The following is a brief summary of the screen. There are four steps the applicant must complete and the Commission will follow:

- (1) *Identify the relevant products.* Relevant products are those electricity products or substitutes for such products sold by the merging entities.
- (2) *Geographic markets: identify customers who may be affected by the merger.* Generally, these would include, at a minimum, all entities directly interconnected to a merging party and those that historical transaction data indicate have traded with a merging party.

³² Merger applicants that wish to facilitate the merger review process should serve potential intervenors with copies of their filing (via overnight delivery), including electronic versions, when they file their applications with the Commission. Cf. Open Access Rule, 61 FR 21618 n.510.

(3) *Geographic markets: identify potential suppliers that can compete to serve a given market or customer.* Suppliers must be able to reach the market both physically and economically. There are two parts to this analysis. One is determining the economic capability of a supplier to reach a market. This is accomplished by a delivered price test, which accounts for the supplier's relative generation costs and the price of transmission service to the customer, including ancillary services and losses. The second part evaluates the physical capability of a supplier to reach the customer, that is, the amount of electric energy a supplier can deliver to a market based on transmission system capability.

(4) *Analyze concentration.* Concentration statistics must be calculated and compared with the market concentration thresholds set forth in the Guidelines.³³

The usefulness of the screen analysis depends critically on the data that are supplied with the application. These data are described in Appendix A. Applicants should file in electronic format the data specified as well as any other data used in their analysis.

If the Guidelines' thresholds are not exceeded, no further analysis need be provided in the application. As stated earlier, if an adequately supported screen analysis shows that the merger would not significantly increase concentration, and there are no interventions raising genuine issues of material fact that cannot be resolved on the basis of the written record, the Commission will not set this issue for hearing. If the thresholds are exceeded, then the application should present further analysis consistent with the Guidelines. The Commission will also consider any applicant-proposed remedies at this stage. If none is presented, or if the analysis does not adequately deal with the issues, we will need to examine the merger further.

The Commission will set for hearing the competitive effects of merger proposals if they fail the above screen

analysis, if there are problems concerning the assumptions or data used in the screen analysis, or if there are factors external to the screen which put the screen analysis in doubt. We may also set for hearing applications that have used an alternative analytic method the results of which are not adequately supported. As discussed in Section III F, the Commission will attempt to summarily address issues where possible and may use procedural mechanisms that permit us to dispose of issues without having a trial-type hearing.

e. *Mitigation.* Although a competitive analysis pursuant to the Guidelines may show that a proposed merger would have anticompetitive effects, the Commission may be able to approve the merger as consistent with the public interest if appropriate mitigation measures can be formulated. In the past, in some cases the Commission has conditionally approved a merger if applicants agreed to conditions necessary to mitigate anticompetitive effects. In some instances, applicants themselves have voluntarily offered commitments to address various concerns.³⁴ Commenters suggested a variety of conditions that we could impose (or remedies that applicants could adopt voluntarily) to solve competitive problems with a merger. These include, for example, the formation of an Independent System Operator (ISO), divestiture of assets, elimination of transmission constraints, efficient regional transmission pricing, and offering an open season to allow the merging utilities' customers to escape from their contracts. Other commenters oppose some or all of these remedies. Some commenters also argue that we should monitor the situation after a merger and impose any new remedies that are needed; other commenters oppose such post-merger review.³⁵

As noted, the Commission's review of merger applications has frequently resulted in the development of particular conditions that are designed to remedy problems associated with the merger. These conditions are imposed as part of our approval of the merger application. We expect that practice to

continue. For example, we expect the competition analysis to focus extensively on generation market power and on whether a proposed merger exacerbates market power problems. We also expect applicants to propose remedies for market power problems identified in their analysis. It is our hope that as our market power analysis becomes more refined to cope with changing circumstances in the industry, applicant-proposed remedies or mitigation strategies will also become more refined or tailored to address the identified harm. Of course, one remedy that an applicant could consider is to propose to divest a portion of its generating capacity so that its market share falls below the share that poses anticompetitive concerns under the Guidelines. This remedy is discussed in the Appendix A section entitled "Competitive Analysis Screen."

Similarly, an applicant's ability to exercise generation market power may be affected by transmission constraints and transmission pricing. In particular, the scope of the geographic market may be limited both by transmission constraints and by the need to pay cumulative transmission rates in order to transmit power across the systems of the merging utilities and neighboring utilities. It is likely that both market concentration and the applicant's market share would be greater within such a circumscribed geographic market. Hence, the opportunity to exercise market power also would be greater. Potential remedies for such market power could include the following. First, a proposal by the applicants to turn over control of their transmission assets to an ISO might mitigate market power. In particular, an ISO might facilitate the implementation of efficient transmission pricing and thereby expand the effective scope of the geographic market. Second, an up-front, enforceable commitment to upgrade or expand transmission facilities might mitigate market power, because the constraint relieved by such an upgrade or expansion no longer would limit the scope of the relevant geographic market. These and other remedies also are discussed in Appendix A. We intend to tailor conditions and remedies to address the particular concerns posed by a merger on a case-by-case basis.

If an applicant does not propose appropriate remedies to mitigate the anticompetitive impact of a merger, the Commission intends to fashion such remedies during the course of its consideration of an application.

We do not intend to rely on post-merger review or on new remedies

³³ The Guidelines address three ranges of market concentration: (1) an unconcentrated post-merger market—if the post-merger Herfindahl-Hirschman Index (HHI) is below 1000, regardless of the change in HHI the merger is unlikely to have adverse competitive effects; (2) a moderately concentrated post-merger market—if the post merger HHI ranges from 1000 to 1800 and the change in HHI is greater than 100, the merger potentially raises significant competitive concerns; and (3) a highly concentrated post-merger market—if the post-merger HHI exceeds 1800 and the change in the HHI exceeds 50, the merger potentially raises significant competitive concerns; if the change in HHI exceeds 100, it is presumed that the merger is likely to create or enhance market power.

³⁴ E.g., Northeast Utilities Services Company/Re Public Service Company of New Hampshire, 50 FERC ¶ 61,266, *reh'g denied*, 51 FERC ¶ 61,177, *clarification*, 52 FERC ¶ 61,046 (1990), *order on reh'g*, 58 FERC ¶ 61,070 (1992), *order on reh'g*, 59 FERC ¶ 61,042 (1992), *aff'd in part sub nom.* Northeast Utilities Services Company v. FERC, 993 F.2d 937 (1st Cir. 1993); Midwest Power Systems, Inc. and Iowa-Illinois Gas & Electric Company, 71 FERC ¶ 61,386 (committed to offer wholesale requirements customers an open season).

³⁵ The comments on remedies are summarized in more detail in Appendix D, Section VI D.

imposed after a merger is approved. We must find that a merger is consistent with the public interest before we approve a merger.³⁶ Moreover, heavy reliance on post-merger review would expose the merging entities to too much uncertainty. However, as the Commission has noted in past merger cases, the Commission does retain authority under section 203(b) to issue supplemental orders for good cause shown as it may find necessary or appropriate.³⁷

The Commission acknowledges that many of the solutions that would mitigate market power or anticompetitive effects cannot be implemented quickly and, in fact, could take an extended period to accomplish (e.g., siting and constructing new transmission lines to alleviate a transmission constraint, divestiture of generation assets, formation of an ISO). While long-term remedies may be necessary to allow the Commission to determine that a merger is consistent with the public interest, a requirement to satisfy such conditions prior to consummating a merger may jeopardize the ability of parties to merge. In turn, customers will experience unnecessary delays in receiving benefits accruing from the merger. Therefore, we will entertain proposals by merger applicants to implement interim mitigation measures that would eliminate market power concerns during the period that it takes to put in place the long-term remedies necessary to address the anticompetitive effects of their proposed merger.³⁸ Such interim measures must fully and effectively address the specific market power problems identified for the merger but should not be viewed as substitutes for the long-term remedies required by the Commission. Applicants should implement long-term remedies as quickly as practical.

C. Effect on Rates

1. Background

In determining whether a merger is consistent with the public interest, one of the factors we have considered is the effect the proposed merger will have on costs and rates. In the past we have

³⁶ For example, an expansion or upgrade of facilities to alleviate a transmission constraint would not be an acceptable mitigation measure unless uncertainties about the utilities' ability to complete the upgrade or expansion are resolved prior to consummation of the merger.

³⁷ See FPA section 203(b), 16 U.S.C. § 824b(b) (1994).

³⁸ For example, an applicant could sell its transmission rights on congested transmission paths to third parties or not trade in markets where it has market power until long-term remedies are implemented.

considered whether the elimination of the independence of the companies and resulting combination of the facilities of the separate entities would be likely to lead to unnecessary rate increases or inhibit rate reductions.³⁹ We have also been concerned with whether the merged companies would be able to operate economically and efficiently as a single entity.⁴⁰ In connection with these concerns, the Commission has investigated applicants' claims about the potential costs and benefits of their proposed mergers and weighed that information to determine whether the costs are likely to exceed the benefits. Our investigations have frequently required trial-type hearings. Although we have considered the applicants' burden of proof to be met by a generalized showing of likely costs and benefits,⁴¹ these hearings have often been time-consuming, and there has been considerable controversy over whether the estimates of future costs and benefits are truly meaningful. Moreover, there has been controversy over the position we have taken that benefits are to be "counted" even if they could reasonably be obtained by means other than the merger. There also has been controversy over the allocation of the projected merger benefits.⁴²

In more recent cases, the Commission has focused on ratepayer protection. We have either accepted a hold harmless commitment (a commitment from the applicant that any net merger-related costs will not raise rates) or have set for hearing the issue of whether the applicants' hold harmless commitment or some other proposed ratepayer protection was adequate. For example, in *Primergy*, the Commission held that wholesale ratepayers would be adequately protected if the applicants were to commit that, for a period of four years after the merger is consummated, the merging companies would not seek to increase rates to wholesale requirements customers.

In *PS Colorado*,⁴³ the applicants submitted evidence on costs and benefits, but also proposed a hold harmless commitment. We noted several concerns with the hold harmless commitment, pointing out that it did not

³⁹ Commonwealth, 36 FPC at 938.

⁴⁰ Edison, 47 FERC ¶ 61,196 at 61,672 (1989).

⁴¹ Entergy Services Inc. (*Entergy*), 65 FERC ¶ 61,332, at 62,473 (1993), *order on reh'g*, 67 FERC ¶ 61,192 (1994), *appeal pending*.

⁴² These benefits have included items such as fuel cost savings; bankruptcy resolution; reducing administrative and general costs; lowering net production costs; and eliminating or deferring construction of new generating units.

⁴³ 75 FERC at 62,043-44.

cover most of the merger-related costs.⁴⁴ We set for hearing the issue of whether the applicants' hold harmless commitment provided adequate protection for ratepayers (those who receive unbundled generation and transmission services as well as those who receive bundled service) and, if not, what ratepayer protection mechanisms would be sufficient. We did not set for hearing the effect on rates as such; that is, we did not instruct the administrative law judge to conduct a factual investigation into the alleged costs and benefits of the merger. In *Cincinnati Gas & Electric Company and PSI Energy, Inc.*, the Commission modified the hold harmless provision, stating that the applicants would have the burden of convincingly demonstrating in future section 205 filings that their wholesale customers had, in fact, been held harmless; that is, they would have to show any rate increase was not related to the merger.⁴⁵ The applicants would be required to make an affirmative showing in their initial case-in-chief that their proposed rates did not reflect merger-related costs unless such costs were offset by merger-related benefits.⁴⁶

In *Union Electric*,⁴⁷ the applicants proposed an open season guarantee for the first five years after the merger was consummated. The open season guaranteed that existing wholesale customers could terminate their contracts by giving notice on the day the applicants filed for a rate increase affecting that customer. The Commission was concerned that the open season commitment might not provide adequate protection for wholesale ratepayers (those that receive bundled generation and transmission service as well as those that receive unbundled generation or transmission service) and set that issue for hearing. We stated that if at hearing it was determined that the open season

⁴⁴ The commitment was not to seek an increase in base rates for five years after the merger. We found, however, that this provided little protection, since the five years would be over before most of the claimed merger savings were projected to be realized. Moreover, the applicants proposed to amortize merger-related costs over five years, but their hold harmless commitment covered only costs that would be "booked to the merger" through the first two years.

⁴⁵ See *Cincinnati Gas & Electric Company and PSI Energy, Inc.*, 64 FERC ¶ 61,237 at 62,714 (1993), *order withdrawing authorization of merger and instituting settlement procedures*, 66 FERC ¶ 61,028, *order denying rehearing and approving settlements and unilateral offers as conditioned and modified*, 69 FERC ¶ 61,005 (1994), *order granting clarification*, 69 FERC ¶ 61,088 (1994).

⁴⁶ *Id.* at 62,714.

⁴⁷ 77 FERC ¶ 61,026 at 61,107-08 (1996), *reh'g pending*.

commitment was not adequate protection, a determination should be made as to what ratepayer protection mechanisms might be suitable for the proposed merger.

In response to the NOI, only a few commenters suggest that we dispose of the effect on rates factor altogether.⁴⁸ Most commenters consider this factor to be essential in deciding whether to approve a merger.⁴⁹ However, commenters differ on how this factor should be assessed.

2. Discussion

We disagree with the argument presented by a few commenters that we need not be concerned about the effect of a merger on rates in this competitive environment because prices will be set by market forces and customers can choose their suppliers accordingly. Also, while it may be true that most of the rate issues in connection with the typical merger affect retail ratepayers and are subject to state jurisdiction, the Commission in order to ensure that a merger is consistent with the public interest still must protect the merging utilities' wholesale ratepayers and transmission customers from the possible adverse effects of the merger. As mentioned in our discussion above on the effect on competition and in our discussion in the Open Access Rule, we recognize that even in an open access environment, markets may not work perfectly or even well.⁵⁰ This is particularly the case during the transition from a monopoly cost-of-service market structure to a competitive market-based industry. For instance, during the transition some customers may be unable to take immediate advantage of competition because of contractual commitments or because of stranded costs obligations. Furthermore, because transmission remains effectively a natural monopoly and will continue to be regulated on a cost-of-service basis, the Commission has reason to be concerned that mergers do not affect transmission rates adversely. For these reasons, we will not abandon the effect on rates factor.⁵¹

Rather than requiring estimates of somewhat amorphous net merger benefits and addressing whether the applicant has adequately substantiated those benefits, we will focus on ratepayer protection. Merger applicants should propose ratepayer protection

mechanisms to assure that customers are protected if the expected benefits do not materialize. The applicant bears the burden of proof to demonstrate that the customer will be protected. This puts the risk that the benefits will not materialize where it belongs—on the applicants.

Furthermore, we believe that the most promising and expeditious means of addressing ratepayer protection is for the parties to negotiate an agreement on ratepayer protection mechanisms. The applicants should attempt to resolve the issue with customers even before filing, and should propose a mechanism as part of their filing. Even if these negotiations have not succeeded by the time of filing, the parties should continue to try to reach a settlement. What constitutes adequate ratepayer protection necessarily will depend on the particular circumstances of the merging utilities and their ratepayers, and we strongly encourage parties to minimize contentious issues and to resolve them without the time and expense of a formal hearing. Parties may not be able to reach an agreement on an appropriate ratepayer protection and the Commission may still be able to approve the merger. As mentioned earlier, this could occur either after a hearing or on the basis of parties' filings if we determine that the applicants' proposal sufficiently insulates the ratepayers from harm.

As described above, the Commission has accepted a variety of hold harmless provisions, and parties may consider these as well as other mechanisms if they appropriately address ratepayer concerns. Among the types of protection that could be proposed are:

- *Open season for wholesale customers*—applicants agree to allow existing wholesale customers a reasonable opportunity to terminate their contracts (after notice) and switch suppliers. This allows customers to protect themselves from merger-related harm.
- *General hold harmless provision*—a commitment from the applicant that it will protect wholesale customers from any adverse rate effects resulting from the merger for a significant period of time following the merger. Such a provision must be enforceable and administratively manageable.
- *Moratorium on increases in base rates (rate freeze)*—applicants commit to freezing their rates for wholesale customers under certain tariffs for a significant period of time.⁵²

⁵² A rate freeze, however, does not insulate the merged utility from a rate reduction if the Commission, pursuant to section 206, determines

- *Rate reduction*—applicants make a commitment to file a rate decrease for their wholesale customers to cover a significant period of time.⁵³

Although each mechanism provides some benefit to ratepayers, we believe that in the majority of circumstances the most meaningful (and the most likely to give wholesale customers the earliest opportunity to take advantage of emerging competitive wholesale markets) is an open season provision. We urge merger applicants to negotiate with customers before filing and to offer an adequate open season proposal or other appropriate ratepayer protection mechanism in their merger applications. If intervenors raise a substantial question as to the adequacy of the proposal, parties should continue to pursue a settlement. If no agreement can be reached, we may decide the issue on the written record or set the issue for hearing.

D. Effect on Regulation

When the Commission in *Commonwealth* referred to impairment of effective regulation by this Commission and appropriate state regulatory authorities, its concern was with ensuring that there is no regulatory gap.⁵⁴ The potential for impairment of effective regulation at the Federal level has been increased by the *Ohio Power* decisions.⁵⁵ That case holds that if the SEC approves a contract for sales of non-power goods or services between affiliates in a registered holding company, this Commission in its rate review may not disallow any part of the payment under the contract in order to protect ratepayers against affiliate abuse.⁵⁶

In recent cases, the Commission has developed its policy regarding the effect of proposed mergers on both state and Federal regulation. For instance, *PS Colorado* involved the creation of a new multistate registered holding company. On the question of a shift of regulation from the state commissions to this Commission, we declined to order a

that the utility's rates are no longer just and reasonable. Also, in circumstances in which ratepayers clearly would be entitled to a rate reduction in the absence of the merger, e.g., expiration of a current surcharge or some other clearly defined circumstance, a simple rate freeze may not provide adequate ratepayer protection.

⁵³ Whether these types of proposals are appropriate in a particular case will depend on the circumstances of the merging companies and the customers and the details of the proposals.

⁵⁴ *Cinergy*, 64 FERC at 61,710 n. 278; *Commonwealth*, 36 FPC at 931.

⁵⁵ *Ohio Power Company v. FERC*, 954 F.2d, 779, 782–86 (D.C. Cir. 1992), cert. denied, 498 U.S. 73 (1992) (*Ohio Power*).

⁵⁶ Cf. *AEP Power Marketing, Inc.*, 76 FERC ¶ 61,307 at 62,515 (1996).

⁴⁸ See Appendix D, section III(A).

⁴⁹ *Id.*

⁵⁰ See Open Access Rule, 61 FR at 21553.

⁵¹ In the past, we have referred to this factor as the "effect on costs and rates." However, the basic concern is with the effect on rates. Accordingly, we will refer to it as the "effect on rates."

hearing, noting that the state commissions had authority to disapprove the merger and that they did not argue that their regulation would be impaired. On the question of a shift of authority from this Commission to the SEC, we pointed out that pre-merger, we had authority to review for rate purposes all the costs the companies incurred, but if the merger were approved, under *Ohio Power* we would lose that authority if the SEC approved an inter-affiliate transaction. Thus, the costs could be flowed through to ratepayers, even if the goods or services were obtained at an above-market price or the costs were imprudently incurred. To guard against this possibility, we gave the applicants two options.⁵⁷ They could either choose to have the issue set for hearing, or they could agree to abide by our policies on intra-system transactions.⁵⁸

In response to the NOI, commenters generally argue that it is important for the Commission to continue to look at the effect of a merger on the effectiveness of state and Federal regulation.⁵⁹

2. Discussion

We will continue to examine the effect on regulation as a factor in our analysis of proposed mergers and will use the approach adopted in *PS Colorado* and subsequent cases. Thus, in situations involving registered public utility holding companies, we will require the applicants to choose between two options and to make that choice clear in their filing. They may commit themselves to abide by this Commission's policies with respect to intra-system transactions within the newly-formed holding company structure, or they may go to hearing on the issue of the effect of the proposed registered holding company structure on effective regulation by this Commission. If applicants choose the first option, we will set the issue for hearing only if intervenors raise credible arguments that because of special factual circumstances, the commitment will not provide sufficient protection.

With respect to the effect of a merger on state regulatory authority, where a state has authority to act on a merger, as in *PS Colorado*, we ordinarily will not set this issue for a trial-type hearing. The application should tell us whether the states have this authority. If the state

lacks this authority and raises concerns about the effect on regulation, we may set the issue for hearing; we will address these circumstances on a case-by-case basis.

E. Other Commonwealth Factors

The other *Commonwealth* factors are evidence of coercion, the proposed accounting treatment, and the reasonableness of the purchase price.

These three factors elicited very little comment. As to evidence of coercion, a few commenters suggest that this should be evaluated by the marketplace rather than by the regulatory process.⁶⁰ Several commenters say that this factor should be considered only if someone demonstrates that it is relevant.⁶¹ OK Com is among the few commenters who favor retaining this factor. It suggests that coercion is a means by which some companies will try to gain oligopolistic control of the market in the coming competitive environment.

As to accounting treatment, some commenters support elimination of accounting concerns as a factor.⁶² PaineWebber notes that most recent mergers were mergers of equals, involving minimal premiums over current market prices. It suggests that a similar market discipline would likely cause shareholders to reject merger transactions involving large merger premiums and excessive amortization. Florida and Montaup argue that the accounting treatment of a merger should not be an issue for hearing unless an applicant seeks treatment different from the Commission's standards. Southern Company contends that the Commission's analysis of this factor should be subsumed within the analysis of the merger's impact on costs and rates.

NY Com and OK Com are concerned about the accounting consequences of mergers. OK Com favors keeping the historical cost approach to accounting for plant acquisitions during mergers and business combinations until competitive market structures are achieved at the national, regional, and state levels. NY Com also urges the Commission to continue to require unrestricted access to all books and records of newly merged entities.

We also received a few comments on looking at the reasonableness of the

purchase price as a factor. A number of commenters⁶³ urge that the Commission not substitute its judgment for the workings of market forces, which will determine the reasonableness of the purchase price. Others⁶⁴ believe that this issue should be examined only if its relevance is raised. However, OK Com argues that purchase price still has some relevance in this era of diversification. It is concerned that the purchase price may be based on expected returns on non-regulated investments, which, if they fail to materialize, may dilute the value of utility stock.

We will no longer consider these three matters as separate factors. Any evidence of coercion will be considered as part of our analysis of the effect of the merger on competition. We have treated the reasonableness of the purchase price as an issue only insofar as it affects rates, so this issue is subsumed in the effect on rates factor. As for the proposed accounting treatment, this is not really a factor to be balanced along with other factors; proper accounting treatment is simply a requirement for all mergers.⁶⁵

If a merger application seeks to recover acquisition premiums through wholesale rates, we will address the issue in post-merger rate applications. However, the Commission historically has not permitted rate recovery of acquisition premiums.

F. Procedures for Handling Merger Cases

We received many suggestions as to how to improve our procedures for handling merger cases. The commenters focused particularly on the need for certainty and the need to expedite the process, at least for some mergers. They suggested various screens or hold harmless provisions. Some suggested that we set forth filing requirements. There were also many comments on coordination with other agencies that are reviewing the merger.⁶⁶

Although we plan to issue a Notice of Proposed Rulemaking in the near future to set forth more specific filing requirements consistent with this Policy Statement and additional procedures for improving the merger hearing process, we have determined that the best way to improve the Commission's handling

⁶⁰ East Texas Coop., EEI, PaineWebber, and Southern Company.

⁶¹ Florida and Montaup.

⁶² East Texas Coop., EEI, and PaineWebber. Although they do not support keeping this factor, EEI and PaineWebber suggest that in light of broad industry changes, this may be the right time for a generic re-examination of accounting concerns, of which accounting for mergers could be a part.

⁶³ CINergy, East Texas Coop., EEI, PaineWebber, and Southern.

⁶⁴ Florida and Montaup.

⁶⁵ See, e.g., Public Service Company of Colorado and Southwestern Public Service Company, 75 FERC ¶ 61,325 (1996); Entergy Services, Inc. and Gulf States Utilities Company, Opinion No. 385, 65 FERC ¶ 61,332 (1993), *order on reh'g*, 67 FERC ¶ 61,192 (1994).

⁶⁶ Appendix D, Section VI.

⁵⁷ 75 FERC at 62,045-46.

⁵⁸ *Accord*, Union Electric, 77 FERC at 61,108-09 (state expressed concern over shift of regulatory authority from itself and this Commission to SEC; Commission noted that state had authority to disapprove merger).

⁵⁹ Appendix B at Section IV.

of merger proposals is to update our merger review policy. As outlined in this Policy Statement, we will generally limit the number of factors we examine in order to determine whether a merger is in the public interest.

The principal area that will require a fact-based review is the effect of a proposed merger on competition. By using the Guidelines as a screen and by informing applicants of the type of information we expect them to file with us when they apply, we hope to expedite our review of applications considerably.

As discussed above under "Effect on Competition," "Effect on Rates," and "Effect on Regulation," we are setting forth for each factor guidance to enable merger applicants ordinarily to avoid a trial-type hearing or to have a hearing focused on limited issues. Moreover, we have set forth above under "Effect on Competition" and in Appendix A the information that we think we need at this point to determine whether a merger would impair competition. We have also discussed ways to mitigate anticompetitive effects. Our consideration of the other two factors, the effect on rates and the effect on regulation, should not require a lot of data or analysis, since we will be relying primarily on the applicants' commitments. This should make it possible for applicants to make filings that can be processed more quickly. The Commission intends to propose a rule to set forth detailed filing requirements.

Another step that can make our processing of merger applications more efficient is to discourage redundant or irrelevant pleadings. We agree with commenters who argue that we should not consider extraneous issues, and we will not consider interventions that raise matters unrelated to the merger. Moreover, in the past, the process has been bogged down by repetitive filings such as answers to answers. We will not consider such filings, nor will we consider "new" information unless it is genuinely new and relevant.

With all the streamlining changes discussed above, we believe that we will be able to act on mergers more quickly after a *complete* application is filed. A complete application is one that adequately and accurately describes the merger being proposed and that contains all the information necessary to explain how the merger is consistent with the public interest, including an evaluation of the merger's effect on competition, rates, and regulation.⁶⁷ We

expect applicants to be able to provide all the necessary information, given the guidance in this Policy Statement. We also emphasize that applicants should not expect speedy action if their merger proposals change, as has frequently happened in the past. The Commission cannot be expected to act quickly on a moving target. If applicants change the mechanism or terms under which they intend to merge or supplement the supporting information in their application, the Commission's review process will restart.

Once we have a *complete* application, we will make every reasonable effort to issue an initial order 60–90 days after the comment period closes. An initial order could take any of several actions, including: requesting additional information from the applicants or intervenors; setting some or all issues for a trial-type or paper hearing; approving the merger; or rejecting the merger. If we determine in the initial order that further procedures are necessary, we will choose among the available procedural options based on the completeness of the record before us, the types of issues that need to be resolved (factual, policy or legal), and the need to give parties adequate due process. However, we are hopeful that the guidance in this Policy Statement will result in more complete applications and more focused and detailed interventions and that we will be able to act summarily on many (or in some cases all) issues in the initial order.

If the Commission determines in an initial order that trial-type or paper hearing procedures are necessary, we believe that we will be able to issue a final order on most applications within 12–15 months from the date that the completed application was filed. We emphasize that this assumes no significant changes in the proposal; any such changes will start the process over and will require that a new notice be issued. Of course, some applications will take more time than others. For example, if a merger raises extraordinarily complex factual disputes, or if the development of competitive remedies or hold harmless agreements is entirely deferred to the hearing, case processing may take longer. On the other hand, if a merger falls below the HHI screen, the applicants propose adequate ratepayer protection mechanisms, and the applicants make the commitments

the merger is consistent with the public interest. In addition, a copy of all applications or other information filed with other regulatory bodies regarding the merger must be provided to the Commission to initiate our review process.

necessary to assuage our concerns about the effect on regulation, we should be able to act much more quickly.

The Commission believes that in order to meet routinely the target dates we have set forth in this Policy Statement, it is appropriate to reexamine whether our procedures for processing merger applications, including hearing procedures, can be tailored better to meet the specific needs of participants in merger proceedings. To that end, in the proposed rulemaking on information filing requirements (see note 3), we will also request public comment on merger processing procedures.

We will not delay our processing of merger applications to allow the states to complete their review, as some commenters suggest. However, we will be willing to consider late interventions by state commissions where it is practicable to do so. In cases where a state commission asks us to address the merger's effect on retail markets because it lacks adequate authority under state law, we will do so.

In response to commenters who are concerned that our decisions be consistent with those of other agencies, we note that since we are adopting the *Guidelines* as a framework for our analysis of the effect on competition, our analysis should be generally consistent with the DOJ's and the FTC's analyses.

G. Other Issues

According to FERC Policy Project, recent changes in the industry may make mergers financially unattractive without planning and operational changes; these changes can harm the environment. FERC Policy Project argues that we should revise our rule that provides that merger applications will not generally require preparation of an EIS or EA. The rule "categorically excludes" mergers unless circumstances indicate that the action may be a major Federal action significantly affecting the quality of the human environment.⁶⁸ FERC Policy Project also argues that the effect on the environment should be considered as a factor in deciding whether to approve a merger. Moreover, it believes we should require applicants to provide with their applications information on the environmental effects of the merger and that we should require mitigation of environmental effects through various means.

The Commission has recognized that a particular merger can have environmental effects and has been willing to study the issue in an

⁶⁷ The information would include all applicable exhibits and accompanying testimony and other data that will constitute applicants' showing that

⁶⁸ 18 CFR 380.4 (a)(16) and (b).

individual case where it is justified.⁶⁹ We do not see the need to change our regulation, which explicitly addresses the possibility that an EA or EIS may, on rare occasions, be needed. However, both our categorical exclusion rule and the absence of environmental concerns from the list of three factors in this Policy Statement reflect the simple fact that most mergers do not present environmental concerns.

Low-Income Representatives argues that the "public interest" standard requires us to consider matters such as the need for service to all households, the need for consumer input into the decisions made by utilities, and other matters. We clarify that the three factors discussed in this Policy Statement are not necessarily the only factors that make up the public interest, and, if appropriate, we will consider other matters that are under our jurisdiction. However, we believe such matters as the need for service to all households are more appropriately the concern of the states.

IV. Administrative Effective Date and Congressional Notification

Under the terms of 5 U.S.C. 553 (d)(2), this Policy Statement is effective immediately. The Commission has determined, with the concurrence of the Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget, that this Policy Statement is not a major rule within the meaning of section 351 of the Small Business Regulatory Enforcement Act of 1996.⁷⁰ The Commission is submitting the Merger Policy Statement to both Houses of Congress and to the Comptroller General.

List of Subjects in 18 CFR Part 2

Administrative Practice and Procedure, Electric power, Natural gas, Pipelines, Reporting and recordkeeping requirements.

By the Commission,
Lois D. Cashell,
Secretary.

In consideration of the foregoing, the Commission amends Part 2, Chapter I, Title 18 of the Code of Federal Regulations as set forth below.

PART 2—GENERAL POLICY AND INTERPRETATIONS

1. The authority citation for Part 2 continues to read as follows:

⁶⁹ See Southern California Edison Company, 47 FERC ¶ 61,196 (1989), *order on reh'g*, 49 FERC 61,091 (1989).

⁷⁰ 5 U.S.C. 804 (2).

Authority: 15 U.S.C. 717–717w, 3301–3432; 16 U.S.C. 792–825r, 2601–2645; 42 U.S.C. 4321–4361, 7101–7352.

2. Part 2 is amended by adding § 2.26, to read as follows:

§ 2.26 Policies concerning review of applications under section 203.

(a) The Commission has adopted a Policy Statement on its policies for reviewing transactions subject to section 203. That Policy Statement can be found at 77 FERC ¶ 61,263 (1996). The Policy Statement is a complete description of the relevant guidelines. Paragraphs (b)–(e) of this section are only a brief summary of the Policy Statement.

(b) *Factors Commission will generally consider.* In determining whether a proposed transaction subject to section 203 is consistent with the public interest, the Commission will generally consider the following factors; it may also consider other factors:

- (1) The effect on competition;
- (2) The effect on rates; and
- (3) The effect on regulation.

(c) *Effect on competition.* Applicants should provide data adequate to allow analysis under the Department of Justice/Federal Trade Commission Merger Guidelines, as described in the Policy Statement and Appendix A to the Policy Statement.

(d) *Effect on rates.* Applicants should propose mechanisms to protect customers from costs due to the merger. If the proposal raises substantial issues of relevant fact, the Commission may set this issue for hearing.

(e) *Effect on regulation.* (1) Where the merged entity would be part of a registered public utility holding company, if applicants do not commit in their application to abide by this Commission's policies with regard to affiliate transactions, the Commission will set the issue for a trial-type hearing.

(2) Where the affected state commissions have authority to act on the transaction, the Commission will not set for hearing whether the transaction would impair effective regulation by the state commission. The application should state whether the state commissions have this authority.

(3) Where the affected state commissions do not have authority to act on the transaction, the Commission may set for hearing the issue of whether the transaction would impair effective state regulation.

Note: These Appendices will not appear in the *Code of Federal Regulations*.

Appendix A—Competitive Analysis Screen

The analytic screen provides applicants with a standard analytic method and data

specification to allow the Commission to quickly determine whether a proposed merger presents market power concerns. Some past merger cases were delayed or set for hearing because an adequate analysis was not part of the application or because sufficient data that would allow the Commission to corroborate or independently check applicants' conclusions was not provided in the application. This is especially true regarding the effect that transmission prices and capability may have on the scope of the geographic market. The chances for hearings and delays will be reduced if the screen analysis and data described below are filed with the application.

A. Consistency With DOJ Guidelines

In this policy statement, the Commission has adopted the DOJ Merger Guidelines (the Guidelines)¹ as the basic framework for evaluating the competitive effects of proposed mergers. The analytic screen applies the Guidelines. Before describing the screen, the Guidelines are briefly summarized so that the screen's consistency with them is clear.

In general, the Guidelines set out five steps for merger analysis: (1) assess whether the merger would significantly increase concentration; (2) assess whether the merger could result in adverse competitive effects; (3) assess whether entry could mitigate the adverse effects of the merger; (4) assess whether the merger results in efficiency gains not achievable by other means; and (5) assess whether, absent the merger, either party would likely fail, causing its assets to exit the market.

The analytic screen focuses primarily on the Guidelines—first step. This step can be broken down into two components:

Defining product and geographic markets that are likely to be affected by a proposed merger and measuring concentration in those markets. The products to consider are those sold by the merging parties. The Guidelines suggest a way of defining geographic markets based on identifying the suppliers that are feasible alternative suppliers to the merged firm from a buyer's perspective: the hypothetical monopolist test. Essentially, if a hypothetical and unregulated monopoly that owned all the supplies inside the geographic market being tested could profitably sustain a small but significant price increase (i.e., suppliers external to the market are not, by definition, sufficiently good substitutes for the buyers in the market), then the limit of the geographic market has been reached.² The sustainability of a price increase depends on both sellers entering the market and the response of buyers to the increase. The concentration of suppliers included in the market is then measured (by summary statistics such as the Herfindahl-Hirschman Index, or HHI, and single seller market share)

¹ U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, 57 FR 41552 (1992).

² The Guidelines suggest that a 5% price increase be used for the test, but allow that larger or smaller price increases may also be appropriate. DOJ Guidelines at 41555.

and used as an indicator of the potential for market power.

Evaluating the change in concentration using the Guidelines' thresholds to indicate problematic mergers. The Guidelines address three ranges of market concentration: (1) an unconcentrated post-merger market—if the post-merger HHI is below 1000, regardless of the change in HHI the merger is unlikely to have adverse competitive effects; (2) a moderately concentrated post-merger market—if the post merger HHI ranges from 1000 to 1800 and the change in HHI is greater than 100, the merger potentially raises significant competitive concerns; and (3) a highly concentrated post-merger market—if the post-merger HHI exceeds 1800 and the change in the HHI exceeds 50, the merger potentially raises significant competitive concerns; if the change in HHI exceeds 100, it is presumed that the merger is likely to create or enhance market power.³

If the concentration analysis indicates that a proposed merger may significantly increase concentration in any of the relevant markets, the Guidelines suggest examination of other factors that either address the potential for adverse competitive effect or that could mitigate or counterbalance the potential competitive harm. Such factors include the ease of entry in the market and any efficiencies stemming from the merger.⁴ If the additional factors examined do not mitigate or counterbalance the adverse competitive effects of the merger, remedial conditions would be explored at this stage.

B. Analytic Screen Components

There are four steps to the screen analysis.

1. Identify the Relevant Products

The first step is to identify one or more products sold by the merging entities. Products may be grouped together when they are good substitutes for each other from the buyer's perspective. If two products are not good substitutes, an entity with market power can raise the price of one product and buyers would have a limited ability to shift their purchases to other products. In the past, the Commission has analyzed three products: non-firm energy, short-term capacity (firm energy), and long-term capacity.⁵ These remain reasonable products under the prevailing institutional arrangements, and applicants should recognize such products in their analysis. Other product definitions may also be acceptable. For example, the lack of on-site buyer storage creates products differentiated by time. Thus, peak and off-peak energy (seasonal and daily) may be distinct products.

The Commission encourages parties to propose even more precise definitions of relevant products where appropriate. Indeed,

³ DOJ Guidelines at 41558.

⁴ In assessing market concentration, the Guidelines state " * * * market share and concentration data provide only the starting point for analyzing the competitive impact of a merger." DOJ Guidelines at 41558.

⁵ See Baltimore Gas & Electric and Potomac Electric Power Company, 76 FERC ¶ 61,111 (1996) at 61,572. The factor that is considered in evaluating long term capacity markets is the effect of a merger on barriers to entry into those markets.

we would expect to see greater precision in product differentiation as market institutions develop.

2. Geographic Markets: Identify Customers Who May Be Affected by the Merger

This is the first of a two-step process of determining the geographic size of the market. To identify customers potentially affected by a merger, at a minimum, applicants should include all entities directly interconnected to either of the merging parties. Additional entities should be included in the analysis if historical transaction data indicates such entities have been trading partners with a merging party. Applicants and others may argue either that there are other customers to be included as relevant buyers or that identified customers are not relevant buyers. Intervenors also may argue that other customers not identified by the applicants will be affected by the merger.

3. Geographic Markets: Identify Potential Suppliers to Each Identified Customer

This second, and key, step in determining the size of the geographic market is to identify those suppliers that can compete to serve a given market or customer and how much of a competitive presence they are in the market. Alternative suppliers must be able to reach the market both economically and physically. There are two parts to this analysis. One is determining the economic capability of a supplier to reach a market. This is accomplished by a delivered price test. The second part evaluates the physical capability of a supplier to reach a market, i.e., the amount of the defined product a supplier can deliver to a market based on transmission capacity availability.

Supply and demand conditions in electricity markets vary substantially over time, and the market analysis must take those varying conditions into account. Applicants should present separate analyses for each of the major periods when supply and demand conditions are similar. One way to do this is to group together the hours when supply and demand conditions are similar; for example, peak, shoulder and off-peak hours. There may even be smaller groupings to reflect periods of significantly constrained transmission capability available for suppliers to reach a market.

The screen analysis also examines historical trade data as a check on which suppliers should be included in the relevant markets.

a. *Delivered price test.* The screen analysis should first identify those suppliers with the potential to economically supply power to the destination market or customer. The merging companies as well as non-traditional suppliers should be included in this test to identify potential suppliers. Basically, suppliers should be included in a market if they could deliver the product to a customer at a cost no greater than 5% above the competitive price to that customer.⁶ The delivered cost of the product to the relevant market for each potential supplier is found

⁶ The Guidelines suggest a 5% price threshold but acknowledge that others may be appropriate. Applicants have the burden of justifying a different price threshold.

by adding the potential supplier's variable generation costs and all transmission and ancillary service charges that would be incurred to make the delivery.⁷ Thus, the farther away a supplier, the more transmission and ancillary service prices that must be added to its power costs. Suppliers that would have to traverse a non-open access system can be included as potential suppliers only to the extent they have firm access rights. The analysis should also take into account the effect of line losses on the economics of trade with a distant supplier.

If a supplier can deliver the product to the market at a cost no more than 5% above the market price, that supplier should be included in the geographic market.

Applicants are expected to provide product-specific delivered price estimates for each destination market or customer.

The delivered price test uses the following data. Applicants should provide in electronic format these data and any other data relied upon in their analysis.

- *Transmission prices.* Applicants should use the ceiling prices in utilities' open access tariffs on file with the Commission. Where a non-jurisdictional entity's transmission system is involved, the ceiling price in its "NJ" tariff should be used. If the entity has not filed an "NJ" tariff, applicants should use their best efforts to secure or estimate transmission ceiling prices. Prices that are not found in a tariff on file with the Commission should be adequately supported. While we are aware that ceiling prices are frequently discounted, this screen analysis is to be conservative. Applicants may present an additional alternative analysis using discounted prices if they can support it with evidence that discounting is and will be available.

- *Potential suppliers' generation costs.* The Commission will consider various measures of costs. Applicants are free to use any appropriate cost data as long as it is verifiable and supported with reasoned analysis. Possibilities include generating plant cost data from the FERC Form 1 annual reports or unit specific data. Another is system lambda data. Either of these data can be used to calculate a potential supplier's costs at various time periods. Other measures or data sources may also be appropriate. The Commission has not reached a firm conclusion on a specific cost measure.

- *Competitive market price.* Electricity markets have not sufficiently matured yet to exhibit single market clearing prices for various products. In addition, price discovery is difficult because the reporting of actual transaction prices is still in its formative stage. Until market institutions mature enough to reveal single market clearing prices, applicants may use surrogate measures as long as they are properly supported. For example, a buyer's system lambda may be used because a buyer is not likely to purchase from a supplier that is more costly than its own costs of production

⁷ This would include the unbundled transmission rates of a seller that is a vertically integrated public utility.

at specific times.⁸ Another possibility might be the price at which the affected customer has been purchasing power.

For each supplier, the screen analysis should then show the amount of each product the supplier could supply to the market. Generation capacity measures are appropriate for this showing.⁹ Different capacity measures should be used, as appropriate, for different products. It is also appropriate, even desirable, to use several measures for one product. Given that competitive analysis is an inexact science and that electricity markets are changing rapidly, using several measures for a particular product will corroborate the result of the analysis. While the Commission has not firmly decided on specific measures for analyzing products, the following discussion of capacity measures is intended to offer guidance on this matter. These are some ways to measure a supplier's ability to supply a particular product to a market. They are not product definitions.

- *Economic capacity.* This is the most important of the measures because it determines which suppliers may be included in the geographic market. Economic capacity is that from generating units whose variable costs are such that they could deliver energy to a relevant market, after paying all necessary transmission and ancillary service costs, at a price close to the competitive price in the relevant market. For example, if the average competitive price in the wholesale market is 2.2 cents/kWh during a particular period, all capacity that can sell into the market at 2.3 cents/kWh (5% above the competitive price) should be included in the market. If a seller has no economic capacity, it should not be considered in the market at this stage of the analysis. The economic capacity measure provides a sense of which suppliers own or control the largest shares of low cost generating capacity that has a pronounced competitive advantage over higher cost capacity in the market.¹⁰

- *Available economic capacity.* This measure indicates how much economic capacity a supplier identified in the previous step might actually have available to sell into a market. It includes capacity from generating units that are not used to serve native load (or are contractually committed) and whose variable costs are such that they could deliver energy to a market at a price close to the competitive price in the market. The presumption underlying this measure is that the lowest running cost units are used to serve native load and other firm contractual obligations and would not be available for other sales. As competition develops, this

presumption may not be valid.¹¹ Because of its focus on variable costs, available economic capacity is useful for evaluating energy (in contrast to capacity) markets.

- *Uncommitted capacity.* This traditional measure is useful for evaluating intermediate-capacity markets. For each supplier included in the relevant market, this measure is computed by subtracting native load and firm contractual obligations from total capacity.

- *Total capacity.* Total capacity has traditionally been used by the Commission and others to analyze markets. While this measure does not account for native load obligations and does not capture the availability or cost of generation, and thus is not useful for a delivered price analysis, it does provide a sense of the overall size of a supplier that is included in the relevant market.

- b. *Accounting for transmission capability.* Once the suppliers that might economically supply the product to a market or customer are identified, and the relevant capacity measures are calculated, each supplier's capacity measures should be adjusted to account for how much of the product that seller can physically deliver to that market. The extent of transmission capability determines the extent of a supplier's ability to physically reach a market.

The flows on a transmission system can be very different under different supply and demand conditions (e.g. peak vs. off-peak). Consequently, the amount and price of transmission available for suppliers to reach wholesale buyers at different locations throughout the network can vary substantially over time. If this is the case, the analysis should treat these narrower periods separately and separate geographic markets should be defined for each period.

It is important to assess accurately the amount of transmission capability available for each supplier's use. The key to incorporating transmission limitations into the merger analysis is to include each supplier in the relevant market only to the extent of the transmission capability available to them. This would be calculated as the combination of the available transmission capability (ATC)¹² and any firm transmission rights held by the supplier that are not committed to long-term transactions.

In many cases, multiple suppliers could be subject to the same transmission path limitation to reach the same destination market and the sum of their economic generation capacity could exceed the transmission capability available to them. In these cases, the ATC must be allocated

among the potential suppliers for analytic purposes. There are various methods for accomplishing this allocation. Applicants should support the method used.

Applicants should also present evidence regarding how transmission capability will be affected by the merger. Transmission line loadings are likely to change as a result of the merging parties' combined operations. These changes are likely to result in transmission availability that is different from historical experience. Applicants should include in their application the following data: hourly TTC¹³ and hourly firm and non-firm ATC, and firm transactions between relevant control areas. The ATC and TTC data should come directly from the OASIS systems once they are implemented. Until then, applicants should file estimates of TTC and ATC with data or other background material that will allow the Commission to verify that the estimates are reasonable. Given these data, the Commission will be able to assess independently the amount of generation capacity that may be available to the market by each supplier.

- c. *Trade data check.* It would be expected that there be some correlation between the suppliers included in the market by the delivered price test and those actually trading in the market. As a check, actual trade data should be used to compare actual trade patterns with the results of the delivered price test. For example, it may be appropriate to include current trading partners in the relevant market even if the above analysis indicates otherwise. Alternatively, if there has been little or no trade between a customer and a specific supplier, it may be appropriate to exclude that supplier from the market, unless the applicants can show why it should be included prospectively. The lack of open access in the past may have prevented trade between the entities but trade may be more likely in an open access environment. Applicants should file historical trade data showing transactions between potential suppliers identified in the steps discussed above and the customers in question. The trade data filed should identify the supplier, customer, and characteristics of the transactions (duration, firmness, etc.). Any adjustments to the suppliers included in the market under the delivered price test must be fully supported.

4. *Analyze concentration.* The final step in the screen analysis is to analyze the effect of the proposed merger on market concentration and competition. To do so, concentration statistics should be calculated using the capacity measures discussed above for each relevant market identified. In cases where limited transmission capability during certain time periods results in a number of time differentiated markets, concentration statistics should be calculated for each. Both HHIs and single firm market share statistics should be presented for both pre- and post-

⁸System lambda data are usually reported by control area. For smaller entities that are within a control area, the area's system lambda may be a reasonable proxy for the cost of energy from the marginal resource.

⁹The DOJ Guidelines support using capacity measures in industries with homogenous products, such as electricity. DOJ Guidelines, at 41557. We note that energy measures (MWH) may also be appropriate.

¹⁰Economic capacity and similar measures were recommended by the DOJ and FTC. See FTC comments at 10 and DOJ comments, Appendix at 8.

¹¹For example, in a market with full retail access and a bid-based power exchange, all generation units would be in the market.

¹²As used by the industry, ATC is a measure of the transfer capability remaining in the physical transmission network for further commercial activity over and above already committed uses. See for example, NERC, *Available Transfer Capability Definitions and Determination*, June 1996 at page 2.

In hours when ATC is zero, a transmission constraint is said to be binding. This prevents the dispatcher from scheduling any additional transactions between the two points in the constrained direction.

¹³As used by the industry, total transmission capability (TTC) is the amount of electric power that can be transferred over the interconnected network in a reliable manner while meeting all of a specific set of defined pre- and post-contingency conditions. NERC, *id.* at page 2.

merger conditions.¹⁴ In calculating HHIs and market shares, the relevant generation capacity of the customers in each market should be included in the denominator of the ratio statistics. For example, if the economic capacity measure is being used, then the customer's economic capacity should be included. Such capacity would be available and turned to as a response to a significant price increase by external suppliers.

The HHI measures should be compared with the thresholds given in the DOJ Merger Guidelines. The Guidelines address three ranges of market concentration: (1) an unconcentrated post-merger market—if the post-merger HHI is below 1000, the merger is unlikely to have adverse competitive effects regardless of the change in HHI; (2) moderately concentrated post-merger market—if the post merger HHI ranges from 1000 to 1800 and the change in HHI is greater than 100, the merger potentially raises significant competitive concerns; and (3) highly concentrated post-merger market—if the post-merger HHI exceeds 1800 and the change in the HHI exceeds 50, the merger potentially raises significant competitive concerns; if the change in HHI exceeds 100, it is presumed that the merger is likely to create or enhance market power.¹⁵

If the Guidelines' thresholds are not exceeded, no further analysis need be provided in the application. We emphasize, however, that the Guidelines are just that: guidelines. There will undoubtedly be instances where concentration statistics may fall just above or just below the thresholds for concern and some additional analysis or judgement is needed.¹⁶ For example, if a proposed merger's effect on concentration falls just below a threshold, the Commission might still want to see further analysis if intervenors have raised significant concerns regarding the proposed merger. It is reasoned analysis, not blind faith in the thresholds, that must carry the day.

Instances where high concentration is indicated in markets that are defined by

fairly short-lived periods of low transmission capability will require additional analysis. The concern with high concentration in a market is that firms will be able to raise prices substantially and adversely impact the market. Relatively short periods of high concentration could be significant if the concentration is high enough. The factors that affect whether such a situation is problematic are the degree of concentration, as measured by HHI statistics, and how long that concentration lasts. High concentration is an indicator for how easy it would be for firms to behave strategically (e.g., collude, or if concentration is high enough, act unilaterally) to raise prices. It is a proxy measure for the degree to which prices could be raised. This, together with the length of time the concentration lasts, gives some idea of the potential severity of anticompetitive impact.

The Commission has insufficient experience to adopt at this time specific thresholds for the various possible combinations of HHI and length of time at which the constrained periods would be problematic. Applicants and other parties are strongly encouraged to analyze short-lived periods of high concentration using the framework discussed above and to support the conclusions drawn from it. There may be cases in which the applicant may be able to show that the anticompetitive effect of constrained transmission availability is *de minimis*. While the Commission has insufficient experience to establish a specific *de minimis* test in this policy statement, applicants may argue in a specific case that the anticompetitive effect of a constraint is *de minimis*. We offer the following general guidance to applicants that seek to make such a showing regarding short-lived transmission constraints. First, peak periods may be more problematic than other periods, because the opportunity to exercise market power likely would lead to significantly higher prices during those hours. Second, some level of market concentration above the DOJ threshold may be acceptable if the applicant can show that there are multiple sellers in the constrained area and/or that there are multiple holders of capacity into the constrained area. And finally, our concern with short-lived periods of high concentration is greater if the merged firm will have market-based pricing authority. Without such authority, the firm may not be able to substantially raise prices.

If the DOJ Guideline concentration thresholds are exceeded, including instances where short-lived periods of high concentration are indicated to be problematic, then the application should present further analysis consistent with steps 2 to 5 in the Guidelines. The additional analysis could address the potential for adverse competitive effects, the potential for entry in the market and the role entry could play in mitigating the increased market power, any efficiency gains that reasonably could not be achieved by other means, and whether, but for the merger, either party would likely fail causing its assets to exit the market.

If entry is considered as a potential mitigating factor, applicants should address

entry barriers, such as the time needed to install any necessary transmission capacity. All entry barriers should be addressed, even if they are not controlled by the applicants. Good market structure can be stymied by entry barriers, regardless of the source, e.g., transmission constraints on a neighboring utility's system.

C. Data

The usefulness of this screen depends on the quality and comprehensiveness of the data filed with the application. The data needed for the screen generally are publicly available. It is important for applicants to file electronically all data used for the screen analysis, including supporting data, and the data specified in this policy statement.¹⁷ The Commission must be able to check on the applicants' analysis independently. To do so, the Commission must have ready access to the data. Otherwise, data requests could result in delay. If there are problems in obtaining or understanding the data, the Commission is interested in developing informal means, such as technical conferences, to gather additional needed data or resolve questions or misunderstandings concerning the screen analysis, before the Commission addresses the merger. This approach could reduce the time needed to get useable data and perhaps reduce the need to set a merger for evidentiary hearing.

D. Other Considerations

We note that the above description of the analytic screen focuses only on monopoly (seller) power. This is not intended to exclude monopsony (buyer) power as a relevant consideration. An analysis of monopsony power should be developed if appropriate. Long-term purchases and sales data for interconnected entities are already collected and could be used to assess buyer concentration in the same way that seller concentration is calculated. In any event, intervenors may raise this issue if it is a concern.

The Commission understands that the screen analysis described in this policy statement will evolve with industry restructuring and market maturation. For example, as unbundling occurs, companies may have market power for sales from individual generating units (e.g., "must-run units"). In addition, markets are developing in response to competition and are spawning new products and increasingly short term exchanges. Markets will probably be differentiated by product (e.g., firm and non-firm energy and reactive power), by time (e.g., peak, off-peak) or by geography (e.g., markets separated by transmission constraints). The definition of relevant geographic and product markets must account for these new realities. Further, methods for trading and information availability are changing. As regional institutions, such as ISOs, and regional markets develop, transmission services may no longer be a series of transactions based on utility-by-utility corporate boundaries, but rather single regional transactions. This will

¹⁷ The data that should be electronically filed in an application is listed in Appendix B.

¹⁴ Post-merger geographic markets could include more or fewer suppliers than the pre-merger markets due to the effect of combining transmission rates. In cases where the merged company will charge a single system wide transmission rate, the merger will result in just one transmission rate where there were two before the merger. Thus, after the merger, some suppliers that were excluded from some destination markets could be included if the elimination of one of the transmission charges allows them to economically reach the market. While a stable geographic market would be preferable for analytic reasons, the effect described here reflects the reality of current transmission pricing policy and market organization. A buyer inside the transmission area of one of the merging companies could see higher transmission rates as a result of a single system rate for the merged company thereby decreasing the competitive options available to it. We also note that a decrease in transmission prices paid could result in increased demand, congestion, and no increase of suppliers in some markets.

¹⁵ DOJ Guidelines, at 41558.

¹⁶ The Guidelines state that the HHI statistics provide a useful framework for merger analysis but they suggest "greater precision than is possible with the available economic tools and information. Other things being equal, cases falling just above and just below a threshold present comparable competitive issues." Guidelines, at 41558.

have important implications for entry, customer response to price changes, and the number of suppliers that have competitive delivered prices.

The means of our analysis may also change. For example, flow based network models that include constraints on transmission networks are likely to be needed for the screen analysis. In the future, the Commission will have to rely less on methods that use costs to assess markets. Generation cost data will become increasingly sensitive, market participants will be less willing to report them, and accounting costs will be increasingly irrelevant to market behavior. The Commission will rely more on actual transaction prices because they will be more available as market institutions such as ISOs and power exchanges produce this information and because they are a better measure of market boundaries. New market institutions will change the ability to exercise market power. High transactions costs of trading tend to exclude competitors. Transactions costs include the costs of obtaining information, searching for trading partners, and completing a transaction. Further, the improved ability of buyers to respond quickly to price changes can significantly reduce market power. ISOs provide one vehicle for reducing transactions costs and making information available to traders via such means as the OASIS. Real-time pricing provides buyers with an improved ability to respond quickly to price changes.

We note that we intend to apply the analytic screen to mergers between firms that are not solely engaged in electricity markets, e.g., electric-gas mergers. However, it will not be necessary for the merger applicants to perform the screen analysis or file the data needed for the screen analysis in cases where the merging firms do not have facilities or sell relevant products in common geographic markets. In these cases, the proposed merger will not have an adverse competitive impact (i.e., there can be no increase in the applicants' market power unless they are selling relevant products in the same geographic markets) so there is no need for a detailed data analysis. If the Commission is unable to conclude that the applicants meet this standard, the Commission will require the applicants to supply the competitive analysis screen data described in Appendix A.

D. Remedy

A problematic merger may be made acceptable if certain remedial actions are taken. In some cases, the Commission may recommend them if we determine that a proposed merger will cause significant adverse effects on competition without a remedy. In other cases, the applicants may propose certain actions to be taken if the Commission approves the proposed merger. We offer the following guidance concerning standards for remedies and specific remedial options.

1. Standards

Any remedies proposed by the applicants or relied upon by the Commission to mitigate

the anticompetitive effect of a proposed merger should meet the following standards.

Nexus. Remedies should be clearly designed to mitigate the specific competitive problems identified in the analysis.

Approval of other authorities. Full and effective mitigation must be in place at the time the merger is consummated. Some, and maybe all, of the possible remedies to market power require the approval of other Federal, state and local authorities. For example, local authorities must approve many aspects of transmission line siting and construction and state commissions would surely have to approve any divestiture of generating plants also used to provide retail service. Promises to the Commission that such actions will be taken in exchange for merger approval are empty if not accompanied by all approvals necessary. We recognize, however, that final approvals may require quite some time to secure. In such cases, we will consider interim mitigation measures that can be implemented more quickly so as not to unduly delay a merger's consummation. We will require, however, that any interim measure must be fully effective in mitigating the identified market power problems.

Specificity. Remedial commitments must specify exactly which facilities are affected by the commitment, e.g., which generating unit(s) will be divested.

2. Remedial options

The remedies discussed in this section are intended to mitigate the market concentration problem caused by the merger. We stress that the options discussion is meant only as guidance and not as an exhaustive list of potentially acceptable remedies.

(a) *Require transmission expansion.* Limitations on available transmission capability that prevent competitors from participating in a market can give substantial market power to incumbents in the market. Conditioning merger approval on eliminating a known constraint could help to mitigate this type of market power. Where constraints on other systems are a problem, the applicants would also be required to seek transmission expansion on those systems. As with relieving constraints on their own system, applicants should show that all necessary approvals have been secured before the Commission could approve the merger. This process does not need to wait for the Commission to identify a problem. Applicants wanting fast approval could include this as part of the application.

(b) *No trade over constrained paths.* If constrained paths are responsible for market concentration problems and they cannot be relieved for any reason, the company could agree to not use those paths for its own off-system trade when other transmission service requests are pending. This condition would keep the merged company from exercising market power in trade in the constrained areas.

(c) *Generation plant divestiture.* In concentrated markets, including those subject to severe and long lasting transmission limitations, splitting up different generating units into independent

and separately owned companies could reduce horizontal market power. Where there are only a few generating units in the market area, divesting those units to just a few owners may not mitigate the market power problem. In such a case, one alternative might be to divest the ownership rights to each unit's energy and capacity to a number of owners. The unit could then be operated as a competitive joint venture and parts of its output could be bid or sold independently.

(d) *Defer to an ISO's analysis and mitigation efforts.* Although ISOs are just now in their formative changes, they hold some promise of playing a part in mitigating certain sources of market power. Applicants' membership in, or commitment to join, an ISO with the authority necessary to mitigate market power could allow the Commission to rely on the ISO to identify and remedy market power problems. The ISO would have access to more information than does the Commission and would possess greater technical expertise to assess problems. More importantly, the ISO would have the proper incentives to mitigate the problems if the ISO's governing body is broadly comprised of market participants. This potential role for ISOs highlights the critical importance of balanced ISO governance.

An ISO would also be a mitigating influence on market power to the extent that it attracts new entrants into a market. An ISO assures comparable and independent access to all customers. These institutional guarantees will serve both to attract new entrants and to encourage continued participation in markets that would otherwise be dominated by vertically integrated utilities.

ISOs are generally thought to be the proper vehicle for dealing with vertical market power, e.g., ensuring transmission expansion or preventing the strategic manipulation of generation dispatch. An ISO would be able to deal with horizontal market power issues to the extent it has the ability to control the dispatch or prices paid to generators. For example, an ISO could identify units with market power (such as must-run units) and those units could be subject to contracts that mitigate those units' ability to raise prices excessively. To take advantage of this option, applicants would be expected to show that: (1) the ISO meets the Commission's standard for independence; (2) already exists or will come into existence before the merger is completed; (3) has a mandate to identify both vertical and horizontal market power issues; and (4) has the authority to either remedy any problems it finds or bring those that it cannot remedy to the Commission.

(e) *Real-time pricing.* Real-time pricing, when combined with other mitigation measures, could help constrain the ability of a firm to raise prices excessively. Buyers who can see the higher prices in real time can respond by conserving. This makes demand more elastic, thereby making it more difficult to exercise market power.

APPENDIX B.—DATA USED FOR COMPETITIVE ANALYSIS SCREEN

Analysis and data element	Sources ¹
Delivered Price Test:	
Hourly System Lambda	FERC Form No. 714.
Plant Generation Costs/Capability	FERC Form No. 1.
Unit Generation Costs:	
Heat Rates	EIA Form 860.
Fuel Costs	FERC Form 423.
Transmission Rates	Filed tariffs, Applicants' filing.
Transmission Capability Test:	
Hourly Capability (ATC)	OASIS, Applicants' filing.
Total Capability	OASIS, NERC Reports.
Developing Capacity Measures:	
Hourly System Lambda	FERC Form No. 714.
Plant Generation Costs/Capability	FERC Form No. 1.
Unit Generation Costs:	
Heat Rates	EIA Form 860.
Fuel Costs	FERC Form 423.
Transmission Rates	Filed tariffs, Applicants' filing.
Adjusting for LT Sales, Purchases, and NUGS:	
Trade Data (Firm Capacity ales)	FERC Form No. 1, OE-411, NERC Reports, Applicants' filing.
Adjusting for Tx Capability:	
Hourly/Total Capability (ATC, TTC)	OASIS, NERC Reports Applicants' filing.

¹ Most of the data listed is publicly available, however the Applicants should assemble the data and file it electronically with their merger application.

APPENDIX C.—COMMENTERS ON MERGER NOTICE OF INQUIRY

Short name	Commenter
APPA	American Public Power Association.
Attorneys General <i>et al.</i>	Attorneys General of the States of Iowa, Maine, Maryland, Minnesota, Oklahoma and Wisconsin.
CA Com	California Public Utilities Commission.
Carolina Association	Carolina Utility Customers Association, Incorporated.
Centerior	Centerior Energy Corporation.
Central and South West	Central and South West Corporation.
CINergy	CINergy Corporation.
Colorado Municipals	Colorado Association of Municipal Utilities.
Com Ed	Commonwealth Edison Company.
Competitive Coalition	Coalition for a Competitive Electric Market.
Diamond and Edwards	Diamond, Joseph and Edwards, Jon D.
DOE	U.S. Department of Energy.
DOJ	U.S. Department of Justice.
East Texas Coop	East Texas Electric Cooperative, Incorporated.
Economists	Economists Incorporated (Mark W. Frankena).
EEL	Edison Electric Institute.
EGA	Electric Generation Association.
Environmental Action <i>et al.</i>	Environmental Action Foundation and Consumer Federation of America.
FERC Policy Project	Project for Sustainable FERC Energy Policy.
Florida and Montaup	Florida Power Corporation and Montaup Electric Company.
FTC	Bureau of Economics of the Federal Trade Commission.
Georgia Municipal	Municipal Electric Authority of Georgia.
Hawes and Behrends	Hawes, Douglas W. and Behrends, Sam (IV).
Illinois Industrials	Illinois Industrial Energy Consumers.
IN Com	Indiana Utility Regulatory Commission.
Industrial Consumers	Electricity Consumers Resource Council, American Iron and Steel Institute, and Chemical Manufacturers Association.
International Brotherhood	International Brotherhood of Electrical Workers.
Joint Consumer Advoc.	Joint Consumer Advocates of Maryland People's Counsel.
KS Com	Kansas Corporation Commission.
Low-Income Representatives	Consolidated Low-Income Representatives.
Lubbock	Lubbock Power & Light.
Madison G&E	Madison Gas and Electric Company.
MidAmerican	MidAmerican Energy Company.
Missouri Basin	Missouri Basin Municipal Power Agency.
MN Public Service	Minnesota Department of Public Service.
MO Com	Missouri Public Service Commission.
NARUC	National Association of Regulatory Utility Commissioners.
NIEP	National Independent Energy Producers.
NM Industrials	New Mexico Industrial Energy Consumers.
NRECA	National Rural Electric Cooperative Association.
NRRI	National Regulatory Research Institute.

APPENDIX C.—COMMENTERS ON MERGER NOTICE OF INQUIRY—Continued

Short name	Commenter
NV Com	Public Service Commission of Nevada.
NY Com	Public Service Commission of the State of New York.
OH Com	Public Utilities Commission of Ohio.
OK Com	Oklahoma Corporation Commission.
OK Industrials	Oklahoma Industrial Energy Consumers.
Otter Tail	Otter Tail Power Company.
PA Com	Pennsylvania Public Utility Commission.
PaineWebber	PaineWebber Incorporated.
PanEnergy	PanEnergy Corporation.
PP&L	Pennsylvania Power & Light Company.
PS Colorado	Public Service Company of Colorado.
RUS	Rural Utilities Service.
Salt River	Salt River Project.
Sierra Pacific	Sierra Pacific Power Company.
Southern Company	Southern Company Services, Incorporated.
Southwestern Electric	Southwestern Electric Cooperative, Incorporated.
Southwestern PS	Southwestern Public Service Company.
TAPS	Transmission Access Policy Study Group.
TDU Systems	Transmission Dependent Utility Systems.
Texas Industrials	Texas Industrial Energy Consumers.
Texas Utilities	Texas Utilities Electric Company.
TX Com	Public Utility Commission of Texas.
UtiliCorp	UtiliCorp United Incorporated.
WI Com	Public Service Commission of Wisconsin.
Wisconsin Customers	Wisconsin Wholesale Customers.
Wisconsin PS	Wisconsin Public Service Corporation.

Appendix D—Summary of Comments on Merger Policies

I. General Comments on Revising the Commission's Merger Policy

A. Direction of Change

Almost all commenters argue that we need to revise our merger policies and standards in light of the changes in the industry. However, they do not agree on the direction of the change. On one side, many commenters argue that mergers may prevent markets from becoming truly competitive.¹ On the other side, some commenters suggest that the Commission should approve a merger unless harm to the public interest is demonstrated.² These commenters claim that most mergers are procompetitive and should be approved unless a problem is identified.

Commenters³ who argue that moving to a more competitive market warrants stricter merger approval criteria are concerned that the recent wave of mergers threatens the development of competitive markets. For example, Industrial Consumers and TAPS believe that the Commission's current policy is too lax. These commenters offer numerous reasons for opposing mergers, including the detrimental effects of large "mega-utilities" and diversion of management's attention from cost minimization. RUS fears that mega-utilities could have market power in generation and political power at the state

and federal levels that could suppress competition in transmission and distribution. Madison G&E is also concerned about the challenge mega-utilities pose to effective state regulation. UtiliCorp notes that the need for efficient dispositions and transfers of capital, which are critical to the transition from a regulated to a competitive industry, warrant a revised merger policy.

Many of these commenters criticize the "consistent with" standard as we have interpreted it—that is, as a "do no harm" standard. They argue that this approach, which was developed in an era of tight regulation, is inconsistent with the public interest in the transition to a competitive environment.⁴ Joint Consumer Advoc. suggests that a merger is not consistent with the public interest unless dollars invested in a merger could not have been used otherwise to lower costs more.

Numerous commenters⁵ argue that we should revise our merger criteria because of general industry restructuring due to open access or new state and federal laws and policies that provide incentives to merge.

On the other hand, commenters who support more relaxed merger criteria argue that the marketplace can best decide the future path of the industry. They argue that the Commission's current policy is simply too stringent;⁶ we should recognize that the transformation to a competitive industry requires a certain amount of industry reshuffling, best accomplished without the Commission's intervention.

For example, CINergy believes that consolidation may be a necessary step toward industry rationalization and disaggregation as companies seek critical mass to spin off generation. This suggests that we should monitor the merger process closely, but not try to predict or dictate the path of industry restructuring. Similarly, Central and South West says that the nearly 150 control areas and the utilities that operate them will not survive competitive restructuring and that mergers may allow market forces to bring about a competitive and workable market structure. UtiliCorp notes that mergers and acquisitions are likely to increase as utilities act to improve their ability to compete in increasingly competitive markets. Some of these commenters argue for automatic approval of a merger if no harm to the public interest is demonstrated. PanEnergy and Hawes and Behrends believe that certain types of mergers are either procompetitive or have no effect on competition and warrant a streamlined approval process.

The Commission also received comments from parties that neither favor nor oppose mergers but suggest a revised approach, for a variety of reasons. For example, NIEP and Diamond and Edwards believe that as markets become more competitive and the Commission reduces some aspects of its regulatory scrutiny, merger standards should be adjusted so that they more closely track traditional antitrust principles. On the other hand, PA Com and KS Com support a "wait and see" approach. PA Com comments that reevaluating merger policy may be premature at this time because the Open Access Rule is being reviewed by the industry and power pools do not have to file their open access tariffs until December 31, 1996. KS Com believes that the public interest and state and federal review processes will benefit if a

¹ For example, APPA, NRECA at 7-8; ELCON at 12-13.

² For example, Utilicorp at 2, 7, 10.

³ Among others, APPA, NRECA, EEI, Texas Utilities, Southern, East Texas Coop (endorsing the joint petition of APPA/NRECA and comments of NRECA), NIEP, Colorado Municipals (endorsing the views of APPA), IN Com, DOJ, Joint Consumer Advoc., TAPS, TX Com, and NY Com.

⁴ East Texas Coop, Joint Consumer Advoc., and TAPS.

⁵ These commenters include Texas Utilities, Southern, DOJ, TAPS, TX Com, NARUC, and APPA.

⁶ UtiliCorp, PaineWebber, Texas Utilities, Southwestern, and Southern.

consistent view of the appropriate markets and regulatory framework, designed to achieve an efficient and sustainable generation market, is developed before merger evaluation standards.

Project argues that our merger policies must ensure that the market functions under rules that promote environmental quality and economic efficiency; specifically, a policy of sustainability.

B. How to Implement New Policies

We received a few comments on whether to adopt our new policies on a case-by-case basis, through a policy statement, or through a rulemaking.⁷

Commenters also expressed differing views on whether our new policies should be applied to pending mergers. Lubbock urges the Commission evaluate all pending mergers under the new merger standards. Wisconsin Customers recommend, however, that the new merger policy be applied only to mergers filed after the date of issuance of the NOI.

Environmental Action *et al.* recommends that mergers be prohibited until the Commission's new merger policy is established through a NOPR process. However, if mergers are not prohibited during this period, there should be a moratorium on unconditional approvals; any mergers approval should be conditional and required to conform to the merger final rule.

The Pennsylvania Commission urges the Commission to let competitive wholesale restructuring develop before approving mergers among the members of power pools.

On the other side, Florida and Montaup argue that any new rule resulting from this proceeding should apply only to merger applications filed after the effective date of a final rule. Merger applications filed before that date should be considered under the filing requirements and standards in effect at the time of their filing. EEI and UtiliCorp request that the Commission move quickly to review those merger applications already before it without waiting to develop a new merger policy.

II. Comments Concerning Effect on Competition

A. Defining the Relevant Markets

1. Defining Product Markets

Some commenters emphasize that relevant product markets should be established from the buyer's perspective, that is, in terms of the delivered product.⁸ Such an approach would examine generation and transmission

in combination, since neither is of use to a customer by itself. They add that in an open access environment, where transmission rates will remain regulated, transmission should be viewed as a substitute for local generation, rather than as a separate market.⁹

Commenters suggest that the Commission examine two or more product markets. However, there is little consensus on which markets to consider. For example, Environmental Action, *et al.* suggests existing generation, new generation, transmission, retail aggregation and sales, physical distribution, demand side management services, ancillary services associated with generation transmission and distribution, and fuels. Industrial Consumers suggests firm and non-firm bulk power, short-term capacity, short-term energy, long-term capacity, and energy and transmission services. To minimize opportunities for affiliate abuse, RUS recommends examining at least markets for generation, transmission, and ancillary services. For applying the Guidelines to the electric power industry, DOJ and FTC suggest that we look at four product markets: short-term energy, intermediate-term energy, long-term capacity, and ancillary services. FTC notes that sales to differently situated customers may constitute separate markets if differential pricing is feasible. APPA proposes similar markets, but suggests considering short-term energy or capacity. EEI proposes a short-term energy and capacity market (up to about two years) and a medium-term (two- to five-year) capacity contract market involving capacity and associated energy sales from excess capacity from existing facilities. MO Com suggests focusing on the commodities market (hourly energy from existing generation facilities) and the contracts market (capacity and energy from existing and new generation). NIEP proposes two broad product markets, generation sales and retail sales. Several commenters suggest that the Commission consider ancillary services as a product market.¹⁰

Other commenters argue that long-term product markets should not be subject to market power analysis. For example, EEI says that the long-term capacity market where sales from new capacity compete with long-term contracts for sales from existing capacity should not be subject to the analysis. APPA makes the same argument for long-run sales from new capacity, since such capacity represents potential entry. Similarly, UtiliCorp argues that we should disregard the long-run generation product market because of our finding in the Open Access Rule that long-run markets are generally competitive. CINergy believes that open access, the absence of artificial impediments to expansion of generation capacity by existing suppliers, and the prospect of entry into the generation business by new suppliers preclude market power in the long run. However, DOJ questions the presumption that utilities do not have market power over long-run energy and capacity.

Com Ed argues that the Commission should disregard short-term energy markets because these markets involve buyers who are able to make purchases to replace energy otherwise available at a higher cost, such as from the buyer's own installed capacity. The cost of energy from such otherwise available capacity effectively limits the price at which short-term energy is offered.

Several commenters cite the need to consider the temporal characteristics of product markets. For example, Florida and Montaup suggest dividing them into short-term and medium-term markets and further dividing these into various product markets as appropriate to the area. Others¹¹ suggest that delivered capacity and energy be analyzed under market conditions during peak and off-peak hours and summer and winter conditions.

As to whether the Commission should examine only the wholesale market, leaving concerns over retail competition to the states, Southern says yes. Several commenters believe that we should also examine the impact on retail competition.¹² They suggest that the Commission has both the authority¹³ and the responsibility to examine the impact of mergers on actual or potential retail competition.

2. Defining Geographic Markets

We received a significant response from commenters on various aspects of defining relevant geographic markets. Most of these comments relate to the approaches (such as generic versus case-by-case) to defining markets, factors that are important to consider in defining markets, and the use of modeling.

DOJ and others¹⁴ define the relevant geographic market as the area in which the seller operates and to which the purchaser can turn for supplies. They suggest that the best way to determine which suppliers are in the relevant market is to look at the physical location of the generating unit (as opposed to disposition of power from the unit). DOJ suggest that we could determine the geographic markets immediately for the electric utility industry for the United States through a rulemaking or technical conference.

Some commenters urge the Commission to recognize the effects of open access on the extent of geographic markets.¹⁵ For example, the Commission should revise its current two-tier analysis because open access will broaden the relevant geographic market beyond two tiers. EEI suggests that the Commission first define the smallest geographic area (under the trading patterns existing before open access) and then broaden the market as choices available to the purchasers increase under open access.

However, some commenters are skeptical that defining the geographic market to include suppliers two or more tiers away is

⁷ For example, DOJ, East Texas Coop, OH Com, NRECA, and Southwestern Electric suggest a rulemaking as the vehicle to implement the Commission's new merger policy; CINergy advocates a case-by-case approach; APPA suggests a combination of various methods; DOJ suggests that we convene a technical conference immediately to delineate the relevant geographic markets for the electric utility industry for the entire U.S. DOJ says that this would greatly facilitate the Commission's (and DOJ's) review of merger applications and enable the Commission quickly to establish safe harbors or screens for any merger application based upon changes in market concentration for a known geographic market.

⁸ For example, EEI, UtiliCorp, and Centerior.

⁹ These include, for instance, EGA, Low-Income Representatives, NIEP, and TAPS.

¹⁰ These include, for example, Industrial Consumers, DOJ, Environmental Action *et al.*, CA Com, CINergy, and UtiliCorp.

¹¹ *E.g.*, Madison G&E and CINergy.

¹² These include PP&L, DOJ, and TAPS.

¹³ Citing *FPC v. Conway*, 426 U.S. 271 (1976).

¹⁴ *E.g.*, EEI, Wisconsin Customers, APPA, and TX Com.

¹⁵ *E.g.*, Industrial Consumers, RUS, UtiliCorp, EEI, Wisconsin Customers, Texas Utilities, TDU Systems, and CINergy.

a wise approach. For example, RUS warns that defining the market too broadly can understate the problems in sparsely populated areas. It argues that the Commission must allow competitors to present evidence that the market is narrower than the first or second tier. TDU Systems question whether suppliers two tiers away can put competitive pressure on the merging utilities. It explains that a seller two transmission charges away incurs transmission costs of approximately 15 to 20 percent of the product price, which is significantly higher than the 5 percent price increase used by the antitrust agencies. Wisconsin Customers argue that the Commission's method of defining the geographic market results in markets that are too large because all first-tier utilities are included, which leads to underestimates of the true market power of the merged entity. RUS emphasizes that the price increase test in the *Guidelines* is inadequate in an industry emerging from a monopoly situation and in which mega-utilities could rapidly acquire excessive market power.

Other commenters suggest various approaches to defining geographic markets. For example, NIEP proposes that Electric Reliability Council areas be used. Many commenters emphasize the importance of the actual behavior of the grid in defining relevant markets. RUS recommends that a separate geographic market for each state be defined for mergers involving utilities or holding companies operating in more than one state. TX Com argues that we must consider the *future* geographic scope of markets.

MO Com suggests three models of competition in defining relevant markets: the utility, the wholesale, and the retail direct access models. The utility model considers utility/non-utility generator competition to meet jurisdictional loads with no retail access. The wholesale model expands the utility model to consider direct access to all wholesale customers, and the retail model expands the wholesale model to reflect direct access to all end-use customers.

Many commenters list factors to consider in defining relevant geographic markets. The most significant factors discussed are transmission constraints and transmission pricing. There is a wide-spread view that we must take account of transmission constraints, particularly because constraints can lead to shifting geographic markets over time and the ability to wield market power in local markets.¹⁶ For example, DOJ, EGA, and TAPS argue that the Commission should give great emphasis to transmission constraints, since they can be exacerbated by mergers and can lead to significant market power in localized areas. Wisconsin PS and Madison G&E note the importance of assessing transmission constraints both alone and together with strategically located generation to give an advantage to a merging entity's own power sales.

¹⁶ Industrial Consumers, FTC, Lubbock, EEI, Wisconsin PS, DOJ, TAPS, NY Com, Environmental Action *et al.*, Southern, TX Com, RUS, Centrior, CINergy, UtiliCorp, MO Com, and CINergy all support this view.

CINergy emphasizes that the extent to which transmission constraints are binding is critical for accurately assessing market conditions. It will be necessary to develop market concentration statistics that account for the distribution of capacity beyond a binding constraint and that include only realistically available supplies inside the area bounded by the constraints. MO Com emphasizes the importance of determining whether constraints will prevent alternative suppliers from having access to the customers of the merged utilities. If available transfer capability is reduced as a result of the merger, the merger increases market power. Even if the merger expands transfer capability as the number of alternative generation sources decreases, the increase in transfer capability may be of little value unless it increases access to generation alternatives. MO Com believes that the burden should be on the applicants to show that limits on transfer capability would not allow them to exercise market power. Further, the Commission should require applicants to have sufficient transfer capability available to meet the net import requirements for base-load power that might be requested by current customers.

On the other hand, Southern cautions the Commission against over-emphasizing transmission constraints, noting that isolated or short-term constraints should not affect the definition of the relevant geographic market. Constraints should be considered only if they impede wholesale trade. Moreover, Southern questions our authority to order the construction of transmission facilities to alleviate constraints. In assessing the significance of transmission constraints, the Commission should consider the ability of new generation to locate in the region, mitigating the problem; the feasibility of alternative transactions (such as transmission capacity resale or arrangements with brokers) to bypass the constraint; and the possibility that new power sales would simply displace existing sales, reducing the likelihood that the constraint would occur.

Finally, various commenters recognize that constraints depend on time and location, which may make defining the relevant market difficult.¹⁷ For example, constraints may be affected by line loadings on a system that vary over the course of a day, week, or year. As a result, increases in congestion on transmission lines under high load conditions can change the boundaries of the relevant geographic market. EEI makes similar arguments, suggesting that time-differing transmission use patterns lead to similarly differing relevant geographic markets if constraints arise during peak periods. DOJ and TAPS note that constraints are affected by how the transmission system is operated in terms of, for example, dispatch, decisions on which utilities to make sales to or purchases from, equipment ratings, maintenance outage scheduling, and decisions concerning equipment sizing and locations. Thus, we should investigate the possibility of operational manipulation of

¹⁷ *E.g.*, DOJ, EGA, Environmental Action *et al.*, TX Com, and TAPS.

transmission systems that gives merging utilities a competitive advantage.

Environmental Action *et al.* suggests that the extent of the geographic market may be unclear because transmission constraints are physical or economic barriers to electricity sales in many locations. DOJ and TX Com caution the Commission not to rely too heavily on historical patterns of trade in determining transmission constraints because open access could create very different constraints in the future.

The second factor mentioned by many commenters as significant in defining the geographic market is transmission costs.¹⁸ For example, Madison G&E believes that pancaking of transmission rates can influence the extent of the market; moreover, postage stamp rates and distance-sensitive rates will lead to different numbers of competitors. FTC believes that geographic markets defined in terms of distance-sensitive rates would correspond to underlying cost conditions more accurately than markets defined in terms of postage stamp pricing. The MO Com proposes that merging utilities be required to specify the market region where they have a strong competitive influence and file a study showing both short- and long-run marginal transmission costs for the region. Industrial Consumers notes that transmission costs include stranded costs.

Commenters mention various other factors as important in defining geographic markets. Some note that institutional arrangements can affect the extent of the market.¹⁹ FTC notes that differences in the degree and sources of geographic competition may arise from temporal distinctions between product markets such as existing transmission and generating obligations.

FTC suggests that computer models of transmission systems be used to simulate the effects of a small, non-transitory price increase imposed by groupings of power suppliers over various alternative geographic areas. This would allow us to determine whether the price increase would be profitable for a hypothetical monopolist and, therefore, which of the areas are relevant geographic markets. FTC also suggests that the Commission consider developing sufficient data and system modeling tools to be able to screen mergers expeditiously, examining the likely relevant geographic market under different assumptions about future transmission rates, different projected transmission improvements, and different generation siting assumptions. However, Madison G&E opposes the use of models. It says that models do not address conditions in the market for delivered capacity and are inherently incapable of taking into account strategic behavior or the potential effectiveness of threats.

Some commenters offer their views on the merits of a generic verses case-by-case

¹⁸ *E.g.*, DOJ, FTC, TAPS, NY Com, TDU Systems, EEI, Industrial Consumers, CINergy, Centrior, TDU Systems, MO Com, Madison G&E, and Com Ed. DOJ argues that it is vital that the Commission quickly replace its case-by-case approach to transmission pricing with a general rule to avoid a merger policy that is inconsistent, inefficient, and inequitable.

¹⁹ *E.g.*, EEI, FTC, Industrial Consumers, and Centrior.

approach to defining markets. For example, Southern believes that the Commission should perform case-specific analyses in which it weighs the effects of significantly reduced entry barriers and open access. Diamond and Edwards disagree, suggesting that this approach is not consistent and that a better approach would be to look at a large area and determine subregions based on trade patterns. Wisconsin Customers warn that using theoretical bases to determine the boundaries of the relevant markets can be misleading because market power can be exercised even on an hourly basis.

B. Determining the Effect on Competition

Many commenters recommend that once the relevant markets have been defined, the Commission determine the effect of a merger on competition by examining market shares, market concentration, and ease of entry.

1. Market Shares

Commenters offer various views on how to measure market shares and how frequently to do so. They generally argue for more frequent calculation of market shares, particularly for energy products.

DOJ suggests that market shares can be assigned based on production, sales, or capacity. It favors capacity because electricity is a homogenous product and because the capability of producing can be readily translated into actual sales. FTC suggests, similarly, that market shares may reflect either output or capacity. It argues that in homogeneous product markets, capacity is a better measure, while in differentiated product markets, output-based measures are usually a better indicator of firms' future competitive significance. The structure of intermediate and long-term markets is reasonably measured by capacity, and the structure of short-term markets is reasonably measured by output if differentiating factors such as reliability and access are important. Madison G&E suggests that market shares for delivered firm capacity be measured by uncommitted capacity, while market shares for energy be measured by the amount of deliverable energy at competitive prices during the time period in question. EEI suggests examining market shares associated with installed capacity and uncommitted capacity or energy that are excess to the capacity committed to serve native load customers, existing contracts, and other obligations. Southern Company believes that excess capacity is a better indicator of a merging entity's ability to exercise market power than is total capacity.

Others also suggest that when calculating market shares, we exclude contractually-obligated capacity; for example, FTC emphasizes that capacity or output that is contractually obligated may not be relevant to calculating market shares of potential suppliers for other customers. For instance, supply that is contractually obligated to local load is unlikely to be a part of the market for short-term capacity. Similarly, Southern Company claims that capacity committed to serve native load, wholesale requirements service, or sales outside the relevant market should not be considered.

As to the frequency with which market shares should be calculated, several

commenters note that generation dominance can create anticompetitive effects in localized markets during certain times (daily, seasonally) due to transmission constraints. Madison G&E would calculate market shares beginning with the year in which the merger is expected to be consummated and several years into the future. It believes that market shares for energy should be calculated for peak and off-peak periods. Similarly, CINergy proposes examining market conditions monthly for energy markets to address problems of market power in particular periods.

As a final word of caution, DOJ states that not all market shares are equal. For example, a utility may possess market power that is disproportionate to its market share if the marginal costs of that utility's generators are closest to the market-clearing price for electricity in that market.

2. Measuring Market Concentration

There is wide support among the commenters for using HHI analysis to measure concentration in relevant markets, but many suggest modifications. For example, EEI suggests that considerable judgment is needed to arrive at the combination of HHIs that best reflects an appropriate structural analysis of market power. If several suppliers have enough excess capacity to meet anticipated incremental market requirements, the Commission can treat each as having an equal contribution to market concentration. EGA suggests that we consider reasonably predictable effects of recent or ongoing changes in market conditions, such as the creation of ISOs, in interpreting market concentration and market share data.

Several commenters suggest that HHI analysis be used as a "screen" for market power to create some sort of "safe harbor" allowing mergers to be quickly approved if they meet certain tests.²⁰ For example, Southern Company believes that the Commission should establish threshold HHI levels that would be safe harbors in the merger review process. It contends that increases in market concentration resulting from mergers often do not pose a significant threat to competition, and that mergers are a means by which industries and individual firms adjust to market change to maximize efficiency and consumer welfare. Similarly, UtiliCorp endorses HHI screens, but suggests that we consider the transitional circumstances of the electric utility industry in designing the screens. The Commission should analyze the effects of the merger under criteria similar to those contained in the *Guidelines* if the merger does not pass the screen.

EEI and APPA argue that the Commission need not be concerned about mergers with a post-merger HHI at or below 2000 (that is, five equal-sized firms). However, EEI emphasizes that selection of a particular threshold value is based upon judgment, not science. The Commission may want to consider specifying more refined thresholds based on experience in wholesale power

markets. Precise numerical HHI thresholds are less important than how these thresholds are used, that is, as screening devices to distinguish mergers that are clearly benign from those requiring further scrutiny. The Commission should be mindful that HHI analyses are based on historical data and that changing regulation and market developments that increase competition may allow the use of higher HHI thresholds or a more liberal interpretation of results. On the other hand, Central and South West proposes that where HHI values are up to 2500, there should be a rebuttable presumption that the region is workably competitive. It believes that the market will eventually encompass all synchronously connected regions under the Commission's jurisdiction.

Some commenters caution against putting too much emphasis on HHI analysis, suggesting that the Commission look at additional factors.²¹ For example, Wisconsin PSC asserts that HHIs (incorporating transmission constraints) can be used as a screen but should not substitute for the Commission identifying potential discriminatory practices in areas such as maintenance, planning, system modeling, equipment ratings, system design, operation control, and use of generation, all of which Wisconsin PSC asserts affect transmission constraints.

Other commenters suggest standards other than HHI analysis for determining if market power would result from a merger.²² Some would require having at least five reasonably comparable suppliers, no single dominant supplier, and reasonably free entry to all segments of the relevant market. Diamond and Edwards opposes this view, stating that the number of firms and level of competition are only loosely related; competition can be intense with only two firms or nonexistent with many firms. It suggests that the Commission entertain the possibility that in the intermediate term, competition among the few (such as between regions), with appropriate market power mitigation measures such as ISOs, retail access, or divestiture, may be necessary as the industry moves toward "workable competition."

NIEP argues that a merger should be presumed to be anticompetitive if the merged entity would have a 20 percent market share, based on either generation sales or retail sales within a reliability council area. Com Ed disagrees, contending that for an undifferentiated product like electric power, the *Guidelines* suggest a higher figure of 35 percent. NIEP further argues that mergers not presumptively anticompetitive would still be scrutinized on the basis of whether the merged firm could sustain a 5 percent price increase.

Centerior and Com Ed oppose HHI analysis. Centerior believes that HHI measures are inadequate to measure market dominance. Rather, an assessment of market power should be based on the number and characteristics of a customer's options. For example, if a customer could look at several generation options and combine them with

²⁰ This "safe harbor"-type issue is discussed further below under "Procedures for Handling Merger Cases."

²¹ *E.g.*, East Texas Coop and Wisconsin PSC.

²² For example, IN Com, Industrial Consumers, and Environmental Action *et al.*

available transmission, so that there are several "delivered power" options, a proposed merger should be acceptable. Centerior notes that EEI's criteria do not account for the potential loss of native load customers, which could create excess capacity that, under HHI analysis, could lead to a finding of market power. An adequate market power screen could be based on regional concentration of competing utilities in the relevant market and/or market shares, as proposed by EEI.

Com Ed objects to any market concentration ratio for energy or even capacity markets based on a capacity measure because the capacity that utilities have available to make economy energy sales fluctuates constantly, depending on system conditions. Only generating units operating on the margin are capable of conferring any degree of market power, and identification of those units requires a rigorous analysis of the mix of generating units controlled by all utilities who could participate in the market. This leads Com Ed to conclude that generating capacity is not a meaningful indicator of market power in the markets for either capacity or energy. As an alternative to looking at market concentration ratios, Com Ed suggests that we review actual competitive conditions and assess the potential for anticompetitive behavior by determining whether there are feasible market manipulation mechanisms that are likely to succeed. Com Ed argues that for the Commission must recognize as a competitive issue the likely effects of a proposed merger on the operations and costs of neighboring utility systems, including effects on the loadings of their transmission systems. EGA shares a similar view, specifically recommending that the Commission focus on whether the merger will increase the transmission costs of potential competitors.

3. Ease of Entry

The Commission received a number of comments on considering the possibility of entry by new competitors in assessing market power. These comments address both the types of entry barriers that might exist in the industry and the importance of entry analysis.

Commenters suggest that there are various barriers to entry in this industry.²³ These include existing law and regulation and economic incentives created by a utility's role as monopolist and competitor; regulatory approval requirements; the amount of time it takes to move from planning to operation of new facilities; the existence of excess capacity in the relevant market; economies of scale and capital requirements; favorable location and access to raw materials; and access to distribution channels (including access to transfer capability of the transmission system and pancaked transmission pricing).

Some commenters believe that entry is a critical factor in merger analysis. For example, Joint Consumer Advoc. and TAPS argue that careful analysis will indicate significant barriers to entry. TAPS notes that

measures of market dominance such as concentration indicate whether a utility currently can dictate price levels, while analysis of barriers to entry indicates whether a utility can foreclose competition prospectively. NY Com urges the Commission to focus its analysis of barriers to entry on factors such as transmission power flow analyses, availability of generation plants, reserve margins, load pocket constraints, and system stability.

Several commenters are skeptical that entry analysis, as done in the *Guidelines*, makes sense for the electric utility industry; they argue that entry will not mitigate market power. For example, Industrial Consumers notes that the *Guidelines* recognize that market power can be defeated if entry is "easy," that is, timely, likely, and sufficient to deter or counteract the anticompetitive effects. However, Industrial Consumers believes that entry into the transmission and distribution business is not easy—nor accomplishable in two years—given the nature of monopoly franchises, obstacles to siting, and "need justification" standard for regulatory approval. Stranded cost recovery also raises a significant barrier to entry by a new participant into the market, even under open access.

DOJ notes that market entry is not likely to mitigate the anticompetitive effects of a merger when there is chronic excess capacity because a new entrant would have to recover both operating and fixed costs, while the merged entity would need to recover only operating costs until excess supply is eliminated. FTC doubts that entry is significant for most electric power merger cases because it may take more than two years to complete new generation and transmission facilities (due to lags in regulatory approvals and construction). These forms of entry are unlikely to respond to an anticompetitive merger in time to deter or constrain the exercise of market power. APPA also believes that potential entry is not an effective restraint where existing capacity is concentrated.

On the other hand, CINergy suggests that even in the short run, pricing behavior can be constrained by potential entry because customers can make long-term commitments to purchase from developers of new generation resources and incumbent suppliers will account for potential long-term load losses in setting their prices in the short run. Southern Company argues that with open access, entry is now easy.

4. Factors Affecting the Market Analysis That Can Change Over Time

There is substantial support among the commenters for the use of dynamic standards, at least to some degree, rather than static standards that may become obsolete as competitive energy markets develop. Some²⁴ recommend that we consider both immediate and long-range effects of mergers. Others²⁵ believe that any anticompetitive consequences should be evaluated not only in the context of the industry as it is structured today (vertically-integrated

utilities serving both at wholesale and retail), but also as to how the industry may evolve. UtiliCorp argues that we should also consider the current state of transition in the industry when we examine merger applications that do not satisfy the market concentration and competition screen. It notes that requirements contracts currently in effect impede competition, but will cause the potential anticompetitive effects of mergers to be exaggerated because more alternatives will be available when the contracts expire.

Most commenters argue that, although open access may enlarge geographic markets and lower entry barriers, we should not expect that market power problems will disappear so that merger analysis will not be needed in the future. They believe that factors such as transmission constraints and lack of true comparability in the use of open access tariffs will continue to warrant market power and merger analysis.²⁶

UtiliCorp recommends that the Commission consider the contingencies of retail competition and restructuring as we analyze the future impacts on competition of market concentration, market power and mergers. Southern Company contends that the Commission should not consider retail competition issues because state regulators are effective watchdogs who protect the interests of retail customers and assess the impact of mergers on competition in retail markets.

Wisconsin PS argues that opening retail markets to competition will result in substantial uncommitted capacity on the systems of merging utilities and will put pressure on them to market capacity through a more intense use of their transmission systems. Centerior suggests that the market analysis may need to consider the effect of competition policies promulgated by the state at the retail level in the future. Excess capacity may increase if retail customers get the right to select a new supplier based solely on lower rates. Therefore, a utility that did not have market power in the past may find that it has increased excess capacity and may thus acquire market power.

CINergy suggests that restructuring should be considered in the review of mergers only if there is a plan already approved by the state regulator, with a set implementation schedule beginning within three years of the consummation of the proposed merger. Future potential changes in the basic structure or regulation of the industry should be addressed by exercising the continuing authority to supplement merger orders under section 203(b), including the possibility of requiring divestiture.

5. Consideration of the Separate Effects of a Merger of Transmission and Distribution Facilities

A horizontal merger of vertically integrated utilities can be viewed as a generation merger, a transmission merger, and a distribution merger. A merger of transmission-owning utilities may have various effects on the grid, such as better planning, coordination, fewer pancaked rates, and strategic control of regional

²³ These commenters include, e.g., Environment Action *et al.*, FTC, Madison G&E, MO Com, IN Com, and NY Com.

²⁴ E.g., Lubbock and Low-Income Representatives.

²⁵ E.g., Com Ed and CINergy.

²⁶ E.g., FTC, East Texas Coop, and Industrial Consumers.

transmission grids. NIEP urges the Commission to recognize that mergers of entities that own only transmission should not raise substantial competitive concerns if the transmission is operated by an ISO. CA Com and DOJ intimate that mergers may occur in order to avoid pancaked rates. CA Com recommends that the Commission use the open access tariffs to remove the anticompetitive factor of pancaking and thus make mergers less attractive.

Several commenters address the effects of mergers at the distribution level.²⁷ Some argue that the consolidation of distribution assets and the creation of large retail monopsonists are competitive concerns that we should address. IN Com believes that physical and economic interactions blur the distinction between the wholesale and retail sectors, requiring that the effects on the retail market be considered to analyze the merger implications in the wholesale market. It would reject a merger that has negative retail effects even if the merger has positive effects in the wholesale market.

Other commenters fault the Commission for disregarding market power in the distribution sector of the industry. They suggest that mergers are likely to increase barriers to entry into the distribution market and monopsony power over sellers of generation.²⁸ As larger distribution systems are created through mergers, smaller, independent generators may be disadvantaged because they lack the resources required to meet thousand-megawatt solicitations with complicated delivery requirements. Environmental Action et al. also contends that the larger distribution systems created by vertical mergers heighten the opportunity for anticompetitive self-dealing between the distribution and generation arms and diminish the prospect for effective retail competition.

6. Vertical Mergers

Com Ed suggests that, in the future, vertical or conglomerate mergers rather than horizontal mergers may offer strategic opportunities to utilities. It recommends that our merger policy be flexible enough to deal with differences in the concerns raised by such mergers and horizontal mergers.

7. Application to Electric Power Purchases

A few commenters raised the issue of monopsony power stemming from mergers. Joint Consumer Advoc. points out that a utility may exercise monopsony power over sellers of generation, obtaining power at a lower price than its competitors.

8. Linked Consideration of Contemporaneous Mergers That Have Interdependent Market Effects

Several commenters argue that the Commission should consider such mergers on a cumulative basis.²⁹ Some argue that one merger may alter the boundaries of the relevant geographic market in which the

other merger occurs; that is, transmission constraints in one market may be altered by new economy energy transactions associated with a merger in a neighboring market. APPA suggests consolidating contemporaneous proceedings that have interdependent market effects. Colorado Municipals notes that regulating the cumulative effect of contemporaneous mergers may be difficult.

III. Comments Concerning the Effect on Costs and Rates Factor

A. General Comments

Many commenters consider the effect on costs and rates to be a critical factor in deciding whether to approve a merger.³⁰ In fact, DOJ notes that the *Guidelines* recognize that some otherwise anticompetitive mergers may be justifiable because they produce important net efficiencies that, on balance, benefit competition and consumers (for example, through rate decreases).

However, commenters supporting this approach differ on how the costs and rates standard should be applied in cases where competitive harm is shown. For example, TDU Systems suggests that when a merger lessens competition, the Commission should not give substantial weight to cost savings and other benefits that could be achieved absent the merger. Moreover, the burden should be on the applicants to show that benefits not attainable without the merger outweigh the harm. IN Com recommends that applicants be required to show a low probability of harm to competition and to show significant, quantifiable net benefits to consumers. CINergy believes that the consideration of benefits should be limited to ratepayer protection and that applicants should be allowed to make an affirmative showing that such benefits will flow back to the ratepayers.

Other commenters argue that the costs and rates factor should be abandoned. For instance, Com Ed suggests that analysis of costs and rates has no place in an emerging competitive arena as long as mergers do not harm the competitive market, because prices will be set by market forces and customers can choose their suppliers based on price. Southwestern PS supports this view, arguing that most regulatory cost and rate issues that remain relevant are retail-related and under state jurisdiction; the Commission should defer to state commissions on such matters.

Others state that the analysis of the effect of the merger on rates is one of the most costly components of a merger analysis.³¹ They assert that in a competitive environment, there will be little need for the Commission to speculate about future costs, as utility managers will be reluctant to enter into mergers that would increase costs.

EEI argues that elimination of the costs and rates analysis would substantially reduce the time to prepare a merger application and the Commission's time to process it. Although merger efficiencies can be substantial, their measurement and allocation serve a limited purpose in the Commission's analysis. Merger applicants should not be required

(but can volunteer) to demonstrate merger efficiencies as part of a filing.

B. Determining the Net Benefits

We received a variety of comments on how to determine the benefits of a merger, the costs of the merger, and the degree to which one offsets the other. Many parties stress the importance of rate reductions.³² International Brotherhood contends that in an era when customers should be able to anticipate rate reductions from competition, rate freezes are not sufficient. Com Ed agrees that consideration of cost and rate impacts may still be appropriate for segments of the industry that are not competitive (transmission and distribution). The KS Com asserts that cost savings from combining the merging companies' stand-alone transmission and distribution systems should be evaluated and that we should require assurances that efficient transactions cannot be arbitrarily discouraged in favor of the merged entity. Some contend that we should look at the effect of a merger on the costs and rates of competitors; however, they admit that this may be another way of assessing the effect of the merger on competition.

Many commenters³³ assert that no weight should be given to efficiencies and benefits that can be obtained by means other than the merger. CA Com suggests that formation of ISOs may provide many of the transmission operational and efficiency benefits typically claimed by merger applicants. Others suggest that the Open Access Rule will facilitate coordination among utilities so that in some cases, mergers will not be required to achieve economies.³⁴ Some argue that we should refuse to count as a merger benefit the substitution of efficient practices for inefficient practices that could be achieved without a merger.³⁵ Personnel reductions may be one example, as many businesses are downsizing without merging. OK Com contends that many of the efficiencies proposed to be passed along to customers through lower rates may actually reflect unavoidable cost reductions forced upon the merging utilities by competition.

However, Southern Company cautions that, in assessing what merger savings could be achieved through coordination without a merger, the Commission must consider section 1 of the Sherman Act, which prohibits certain joint actions as anticompetitive and restricts the sharing of information between competitors. What appear to be benefits achievable outside the merger may only be achievable if the companies illegally collude.

NY Com proposes that, instead of relying on claimed merger benefits related to scale economies, the Commission should look at the results of the merger: how the merger will affect price, ease of competitive entry, and quality of service (for example, closings of customer service centers). Environmental Action et al. believes that, in comparing

²⁷ E.g., NV Com, NRECA, Joint Consumer Advoc., and TX Com.

²⁸ Including APPA, EA & CF of A, IN Com, East Texas Coop, Otter Tail, and Industrial Consumers.

²⁹ E.g., Environmental Action et al., IN Com.

³⁰ E.g., Industrial Consumers and Environmental Action et al.

²⁷ E.g., CCEM and NIEP.

²⁸ E.g., Joint Consumer Advoc, Environmental Action et al.

²⁹ E.g., APPA, NRECA, Environmental Action et al., Joint Consumer Advoc., and Colorado Municipals.

³⁰ E.g., CINergy, TDU Systems, IN Com, DOJ, and Centerior.

³¹ E.g., CINergy, PaineWebber.

costs and benefits, the acquisition cost and its rate treatment should be considered; it suggests that the Commission reject a merger if the merged company intends to seek recovery of the acquisition premium from captive customers. OK Com is concerned that mergers may require utilities to incur costs such as construction of transmission lines to meet the integration requirement.

Some commenters contend that the Commission should not count claimed savings if the applicants are not willing to bear the risk of not achieving the savings.³⁶ They say that the level of claimed savings is typically insignificant compared to total company costs. Industrial Consumers argues that the concept of savings from "deferral" of capacity is meaningless.

With respect to how net benefits of a merger should be calculated, some commenters maintain that claimed savings should be discounted to present value, as cost savings tomorrow are worth less than cost savings today.³⁷ RUS recommends that the Commission calculate the "revenues gained" by the prospective merged entity, adapted from the revenues lost approach set forth in Open Access Rule for determining stranded cost exposure on a net present value basis.³⁸

Several commenters contend that the savings claimed for previously approved mergers did not materialize. They urge the Commission to scrutinize claimed savings more carefully.³⁹

Low-Income Representatives recommends that the Commission carefully scrutinize claimed savings to ensure that cost reduction does not mean service or quality reduction. Environmental Action *et al.* notes that despite the vigorous efforts made by merging companies to win merger approvals with promises of rate reductions, little time is spent in Commission proceedings reviewing the effects on rates. It believes that more scrutiny on rates in the merger proceeding will establish more clearly, before final commitments are made, who is bearing what risk. It also explains that there are good reasons to be skeptical about savings from a proposed consolidation of generating assets because studies suggest that unit scale economies are reached at 400 MW and multi-unit plant economies at 1600 MW. Similarly, NRR1 states that for the majority of firms in the industry, average costs would not be reduced through the expansion of generation, numbers of customers, or the delivery system.

C. Allocation of Benefits and Costs

Several commenters raise the issue of how net benefits should be allocated between investors and customers. East Texas Coop says that net benefits should not include any part of the benefits allocated to shareholders; benefits not allocated to ratepayers cannot be claimed as a benefit to the public interest. APPA and NRECA want the Commission to

³⁶ *E.g.*, Joint Consumer Advoc., TX Com, and Environmental Action *et al.*

³⁷ Industrial Consumers, East Texas Coop, and RUS.

³⁸ Open Access Rule, 61 FR at 21662.

³⁹ Joint Consumer Advoc., TX Com, Industrial Consumers, and NRECA.

develop standards for allocating cost savings and other benefits among customers, ratepayers, and shareholders. NY Com further proposes that requiring merger applicants to share claimed savings between customers and shareholders would discourage utilities from overstating the claimed benefits of a merger.

Some commenters argue that an acquisition premium is a cost of the merger that should not be recoverable from ratepayers if it would lead to an increase in rates.⁴⁰ NY Com contends that allowing recovery of such premiums from ratepayers may inflate purchase prices and result in exaggerated claims of merger savings to increase chances of approval, rewarding the purchaser. OK Com would give rate consideration to an acquisition adjustment for mergers determined to be consistent with the public interest, and says that states should have a role in defining the public interest. Environmental Action *et al.* would prohibit the merger if the merged utility has a retail sales monopoly and the state does not have a policy of excluding the acquisition premium from retail rates.

Environmental Action *et al.* also believes that the proper cost allocation arrangement for a merging company, where the customer groups have different cost histories associated with different assets, is to have the price charged by the seller in inter-affiliate transactions be a market price. In this manner, the "buying" customers will take the power only if it is the best price on the market, and the "selling" customers will receive a reward commensurate with their risk. If the merging companies cannot, under this treatment, come up with sufficient benefits to satisfy the acquired company, the merger does not meet market standards and should not be approved. Environmental Action *et al.* claims that any other approach makes the acquiring company's ratepayers unwilling donors to the financial success of an expansion strategy.

IV. Comments Concerning the Effect on Regulation Factor

Most commenters agree that regulatory impact continues to be relevant and important. EEI argues that mergers could affect regulatory effectiveness either through impacts arising from the transfer of authority from one regulatory jurisdiction to another or problems associated with cost allocation. EEI notes that merger does not change the Commission's authority over transmission in interstate commerce and sales for resale nor state commission authority over retail rates. Neither does merger affect the Commission's ongoing jurisdiction to determine cost allocation and to specify proper accounting treatment of cost allocations generically.

Several commenters stress that mergers resulting in multi-jurisdiction utilities and creating possible federal preemption deserve special attention.⁴¹ OK Com also argues that regional regulatory bodies may be necessary in the future and is concerned that mergers

⁴⁰ *E.g.*, Joint Consumer Advoc. and NY Com.

⁴¹ NV Com, WI Com and NRECA.

can interfere with their effectiveness and formation.

CINergy dismisses the relevance of the effect on regulation, given that the Commission has held that a transfer of jurisdiction from one regulatory body to another in no way implies that regulation will be any less effective.⁴² CINergy agrees with the Commission's holding and suggest that the regulatory effectiveness criteria be eliminated.

Others commenters stress the importance of this factor, but link it to other factors. Southern Company recommends that analysis of this factor should be subsumed within analysis of the merger's impact on costs and rates. APPA believes that the analysis of the merger's impacts on regulation should be linked to a requirement that merger produce affirmative public benefits, including structural changes that enhance competition and reduce the need for regulation. It also argues that the Commission should give deference to state action when assessing the impact on state regulation, although the Commission must make the final call on this factor.

V. Comments Concerning the Other Commonwealth Factors

The other *Commonwealth* factors are evidence of coercion, the proposed accounting treatment, and the reasonableness of the purchase price. These factors elicited very little comment. As to evidence of coercion, a few commenters suggest that this should be evaluated by the marketplace rather than by the regulatory process.⁴³ Several commenters say that this factor should only be considered if someone demonstrates that it is relevant.⁴⁴ OK Com is among very few commenters who favor the retention of coercion as a criterion. It suggests that coercion is a means by which some companies try to gain oligopolistic control of the market in the coming competitive environment.

As to the accounting treatment, some commenters support elimination of accounting concerns as a factor.⁴⁵ PaineWebber notes that most recent mergers were mergers of equals, involving minimal premiums over current market prices. It suggests that a similar market discipline would likely cause shareholders to reject merger transactions involving large merger premiums and excessive amortization. Florida and Montaup argue that the accounting treatment of a merger should not be an issue for hearing unless an applicant seeks treatment different from the Commission's standards. Southern Company contends that the Commission's analysis of

⁴² Entergy Services, Inc. and Gulf States Utilities Company, 62 FERC ¶ 61,073 at 61,373-74, *order on reh'g*, 64 FERC ¶ 61,001 (1993), *appeal pending*, 94-1414 (D.C. Cir).

⁴³ East Texas Coop., EEI, PaineWebber, and Southern.

⁴⁴ Florida and Montaup.

⁴⁵ East Texas Coop., EEI, and PaineWebber.

Although they do not support keeping this factor, EEI and PaineWebber suggest that in light of broad industry changes, this may be the right time for a generic re-examination of accounting concerns, of which accounting for mergers could be a part.

this factor should be subsumed within the analysis of the merger's impact on costs and rates.

NY Com and OK Com are concerned about the accounting consequences of mergers. OK Com favors retention of the historical cost approach to accounting for plant acquisitions during mergers and business combinations until competitive market structures are achieved at the national, regional, and state levels. NY Com also urges the Commission to continue to require unrestricted access to all books and records of newly merged entities.

We also received a few comments on looking at the reasonableness of the purchase price as a factor. A number of commenters⁴⁶ urge that the Commission should not substitute its judgment for that of market forces, which will determine the reasonableness of the purchase price. Others⁴⁷ believe this issue should be examined only if its relevance is raised. However, OK Com argues that purchase price retains some relevance in this era of diversification. It is concerned that the purchase price may be based on expected returns on non-regulated investments, which, if they fail to materialize, may dilute utility stock.

VI. Procedures for Handling Merger Cases

A. Comments Concerning Filing Requirements

Some commenters⁴⁸ urge the Commission not only to spell out the precise standards it will use to review merger applications, but also to establish understandable filing requirements that clearly identify the necessary information on the effects of the proposed merger on competition and on rates. East Texas Coop says that having more substantive filing requirements and early access to computer studies and simulations would benefit all parties and the Commission. Low-Income Representatives believes that a merger applicant should be required to show that there is workable competition for each customer class in any market in which it participates. NY Com proposes that the Commission require merger applicants to submit estimates of the price elasticity of both supply and demand in the relevant markets, and an analysis of entry barriers to new supply. Southern Company advocates the adoption of filing requirements designed to support use of the *Guidelines*, as modified for the electric power industry.

Commenters also recommend that the Commission adopt new filing requirements to enhance and expedite our analysis of the rate impacts of merger applications. Florida and Montaup argue that the Commission should set out filing requirements related to merger cost and savings, which would have to be met only if the applicants claim that the merger results in consumer savings. International Brotherhood asks the Commission to require merger applicants to file an economic impact statement analyzing the effect of the proposed savings (many

achieved through layoffs) on the economy of the communities served.

Project proposes that the Commission require merger applicants to include an assessment of the environmental and related economic impacts of the planning and operational changes that are expected to result from the merger. The required information would include changes in dispatch, resource planning procedures, and resource acquisition plans; changes in emissions of SO₂, NO_x, CO₂, and particulates; and changes in resources devoted to research and development, DSM programs, and renewable technology investments.

Many utility commenters want a faster merger consideration process.⁴⁹ Some claim that delays in processing merger applications harm the public interest in various ways: utilities lose the ability to respond to market forces quickly (thereby retarding procompetitive restructuring efforts); benefits to consumers are postponed; investors experience uncertainty (creating problems in capital markets and the efficient flow of capital); utility employees lose productivity as doubts linger about their future roles; and the public loses confidence in the regulatory process. Some commenters argue that we could act faster if we looked at any one or two of the *Commonwealth* factors.⁵⁰

Com Ed believes that in the coming competitive marketplace, it will be important for the Commission not to allow the merger approval process to become captive to intervenors, who allegedly are often seeking merely to gain a competitive advantage through delay. Noting that the DOJ and FTC initial review process can be completed within 30 days, Com Ed and others question why the Commission's review needs to take significantly longer.

Some commenters ask for faster merger consideration for certain types of mergers,⁵¹ particularly for uncontested applications; mergers between a utility and a non-utility firm; mergers between affiliates; and mergers between small, non-dominant utilities. Haves and Brehrenda also advocate expedited treatment for: a disaggregation (an internal disaggregation within a holding company, a spin-off to shareholders, and a disaggregation coupled with a merger); a merger of a jurisdictional electric utility with a gas utility; a combination of non-interconnected electric utilities; and a merger of a jurisdictional utility with a company that is not an electric utility, even if the latter owns a power marketer.

Some utility commenters⁵² recommend that we identify specific time frames or themselves suggest time frames for the Commission either to rule on the application or to request further information. Florida and Montaup argue that we should not routinely set all merger cases for hearing. The Commission should use procedures that

would allow intervenors to conduct voluntary discovery before an application is set for full hearing and refer the proceeding to an Administrative Law Judge (ALJ) for the limited purpose of resolving discovery issues. Another suggestion is that we streamline discovery and coordinate the activities of parties with similar positions during the hearing and the briefing phases of cases set for hearing by working the ALJ.⁵³

On the other hand, some commenters argue that mergers that create large utilities are being processed too quickly.⁵⁴ They say that intervenors do not have time to obtain information and develop a case. Some of these commenters urge the Commission to lengthen the time period for interventions in merger proceedings, and to permit intervenors to conduct discovery during this period. East Texas Coop also requests that the Commission not allow answers to protests and not allow merger applicants to have a formal right to "the last word."

APPA and East Texas Coop both oppose the adoption of strict time schedules for Commission action. Many commenters urge the Commission not to approve a merger before it can assess adequately the effects of increased concentration in the industry.

B. Safe Harbor Suggestions

DOJ and EGA urge the Commission to "refine and sharpen" the focus of its merger review analysis so that mergers are processed more efficiently, with desirable mergers receiving swift approval, while undesirable mergers are set for hearing.

Other commenters⁵⁵ suggest that we use a two-stage process allowing a merger passing a safe harbor test to be approved quickly. EEI proposes detailed regulations covering pre-filing consultation, initial filing requirements, a two-step review process based on an initial market power screen (consisting of an initial filing and an initial finding order), the hearing process, appeal, and interests to be balanced by the proposed regulations.

Commenters generally suggest that the first stage analysis be simple, with basic filing requirements and, if the applicants pass certain merger screens, approval would be automatic or quick, perhaps with a paper hearing. Applications that do not pass the merger screen would face additional, more detailed filing requirements and a more in-depth second stage analysis, probably with a trial-type hearing. Some would allow ample opportunity to settle, however, and so avoid a lengthy hearing.

EEI urges that if a merger does not pass the initial merger review screen, it should not be rejected; rather, this merely indicates that the Commission needs to consider other evidence regarding the merger's impact on the competitive market.

East Texas Coop's two-stage procedure has a slight variation: the opportunity for an intervenor to show that a proposed merger will result in the strategic control of

⁴⁹ *E.g.*, Texas Utilities, Southwestern PS, Sierra Pacific, Southern Company, UtiliCorp, and EEL.

⁵⁰ *E.g.*, Southwestern, Southern, and PS Colorado.

⁵¹ UtiliCorp, PaineWebber, PanEnergy, Com Ed, Centenor, Southern, APPA, NRECA.

⁵² *E.g.*, Sierra Pacific, UtiliCorp, MidAmerican, and PP&L.

⁵³ PP&L.

⁵⁴ *E.g.*, International Brotherhood, Joint Consumer Advoc., East Texas Coop, and Environmental Action *et al.*

⁵⁵ *E.g.*, Texas Utilities, Southern, EGA, DOJ, CINergy, East Texas Coop, and NRECA.

⁴⁶ CINergy, East Texas Coop, EEL, PaineWebber, and Southern.

⁴⁷ Florida and Montaup.

⁴⁸ Missouri Basin, NIEP, Centenor, Florida and Montaup, APPA, and Southern.

transmission assets, even if the merger application passes the Commission's stage-one screens.

Some commenters⁵⁶ propose that if the safe harbor screens are satisfied, the merger should be approved automatically, either by the Commission's staff under delegated authority or under a "limited review" procedure. Under the "limited review" procedure, the case would be referred to an ALJ with a short time schedule to render a decision, after which approval would be granted by staff through delegated authority unless the ALJ or staff determines that the issue should be considered by the Commission. PanEnergy also argues that an unopposed merger should be approved by delegated authority without a hearing.

Various factors were suggested for setting the screens. Commenters suggest that the Commission consider the merged company's absolute size, its market share, its ownership or control of transmission, its affiliation with suppliers of competing forms of energy (such as natural gas), absolute market concentration, the effect of the merger on market concentration, whether a small group of firms could act in a collusive or coordinated manner, whether the acquisition is by a new entrant, and the existence of barriers to entry in the wholesale generation market in which the merged entity would participate, among other factors.

A number of commenters⁵⁷ recommend that the Commission use market concentration screens similar to those adopted by DOJ and FTC. With regard to the HHI screen used in the *Guidelines*, DOJ uses two HHI screens for a horizontal merger: (1) the increase in the HHI caused by the merger, and (2) the post-merger HHI. The *Guidelines* indicate that a merger falls within a safe harbor if the post-merger HHI for the relevant market is no higher than 1,000 or the increase in the HHI is no more than 50. (The HHI approaches 0 if there is a large number of small competitors, and is 10,000 if there is just one firm.) APPA would screen from full analysis any merger for which the market's post-merger HHI is less than 1000.

Other commenters⁵⁸ oppose a safe harbor or two-stage screening process to expedite merger approval. Some argue that this proposal would not give the Commission enough time to closely scrutinize the effects of the merger on such important factors as barriers to entry and short-term monopoly rates. PP&L argues that the Commission should not use merger screens until it has more experience with analyzing mergers in a more competitive electric market.

C. Coordination With Other Agencies

Many commenters say that the Commission should coordinate its consideration with that of other state or federal agencies. The New York Commission calls for improved coordination between the Commission and the states in order to give the industry clear regulatory guidance on the treatment of mergers during the transition to competition. NARUC, CA Com, and IN Com

suggest several alternative coordination options. Commenters offered the following specific proposals on how the Commission could coordinate better its merger review with those of the states.

First, several commenters support having a "scheduling conference" with the Commission and all state regulatory agencies. NARUC suggests that, when the Commission receives a merger application, we should convene a scheduling conference with representatives of the relevant state commissions to coordinate the schedules for the federal and state reviews of the merger applications. Such an arrangement would permit each agency to consider the merger proposal fully, while also providing state regulators with the means of conveying their views to the Commission. Sierra Pacific urges us to rely more frequently on joint conferences with state regulators.⁵⁹ Such an approach would expedite the processing of mergers, limit unnecessary duplication of procedures, and produce more uniform federal-state results.

Second, several commenters recommend that the Commission let state regulatory commissions complete their review and then comment in the Commission's proceeding.⁶⁰ NARUC and others observe⁶¹ that during the state proceeding, state regulators cannot take a position in a Commission proceeding without prejudging the outcome of the state proceeding. They ask that the Commission defer its decision until after state proceedings have been concluded, or that we give states a reasonable opportunity to conclude their proceedings before they must file testimony here. Similarly, APPA argues that the Commission should give deference under FPA section 201(b) to state determinations by adapting our procedures to allow states to intervene after state review is completed. The Commission could distinguish between two kinds of state intervenors: state consumer advocates or executive branch representatives, who must meet the same intervention requirements as do other parties; and state commissions acting in parallel on the same merger application, who would file later.

Third, a number of commenters say that there should be some joint federal-state vehicle to coordinate merger consideration with state regulators, such a joint filing requirement, a joint record, or a joint proceeding.⁶² Environmental Action *et al.* suggests that a merger application should be filed as one document with the Commission and relevant state regulatory commissions at the same time. PP&L asks that we require any state applications to be filed simultaneously with and attached to the Commission application. NARUC suggests that a joint record be developed by the Commission and the states. It also suggests that the Commission consider a joint proceeding. However, PP&L opposes this, arguing that because state commission issues and

procedures might differ considerably from those before the Commission, joint or concurrent hearings probably would not save any resources and could complicate the hearing process. Accordingly, PP&L argues that we should continue to process mergers separately from the states.

Fourth, some parties say that the Commission should defer to state commissions on certain matters. Some argue for deference regarding a merger's effect on retail costs and rates.⁶³ PaineWebber argues that the responsibility for determining the effects of a merger on retail customers is not subject to this Commission's review. NARUC, however, says that both state and federal regulatory agencies should evaluate a merger's effect on rates, as well as on generation competition and on access to transmission facilities. Similarly, some parties argue that the Commission should generally defer to state commissions regarding the impact of mergers on competition in retail markets.⁶⁴

Another suggestion is raised by the Ohio PUC, which proposes a specific new process for federal-state coordination of merger consideration. The purpose is to analyze market power in unbundled electric service markets, with the Commission assessing the merger's effect on transmission market power and the state commissions assessing the merger's impact on generation and distribution market power. The proposal contains five steps: (1) the applicants file their applications simultaneously at both the federal and state levels; (2) each state commission determines whether the merging utility operating in the state has pre-merger market power (with the several states sharing their data resources, methodologies, and modeling capabilities, and possibly undertaking a joint review); (3) the Commission analyzes the transmission systems affected by the merger, relying on a *Guideline*-type analysis to assure that transmission constraints do not create barriers to entry by competing generators; (4) all regulators then collaborate to determine if the merging entities will likely possess any regional post-merger market power; and (5) the merger is either approved outright, approved with conditions, or set for hearing by the various regulators. Whether it is set for hearing would depend on whether there is agreement among the state regulators that the applicants will possess no local or regional generation market power, and whether the Commission determines that no transmission barriers to market entry can be identified.

DOJ urges the Commission to adopt the *Guidelines* so that there will be consistency between DOJ and the Commission. As discussed above, many others echo this view. PP&L urges the Commission routinely to obtain the views of DOJ and the FTC about each merger application. Further, PP&L suggests that the Commission could require an evidentiary hearing if DOJ or the FTC suggests that a hearing is necessary or opposes the merger. PP&L also proposes that the Commission require the filing of the Premerger Notification forms that merging

⁵⁹ Citing Subpart M of our Rules of Practice and Procedure (sections 1301, *et seq.*)

⁶⁰ *E.g.*, NARUC, APPA, KS Com, Environmental Action, *et al.*

⁶¹ KS Com, Environmental Action, *et al.*

⁶² NARUC and Sierra Pacific.

⁶³ *E.g.*, Southwestern.

⁶⁴ Southern, NY Com, and OH Com.

⁵⁶ *E.g.*, Hawes and Behrends.

⁵⁷ *E.g.*, Utilicorp.

⁵⁸ *E.g.*, PP&L, Joint Consumer Advoc.

parties must file with the DOJ and the FTC under the Hart-Scott-Rodino Antitrust Improvements Act.⁶⁵ PP&L claims that the information in these forms would be useful to the Commission in evaluating mergers.

Several commenters argue that we should limit the scope of merger proceedings to issues that are directly related to the merger and not allow intervenors to raise extraneous issues or extract concessions.⁶⁶ Moreover, we should not use merger proceedings as an alternative means of promoting or requiring the generic restructuring of the electric industry.⁶⁷

D. Remedies

No commenter says that a merger must be rejected if it fails initially to satisfy the public interest test. Commenters recommend certain courses of action to remedy the initial failure. These include items such as: settlement; a merger condition closely related to the difficulty (*i.e.*, divestiture, releasing wholesale customers); and voluntary mitigation measures.

Several commenters ask the Commission to monitor the effects of a merger after it is approved either to verify claimed benefits or to detect anticompetitive effects that escaped the analysis.⁶⁸ We could grant relief from negative effects or impose new conditions.⁶⁹ APPA recommends that approval of a merger be conditioned on a post hoc review of market performance, including consideration of the effect on rates. EGA suggests that the Commission should impose "provisional" or "contingent" conditions on a merger; that is, conditions that the merged companies must comply with if certain future circumstances occur.

CINergy suggests post-merger analysis as an alternative to extensive pre-merger analysis. It urges the Commission not to burden merger applicants with a requirement to forecast potential merger effects under various industry and state restructuring scenarios. Such a requirement would paralyze the merger application process and yield only speculative results. CINergy suggests that, if the Commission does ask for such an extensive analysis, we should offer merger applicants the alternative of filing a new market analysis every three years for ten years after merger approval; as a condition of merger approval, the applicants would agree that if the Commission finds too much market power in a new market analysis, they will implement any necessary mitigation measures, including generation divestiture.

On the other hand, some commenters advise against post-merger reviews and conditions.⁷⁰ They argue that ongoing Commission review or a suggestion that approval may be reversed would introduce uncertainty in the market and prevent the proper pricing of a merger.

Most commenters do not deny that the Commission has authority under section 203 to impose conditions on its approval of a

merger. Rather, some commenters debate the scope of such conditions.⁷¹ Several say that the Commission has the authority to impose conditions only if there is a detriment to the public interest, and then only in ways related to the specific detrimental effects. Florida and Montaup asserts that there is no authority to order divestiture as a condition.

Project recognizes that NEPA does not expand our powers under the FPA. However, it says that the Commission has ample authority under the FPA, given its NEPA obligations, to condition its approval of mergers to promote NEPA goals and policies.

Several commenters urge the Commission to impose a particular condition on its approval of all or most mergers. Their principal argument is that mergers generally have a negative effect on competition. Recently, the Commission counterbalanced this effect by requiring open transmission access, which enhanced competition. The Commission should replace the open access condition with a new condition that enhances competition to ensure that the merger is procompetitive. TAPS, for example, supports this view.

Other commenters would impose a condition only to remedy a specific problem. For example, EGA and DOJ argue that the Commission should impose a procompetitive condition only to prevent harm to competition. TDU Systems suggests that the Commission consider mitigation of harm to competition only after it has assessed the likely competitive consequences of an unconditioned merger on the market structure. TDU Systems also believes that we should remedy each likely anticompetitive effect of a merger, even in cases in which the merger overall seems likely to have public benefits. Environmental Action *et al.* would approve mergers with anticompetitive effects only if the Commission can impose conditions that will mitigate the anticompetitive effects of the merger.

Some commenters distinguish imposing a condition on a merger (for example, an open access tariff that must be filed for the merger to be approved) from conditional approval of a merger (the merger is approved for now but if it has a negative effect, the approval can be revoked or made subject to a new condition). Several commenters (*e.g.*, NRECA, PP&L and RUS) caution the Commission to use only sparingly its authority to approve mergers on a conditional basis. While this "reach-back" authority may be appropriately used in "fast-track" merger approvals, it should not be routinely relied upon as a substitute for either the rejection or mitigation of mergers that are likely to have significant anticompetitive effects.

Centerior argues that conditioning authority should be used sparingly and only in those situations where the Commission finds that there is a high possibility of specific harm to competition. Commenters offer several arguments against imposing a generic merger condition or having a low threshold for imposing a condition.

Not all mergers are alike, so it is not appropriate to impose the same condition on

all merger approvals, according to others.⁷² A condition should be related to the effects of a specific merger.

Southern argues that any generic merger conditions would go far beyond the approach of the *Guidelines*, which are aimed merely at preventing mergers that would "create or enhance market power or facilitate its exercise." Generic merger conditions are typically designed to require merger applicants to establish positive merger benefits, contrary to FPA and antitrust precedent. Some argue that we should not use merger approval as a tool for achieving an unrelated policy goal. They say that this would discourage procompetitive mergers.⁷³

Commenters proposed over a dozen specific conditions for merger approval. Some conditions are proposed for all mergers and others to remedy a problem with a specific merger. Most of the suggested conditions are designed to mitigate market power or to ensure that rates do not increase as a result of the merger. The proposals are to require the merged company to:

(a) *Form an ISO.* Some urge the Commission to require merging parties to form an ISO or to participate in a regional ISO, resulting in single-system, regionwide, nonpancaked transmission rates.⁷⁴ For instance, the WI Com would require an ISO or transmission divestiture where the merging companies own a major transmission bottleneck. Otter Tail and Industrial Consumers view the ISO as one possible way to mitigate market power.

(b) *Divest generation or transmission assets.* Some commenters support generation divestiture as a remedy for an anticompetitive merger.⁷⁵ The FTC believes that this remedy would remove the anticompetitive effect of the merger without hampering its procompetitive or efficiency-enhancing aspects. Wisconsin PS would impose divestiture only if it would prevent the exercise of market power. Project would require all merging companies to separate their distribution assets and functions from the generation business within a reasonable time, creating legally and functionally separate entities to provide the different services.

Wisconsin Customers appear to advocate divestiture of transmission from generation and distribution as a condition of all merger approvals. It sees divestiture as preferable to an ISO because the Commission would not have to perpetually construct rules to avoid unfair use of the transmission system and then monitor compliance.

Both Southern and Centerior oppose divestiture as a drastic action that would probably kill efficient mergers or limit the ability of the merged company to compete.

(c) *Reform transmission pricing.* Several commenters argue that elimination of rate

⁷² For example, Southern, DOJ, FTC, and Wisconsin PS.

⁷³ For example, Com Ed, Southwestern, DOJ, FTC, Paine Webber, EEI, Wisconsin PS, and Florida and Montaup.

⁷⁴ TAPS, Wisconsin Customers, WI Com, and APPA.

⁷⁵ For example, FTC, PP&L, Wisconsin Customers, and Lubbock.

⁶⁵ 15 U.S.C. § 18a (Supp. 1996).

⁶⁶ *E.g.*, Southwestern, Com Ed.

⁶⁷ *E.g.*, Southwestern, Southern.

⁶⁸ *E.g.*, APPA, Joint Consumers Advoc., NRECA.

⁶⁹ *E.g.*, APPA, EGA, NRECA.

⁷⁰ Among others, PaineWebber.

⁷¹ For example, FTC, PS Colorado, Southwestern, and Southern.

pancaking should be a condition for all mergers.⁷⁶

APPA and TDU Systems urge the Commission to codify or apply as a general condition its current requirement of single system transmission pricing for all merged systems, unless the applicants show a public interest basis for different treatment. TDU Systems also suggests that all merging parties be prevented from reducing the transmission capacity presently available for use by transmission customers. Environmental Action *et al.* would prohibit market pricing for power transactions among affiliates of merged companies in regions lacking regional transmission pricing.

(d) *Eliminate transmission constraints.* Some commenters state that transmission constraints should be addressed by conditioning the approval of the merger on the applicants' building facilities to alleviate the constraints or taking other measures to eliminate local market power.⁷⁷

Competitive Coalition and TDU Systems suggest that where two constrained systems are merging, divestiture of transmission assets should always be considered.

Southern Company cautions against becoming overly concerned with remedying transmission constraints by imposing conditions or by market definition, since other potential remedies or alternatives exist.

(e) *Have retail access.* Competitive Coalition realizes that the Commission's authority does not extend to ordering direct access at the retail level, but suggests that the concerns over monopsony would be eliminated if merging parties offered open-access distribution. Industrial Consumers, supported by Otter Tail, recommend that, where necessary to avoid anticompetitive effects, we condition approval of mergers by adjacent suppliers on their agreement to provide nondiscriminatory direct access or a finding that a state's adoption of a direct access initiative avoids anticompetitive concerns.

(f) *Forego stranded cost recovery.* Several commenters see a need to require all merging parties to forego stranded cost recovery in order to mitigate market power.⁷⁸

(g) *Reform contracts.* Commenters argue that all merging utilities should be required to offer an open season for all of their wholesale requirements contracts and transmission contracts. UtiliCorp argues that many utilities and wholesale customers remain bound to requirements contracts that impede their ability to take advantage of the benefits of the recent competitive influences in the market.⁷⁹

To achieve unrestricted wholesale competition, Competitive Coalition calls for the complete unbundling of transmission services to be required of all merger applicants, including the transmission services contained in existing requirements contracts. It would also extend the

unbundling requirement to the transmission services embodied in pooling or bilateral coordination and joint transmission agreements to which merger applicants are parties.

(h) *Eliminate affiliate advantage.* APPA urges the Commission to adopt standard conditions for utility mergers to govern affiliate transactions.

(i) *Monitor achievement of claimed benefits.* Joint Consumer Advoc. argues that there should be a mechanism to monitor whether claimed benefits are actually achieved, but does not offer any specific proposals.

(j) *Freeze or reduce rates.* Several commenters advocate guaranteed cost reductions to be passed on to consumers or rate freezes by the merger applicants.⁸⁰ This would be a condition to overcome the potentially anticompetitive effects of the merger and to ensure that claimed benefits of the merger are received.

Environmental Action *et al.* believes that a better approach than rate freezes is to simply set rates appropriately.

Florida and Montaup argues that the Commission should not require rate freezes as a condition of approving a merger or a condition to avoiding a hearing on a rate freeze. WI Com discounts the value of a four-year rate freeze if a utility will no longer have restrictions on its pricing other than the market by the year 2000. It prefers a market structure that ensures that customers have access to many suppliers, none of which will be able to exercise significant market power over the long term.

CINergy, with support from OK Com, argues that rather than debating claims of net benefits, the Commission should protect customers by requiring all merging companies to commit not to recover merger-related costs from ratepayers. Low-Income Representatives would condition all mergers to: (1) continue existing rates, payment programs, protections regarding customer service, and shut-offs for low-income consumers; and (2) assure no impact on attaining or maintaining universal service.

(k) *Retain generation reserve sharing and other coordination arrangements.* TAPS and TDU Systems believe that the Commission should consider imposing a requirement that all merged utilities engage in joint planning and joint ownership of future facilities, continue to offer basic reserve sharing and coordination services, and continue to offer cost-based firm full requirements and partial requirements service.

(l) *Maintain reliability and the quality of service.* International Brotherhood would require every merger application to contain a plan to maintain or improve reliability and the quality of service.

(m) *Eliminate economic impacts.* International Brotherhood would require every merger application to demonstrate a lack of adverse economic impact on the economy of the communities served.

(n) *Eliminate environmental impacts.* Project would condition mergers to mitigate

significant adverse environmental impacts identified in an environmental assessment. It would require applicants to bring existing generation units up to standards comparable to the environmental restrictions on their competitors, in effect, to hold the environment harmless from merger-related impacts.

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DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Part 178

[Docket No. 96F-0101]

Indirect Food Additives: Adjuvants, Production Aids, and Sanitizers

AGENCY: Food and Drug Administration, HHS.

ACTION: Final rule.

SUMMARY: The Food and Drug Administration (FDA) is amending the food additive regulations to provide for the safe use of triisopropanolamine as a component of phosphorous acid, cyclic butylethyl propanediol, 2,4,6-tri-*tert*-butylphenyl ester, as a stabilizer for olefin polymers intended for use in contact with food. This action is in response to a petition filed by General Electric Co.

DATES: Effective December 30, 1996; written objections and requests for a hearing by January 29, 1997.

ADDRESSES: Submit written objections to the Dockets Management Branch (HFA-305), Food and Drug Administration, 12420 Parklawn Dr., rm. 1-23, Rockville, MD 20857.

FOR FURTHER INFORMATION CONTACT: Vir D. Anand, Center for Food Safety and Applied Nutrition (HFS-216), Food and Drug Administration, 200 C St. SW., Washington, DC 20204, 202-418-3081.

SUPPLEMENTARY INFORMATION: In a notice published in the Federal Register of June 19, 1996 (61 FR 31141), FDA announced that a food additive petition (FAP 6B4507) had been filed by General Electric Co., 1 Lexan Lane, Mt. Vernon, IN 47620-9364. The petition proposed to amend the food additive regulations in § 178.2010 *Antioxidants and/or stabilizers for polymers* (21 CFR 178.2010) to provide for the safe use of triisopropanolamine as a component of phosphorous acid, cyclic butylethyl propanediol, 2,4,6-tri-*tert*-butylphenyl ester, as a stabilizer for olefin polymers intended for use in contact with food. The additive, triisopropanolamine, was identified in the filing notice (61 FR

⁷⁶ For example, OK Com, NV Com, CCEM, and TDU Systems.

⁷⁷ For example, Florida and Montaup and Wisconsin PS.

⁷⁸ Industrial Consumers, Otter Tail, TAPS, and Wisconsin Customers.

⁷⁹ For example, UtiliCorp, CCEM, Wisconsin Customers, and Southwestern Electric.

⁸⁰ Joint Consumer Advoc., Industrial Consumers, Otter Tail, CINergy, Illinois Industrials, and Texas Industrials.