BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: : Docket Numbers:

TECHNICAL CONFERENCE ON THE COMMISSION'S : RM05-32

MERGER AND ACQUISITION REVIEW STANDARDS : RM05-34

- -x

Hearing Room 2C

Federal Energy Regulatory Commission

888 First Street, NE

Washington, DC

Thursday, March 8, 2007

The above-entitled matter came on for technical conference, pursuant to notice, at 10:05 a.m.

BEFORE:

JOSEPH T. KELLIHER, Chairman

FERC COMMISSIONER

APPEARANCES:

COMMISSIONERS PRESENT:

CHAIRMAN JOSEPH T. KELLIHER

COMMISSIONER SUEDEEN G. KELLY

COMMISSIONER MARC SPITZER

COMMISSIONER PHILIP MOELLER

COMMISSIONER JON WELLINGHOFF

P R O C E E D I N G S

(10:05 a.m.)

CHAIRMAN KELLIHER: Good morning. Welcome to the Federal Energy Regulatory Commission Technical Conference on Appendix A Merger Policy Review.

As Commissioner Ervin has just noticed, we're unbalanced. Two of our colleagues -- one of our colleagues, Marc Spitzer, will be joining us later today. He had an outstanding commitment this morning.

Jon Wellinghoff also had a longstanding commitment, but he is an avid watcher of FERC meetings, even technical conferences, and I think an IPod -- can you watch and IPod? I'm not a man of science.

I want to encourage everyone to make sure -- this is the most interesting conference available, so, Jon won't be tempted by an inflight movie or something.

(Laughter.)

CHAIRMAN KELLIHER: I'm sure he will watch our conference.

Let me just make some brief opening comments, and then turn to my colleagues, the we can start.

The Energy Policy Act of 2005, expanded the Commission's authority to review mergers and asset dispositions, granting us authority over holding company mergers and transfers of generation facilities.

I supported and advocated for this new regulatory authority, which improves our ability to prevent the accumulation and exercise of generation market power.

EPAct 2005's merger provisions largely codify the public interest test adopted in the Commission's Merger Policy Statement. The rulemaking that implemented our new authority through Order 669, the Commission received comments asking us to revisit our merger review policy, which would be the Appendix A analysis used to measure horizontal market power.

The Commission is holding this technical conference to address concerns that we should consider revising our criteria for analyzing mergers, in response to the changed regulatory environment associated with the repeal of the Holding Company Act and the new authority under Section 203 that Congress gave us in EPAct, as well as changes within the industry.

In response to these comments, the Commission committed to hold a technical conference to learn more about these concerns once we've had an opportunity to gain more experience in evaluating Section 203 applications, using the new authority granted to us by Congress in EPAct 2005. Having attained that experience using our new authority, the Commission has today followed through on our commitment to hold a technical conference to learn more about whether

there's a need to revise our merger review policies.

On December 7, 2006, the Commission also held a technical conference that considered, among other things, whether the Commission needs to take additional actions to guard against unlawful cross-subsidization in reviewing Section 203 applications.

Today we invite panelists to share their views on whether the Commission should revise the other factors that it uses in analyzing mergers and dispositions under Section 203, namely, the transactions' effect on competition, rates, and regulation.

We also invite panelists to address whether the Commission's current tools for measuring a merger's effect on competition, as described in Appendix A of the Merger Policy Statement and the accompanying merger filing requirements rules, adequately address a merger's effect on competition.

We would also appreciate hearing panelists' views on whether the extent of coordination, including information exchange, is appropriate between the Commission and others with jurisdiction over utility mergers.

I just want to thank each of our panelists for being here today, and look forward to hearing your views. I'd like to ask my colleagues if they'd like to make a statement.

COMMISSIONER KELLY: Thank you, Joe. In the Order No. 669's rulemaking, a number of commenters, a number of them represented here today, recommended that we rethink our current merger policy and make decisions as to what "consistent with the public interest" means, in light of amended Section 203 and the repeal of PUHCA of 1935.

We responded in that rulemaking, that we thought that our existing standard of review, is flexible enough for us to consider any changes in market structure that ultimately result from the Energy Policy Act of 2005 and the repeal of PUHCA of 1935.

However, we also said that once we had gained some experience with evaluating mergers under Section 203, under the new statute, we would consider reevaluating our merger policy, in general.

That time has come today. In fact, I was looking at some statistics. Since 1996, when FERC announced its existing merger policy and issued the Merger Policy Statement, FERC has approved a total of 69 mergers or about seven a year, and, consistent with those statistics, since we issued or since our new regulations for Section 203 became effective in February of 2006, we have approved eight mergers.

Perhaps some of the more prominent of the recent mergers that were decided under the new Section 203, were

between KeySpan and National Grid and Northwestern Corporation and Babcock and Brown Infrastructure, Limited.

It's likely that the proposed $45 billion acquisition of TXU by Kohlberg, Kravis, Roberts & Company and Texas Pacific Group, will also be subject to review by FERC under Section 203. Although the bulk of TXU's transactions take place within Texas, they do have a FERC-approved market-based rate tariff on file.

I think it is timely for us to be undertaking this review, and I want to thank the panelists that have come today, and the commenters who asked us in the 669 proceeding, specific questions to take into account. Thank you for being here today and helping us to answer those questions.

CHAIRMAN KELLIHER: Thank you. Commissioner Moeller?

COMMISSIONER MOELLER: Thank you, Mr. Chairman. I want to echo, particularly, Commissioner Kelly's comments, and I appreciate the efforts all the panelists have made to be here to give testimony to us. I look forward to a good discussion today. Thank you in advance for being here. I look forward to the next five hours.

(Laughter.)

CHAIRMAN KELLIHER: I hope Jon has a long flight.

I'd like to now recognize the Honorable Sam

"Jimmy" Ervin, IV. I didn't realize you had Roman Numerals after your name. He's a Commissioner with the North Carolina Utilities Commission and Chairman of the NARUC Electricity Committee. Welcome.

MR. ERVIN: Mr. Chairman and members of the Commission, I appreciate the opportunity to speak with you briefly this morning.

In thinking about what I might say, it would be helpful -- I was reminded of the old admonition that a little learning is a dangerous thing. I have very little learning and so I'm particularly dangerous this morning.

I want to speak to you, not so much about the competition measurement issues, which were discussed in the Notice, but rather to talk with you a little bit about concerns with respect to mergers.

As you indicated, I serve both on the North Carolina Utilities Commission -- and we have handled a number of mergers in recent years -- I'm not really planning on talking about any of those, in detail. I'll be happy to discuss them with you, if you'd like.

I thought it might be more helpful, given that I was in my role as NARUC Electricity Committee Chairman, at least partially responsible for the comments that NARUC filed in the PUHCA reform proceeding, in the Section 203 rulemaking proceeding, to at least talk with you a bit about

some of the things that I learned in that process, that pertain to those portions of the rules and practices that are of particular relevance to state commissions.

The first thing I would emphasize to you, is that there is a wide variety of opinions within state commissions, as to how you ought to answer the substantive questions brought before you.

I think, given that different states have very different degrees of reliance on wholesale markets for the provision of service to their retail customers, we have a fairly wide variety of views within the state commission community as to how FERC ought to exercise its authority.

I think, in reflecting on what I have heard my colleagues say about those subjects, it seems to me that one of the things that you ought to seriously take into consideration in thinking about the portion of your Appendix A standards that deal with the impact on state regulations, is to look at, in a more granular way, what state transfer statutes actually look like, because we find ourselves ranging from a situation in which there is no transfer statute, to situations like the North Carolina experience, where have a pretty bald transfer statute that allows us to review all transactions that affect the utility franchise, statutes that fall somewhere in between, that would affect direct transfers of the franchise, but might not apply to

holding company transactions.

So, as you look at how you apply that portion of your existing standard, that discusses the impact on state regulation, I think you might want to give some thoughts to looking at state transfer statutes on a more granular level, because of the fact that they may or may not apply to a greater or lesser extent, given the changes that we've seen in the industry, with increasing use of holding company structures and other things like that.

For those of us who live in a traditionally-regulated world in which we don't have a huge reliance on the wholesale market, but rely on it more as a backstop for the power to supply the customers, we continue to look at the same kind of things that I think state commissions have traditionally looked at, such as:

What's going to be the impact of the merger on our rate jurisdiction? Do we need to impose any conditions to protect it? Are we going to have an increase in the extent of affiliate transactions, and do we need to impose additional accounting rules, in order to protect ratepayers from the acknowledged dangers of such transactions, recognizing that they can also have benefits?

Do we need to look at internal cost allocation issues, to a greater extent than would be the case otherwise? That's the kind of thing we tend to look at.

My colleagues, particularly in the states that are served by organized markets, or who have moved to restructure the retail electric delivery systems, I think, are more dependent on the FERC than was the case under the old regime.

My sense from talking to some of them, is that they are interested in having you take a more detailed look at certain transactions, because, having placed greater reliance on the wholesale market, and recognizing that the wholesale market is primarily subject to your regulation, they have, in effect, placed their trust in you to look at those transactions and to make sure that there is no adverse impact on wholesale competition, because, if there is, that could have some pretty direct effects on their regulation.

As I look at the portion of Appendix A that talks about the consideration of the effect of mergers on state regulation, it seems to me, therefore, that your existing approach, generally, which is to say that if a state commission has transfer authority, that you can rely on the state to protect itself, is probably appropriate, and I would urge you to continue to adopt that approach, as a general matter.

However, I would urge you to look at state statutes, to perhaps communicate with the state commissions to see if they believe that they may have some more nuanced

problems with applying their statutes in a particular set of circumstances, to make sure that the mere existence of the transfer statute, does, in fact, give them complete control or not, and then to act accordingly.

I think the state commission is the best judge of the adequacy of its own jurisdiction, so I think that's the source at which you ought to look for that information, but I do think that that more nuanced look at that issue, is probably appropriate, given the situation in which we find ourselves.

I was invited by your Staff, also to briefly touch upon an issue that's really on the afternoon agenda, rather than the morning agenda, which is the coordination issue.

I think that as we have bigger and bigger companies that affect more and more states, coordination becomes important. We need not to be making decisions that touch upon the same issues in inconsistent ways, where possible.

I think it is wise that we try to figure out how to do coordination in a better way than perhaps has been done in the past. It's difficult for me, as a state commissioner, to see how to do that, given that we wind up, typically, being involved more with the process, but I do believe that there ought to be some way that we can explore

how to at least share information without violating our free judgment or ex parte statutes, to perhaps get a better understanding of how we each approach these questions, in the hopes that our view is both more focused at the federal level and the state level, and to avoid placing any more burden on parties, regardless of what they may think about the merits of the particular proposal.

We have had a number of instances in recent years, in which we have tried to form joint working groups. This may be another one that's worth thinking about.

I wish I had some more specific suggestions that I could give you this morning. I spent three hours in the Raleigh-Durham Airport last night, waiting for my flight to get up here, but I did not have inspiration as I sat there.

(Laughter.)

MR. ERVIN: Whether that means the airport is not conducive to great thoughts, or whether my mind is limited, but I do think it's worth considering, and, with that, I look forward to hearing from my more learned colleagues to my left, and I appreciate being invited.

CHAIRMAN KELLIHER: Thank you, Jimmy. I now recognize Sue Kelly, the Vice President of Policy Analysis and General Counsel of the American Public Power Association. Welcome.

MS. KELLY: Thank you very much. Let me

apologize to Commissioner Ervin for not knowing how to kill myself.

Thank you very much for asking me to represent APPA at this conference. APPA has a longstanding interest in the Commission's policy for evaluating mergers.

In January of 1996, we jointly filed with NRECA, a petition with the Commission, seeking to have it review its then-existing merger policy. That's what resulted eventually in Order 592 and 592-A and the Appendix A we now have.

Approximately ten years have passed since then. Interestingly enough at the same time, the amount of time has passed that caused you to revise your open access tariff, and for the same reason we think it's time for you to take a look at your merger policy.

A wave of independent power generators and marketers have entered the industry and have constructed a fleet of natural gas-powered electric generation.

Many of those suppliers have now gone, through bankruptcy or exiting the industry entirely, or selling the generation assets, or turning them over to their lenders. I think this vividly illustrates the high barriers to successful long-term entry into this industry.

Approximately 25 states have implemented retail access, and many of them require their public utilities to

sell off their generation. Those assets, in many cases, were purchased by unregulated affiliates of the same utilities, or by unregulated affiliates of other utilities in other parts of the country.

Most of the retail access states are in the footprints of RTOs, which operate centralized wholesale markets for day-ahead and spot energy and ancillary services, and are now implementing capacity markets.

And that definitely changes the landscape, and the regulatory landscape has changed, as well.

In 2005, Congress repealed PUHCA, eliminating SEC review of holding company mergers, and previously associated integration requirements. Congress in 2005 also amended Section 203, as you noted, giving the Commission explicit jurisdiction to consider cross-subsidization issues and jurisdiction over acquisition of generation assets.

Given all these events, we believe it's an appropriate time for the Commission to examine its merger policies, and we thank you very much for holding this conference to start that process.

With these thoughts in mind, I respond to the four questions posed by the panel. Actually, I wish I had the luxury to say what I really want to say, but I'm going to respond to the questions from the panel.

I hasten to add that I'm a regulatory lawyer; I'm

not an economist; I'm not an antitrust lawyer; I'm a FERC practitioner, for good or for ill.

The first question asks whether Appendix A effectively measures the effect of long distance mergers on competition. The long-run implications of PUHCA repeal are not going to be known for some years, because of the integration requirement.

PUHCA, at least when it was fully enforced by the SEC, discouraged long distance mergers. That was the case when the Commission adopted the Appendix A analysis, hence, geographically distant mergers, are much less likely to be filed with you.

Now it's off the books, and we an easily see more such mergers. We believe such mergers raise unique competitive concerns that Appendix A, as now applied, does not capture.

One concern is foregone competition between potential competitors, even where those entities are not currently strong competitors in overlapping markets.

The SEC actually raised this concern in Order 642, the docket where you did the actual filing requirements to follow on to Appendix A.

Even if a regulated public utility operates in a single footprint, it's likely to have unregulated affiliates that operate in other markets around the country, and if two

such public utilities were to merge, it's much less likely that both sets of affiliates will compete in either one's home market or in another market.

We also think the Commission needs to examine the increased risks of collusion or oligopolistic pricing, which may arise when the same reduced set of competitors meets again and again in different markets.

We're especially concerned about the RTO-run centralized markets with their repeated auctions and repeated opportunities for interaction and observation.

The second question asks whether Appendix A effectively measures the effect on competition in mergers involving applicants in RTO markets.

Appendix A relies nearly exclusively on a concentration analysis. APPA is quite concerned that concentration measures alone, such as the HHI -- and I will not even attempt to say what that stands for -- are not adequate to analyze competition in electricity markets.

Concentration measures may not reveal harms associated with the potential for market power exercise, even where the merged firm's markets share is below what would be typically deemed troublesome in most industries.

Some academic studies seem to indicate that, under a centralized RTO market, it's possible for bidders with relatively small market shares, to influence price

outcomes and for bidders to engage in what they call repeated games that can maximize their profits at the expense of consumers.

We're also concerned that the Commission does not examine competitive effects on all different wholesale power products. Since our members are often net buyers and depend on long-term load-following-type products, we're very, very concerned when public utilities merge, because those are the entities most likely to be able to supply that type of product to us.

The third question asks whether Appendix A adequately considers the effects of generation-only mergers and acquisitions. We are concerned that Appendix A may not adequately take this into account.

Due to the financial distress of many of the new entrants, many of their projects have changed hands many times, some ending up in the hands of financial players and others in the hands of incumbent utilities.

These individual transactions are often pretty small in the big picture of things, but taken together, we are concerned that they could be the death of a thousand cuts for the competitive generation markets.

The last question is whether changes were needed in how Appendix A accounts for transmission constraints. Commssion practice under Appendix A recognizes the role of

constraints in market definition, but, frankly, it's up to the applicants, who are the ones who prepare the Appendix A analysis at the present time.

The question is whether they recognize these transmission constraints. If they don't, it's up to the intervenors to try to point that out.

I want to close by suggesting some other lines of inquiry for the Commission, as it reviews it.

Do these policies, your current merger policies sufficiently evaluate the more traditional side-by-side mergers that they are intended to look at?

The Commission's Appendix A analysis is largely based on the DOJ's horizontal merger guidelines, yet the Commission and DOJ have, in certain cases, reached different conclusions about the competitive implications of these same mergers.

Certain states have taken an even more activist approach than either DOJ or FERC, and I guess the question arises, why are these various agencies and entities seeing the same merger differently? And that goes, perhaps, to the question that Commissioner Ervin raised.

Is the Commission considering the potential long-term effects of the new kinds of players that are now entering the industry, such as financial institutions with substantial trading books and activities in financial

markets, private equity firms, and hedge funds?

PUHCA's limitations on other lines of business, could discourage, in many cases, such entities from entering the industry. Well, now, PUHCA is dead and the barbarians are here at the gate.

Since the Commission uses a broad, "consistent with the public interest" standard, should it be looking at applicants' business strategies, in seeking to protect ratepayers from the adverse consequences of strip-and-flip type strategies, and should the Commission consider better coordinating its market-based rates and its merger policies?

Right now, they operate in completely different spheres of influence, with different standards, although a delivered-price test is a common feature of some or both of those. Should you consider expanding your toolbox of possible conditions on merger approvals?

Additional remedies could include requiring the applicants to offer joint ownership in their existing transmission facilities, or participation possibilities in new transmission or new generation. You knew I couldn't get through a presentation without mentioning joint ownership.

These may seem radical proposals today, but conditioning merger approval on the provision of open-access transmission service, once seemed radical, too.

I want to close by noting that you are the only

federal agency that has, as your core mission, the regulation of wholesale power markets and to guard consumers from the exploitation by non-competitive power supply companies. That's not the role of the antitrust agencies.

This mission is critical to your consideration of mergers under 203. If you allow endemic market structures to undermine wholesale power markets, then you can't rely any longer on competition to discipline rates to just and reasonable levels.

That's going to bring on a whole host of other problems, so this is truly an area in which an ounce of prevention can mean a pound of cure, and I just urge you to timely review all of these policies, given the environment in which we're operating.

Thank you. I look forward to your questions.

CHAIRMAN KELLIHER: Thank you very much. I'd like to now recognize Dr. Darren Bush, Assistant Professor of Law at the University of Houston Law Center.

MR. BUSH: Thank you, Mr. Chairman and Commissioners and FERC Staff, for giving me the opportunity to speak today about merger policy in the context of the electricity industry.

More importantly, I want to thank you for asking the hard questions about the direction of FERC merger review, in light of the experiences in merger enforcement

over the past decade.

My remarks here today, are my own, as I, quite sadly, do not represent anyone.

(Laughter.)

MR. BUSH: I speak today, based upon my experience as an Antitrust Division Trial Attorney focused on matters involving the electricity sector, as an economist, and as a law professor whose research, writing and obvious, for that matter, focus on antitrust issues arising in the context of the regulated and deregulated industries.

A basic underlying purpose of any merger analysis, is to determine whether, under a theory of harm, the merger could injure competition, in general, and consumers, in particular. This theory of harm and any eventual discovery as to the theories of validity, unifies merger analysis.

Absent a theory of harm, any merger analysis is without guiding force, potentially causing a disconnect between the merger analysis and the proposed remedy, and potentially creating Type I and Type II errors by requiring a remedy in instances where no harm arises and by missing harms that do not fit into preordained relevant markets and concentration statistics. Appendix A analysis, quite frankly, fails to consider this relationship between

consumer injury, the relevant market, and the remedy. As an example, compare the DOJ's analysis in Exelon, with the Commission's analysis.

The DOJ espoused a fuel curve theory of harm, namely, that the combination of marginal generation assets at inframarginal units, created an incentive and ability to raise prices in wholesale energy markets in PJM East and PJM Central East.

DOJ's remedy was designed to eliminate the ability of the firm to increase wholesale prices by requiring divestiture of specific marginal units.

In contrast, FERC, it seems to me, posited harm to be a violation of the merger screen itself, without further analysis. The imposed remedy was de-concentration by virtue of actual divestiture of unspecified assets.

The question arises as to what harm FERC is seeking to eliminate, apart from increased market power. Certainly, the fuel curve theory of harm was not considered, as divestiture did not specify particular assets.

This leads me to my second point: Appendix A analysis by FERC, is based on traditional horizontal concentration in nontraditional markets, and may miss serious competitive effects in particular relevant markets.

I've already just mentioned the fuel curve theory of harm, and how Appendix A might miss a fuel curve theory.

Vertical considerations such as those encountered in P-Anova, and issues concerning transmission manipulation, are, similarly, not addressable under a next-day analysis.

Moreover, harms related to mergers of noncontiguous entities, may not be addressable, either. The largest theory of harm related to noncontiguous mergers, is perhaps the Potential Competition Doctrine.

The horizontal merger guidelines theory referred to in the DOJ's 1984 guidelines, had as an authority on non-horizontal mergers and thus includes potential competition in non-horizontal analysis.

While the horizontal merger guidelines view what some courts might consider to be potential competitors, as either in the market or entry that mitigates anticompetitive harm, there are certainly some other potential entrants that are treated under an entirely different framework.

Such determinations are highly fact-intensive. Rudimentary market shares are not sufficient.

Indeed, often, the subjective views of the parties regarding perceived potential competitors are necessarily obtained through documentary evidence. It is possible, however, to devise a test for determining whether merging parties are potential competitors, as has been done in the 2004 Wisconsin Law Review article by two Department of Justice alums, one of which happens to be me.

However, such an analysis is deeply document-intensive, by necessity, and not suited for inclusion in Appendix A analysis.

My final point concerning Appendix A analysis, arises from the starting point of a merger analysis, namely, defining the relevant market. HHIs hinge entirely upon how one defines the market and the modeling techniques of the merging parties.

I will leave it to others to discuss the latter issue, but I want to address my deep concern about defining relevant markets in a vacuum.

First of all, geography plays a crucial role in this industry, perhaps greater than those in the general economy. Geographic constraints are not continuous in time; they vary by hour, day, season, depending on the nature of transmission constraints.

Thus, it cannot be the case that we can assume that the relevant market is an RTO or ISO. Certainly, the Exelon case and NRG, speak to that.

Facts must be obtained in order to support any relevant market determinations. This is easier in RTO markets, as the facts already exist in the form of data already gathered by the RTO, but it's much more difficult to determine in non-RTO markets. In such markets reliance on traditional standard tools of gathering information is

required.

Fourth, it may not be the case that the Commission can assume a single relevant product market. In addition to the capacity and energy markets, it may be defined by the ISO or RTO.

There are potentially products which certain customers seek in a bundle, thus, an examination of the industry-recognized markets, may be insufficient.

Also, determining whether entry will mitigate anticompetitive conduct, cannot strictly be based upon the de-concentrating effect of such entry into the market.

The geographic location of the generating unit entering the market, might be critical, as well as cost of providing energy.

I hope I have communicated that merger review is fraught with, well, peril. It is highly subject to determinations as to relevant markets. Often, traditional market screens will completely miss the harm caused by the merger, thus, I fear the search for a merger screen is a quest for the Holy Grail, and, by relying on the economic analysis of applicants with an obvious interest in enhancing the effects of a transaction, while minimizing their anticompetitive harms, the Commission has relied upon analysis that is biased -- and I'm using that in the strict academic sense of the term -- from the outset.

Instead, I believe the Commission should focus its efforts upon what authority it has to investigate mergers, how it might be able to obtain competitively-sensitive information from the parties, without that information being shared with others, to the detriment of the market.

It should also focus the filings of the parties to provide the Commission with the raw information necessary to examine the theories of harm I have outlined above, and it should require the applicants' information analysis, demonstrating that the first transaction does not raise any of the described concerns.

To conclude, the detection of market power is not for the faint-hearted. It requires rigorous analysis and large amounts of information, and serious thinking about the boundaries of the market, including: Consumer preferences, available supply, transmission constraints, and the multitude of electricity products offered, and the like.

It also requires an examination of entry, potential entry, potential exercises in conduct, and a whole host of other things. A market power screen, properly applied, may determine in some instances, the boundaries of the market and market shares within that market.

However, it will not capture certain types of conduct, particularly if the screen is slavishly applied,

such that facts indicating different market analyses that ought to be undertaken, are ignored.

In sum, screens are not the Holy Grail of market power detection. Econo-market power screens is a link, while Grail-shaped, and are barely that.

The screens fail to heed the caution implicit in the guidelines that the market actually is explicit in the guidelines, now that I remember. There's a passage there, "Markets are complex enough that rigid application of the guidelines, may not lead to the right answer."

Worse, they ignore the fundamental purpose of the exercise in question, a determination of whether the merger yields anticompetitive conduct that injures consumers.

The guidelines' caution regarding rigid application rings particularly true in electricity markets, and the Commission should be wary of using screens that would be unable to detect many instances of exercises of market power. Thank you.

CHAIRMAN KELLIHER: Thank you, Dr. Bush. I'd like to now recognize Dr. Mark Frankena, Deputy Director for Antitrust, Bureau of Economics, Federal Trade Commission. Welcome.

MR. FRANKENA: I would like to thank all the people in this semicircle in front of me, for inviting me and giving me the opportunity to share some views about some

important topics.

I should start with a couple of disclaimers. First, I'm required to say that all the views I express today, are my own, alone, and they do not represent the views of the Federal Trade Commission or any individual Commissioner.

I will say that that disclaimer is not as complete as some disclaimers we've used. There was a time, many years ago, when we wrote a report and we put that standard disclaimer on it, but in addition, we couldn't get anybody who was willing to put their name on it. So it said that it was only the views of the author, but there was no author.

(Laughter.)

MR. FRANKENA: The second disclaimer is that I spent a lot of time working on electric utility mergers, up until 2001. I spent about 12 years working on mergers. I appeared many times and testified many times at the Federal Energy Regulatory Commission and state commissions and so forth.

But in 2001, I decided to do something different, and I went back to the Federal Trade Commission, so I haven't looked at an electric utility merger, nor Appendix A in six years, so this is a bit of a time warp in that sense. So, if I say something that seems out of date, it is out of

date.

But, on the other hand, perhaps what I do bring, is familiarity with how antitrust analysis is done at the antitrust agencies, in particular, the Federal Trade Commission.

I have a handout, I'd just point out, which lists a number of publications that amplify the various things I'm going to be talking about.

I think we can all agree that even though we may disagree about certain things, I think we can all agree that the proper analysis of market power in the electric power industry, is a really challenging task. It's hard.

With that in mind, what I'd like to do, is spend the next few minutes providing some background on the analysis of market power, by telling you a bit about how we approach things at the Federal Trade Commission.

Then I'll make a few brief comments about Appendix A. I will talk mostly about what goes on in a merger investigation when we're looking at a horizontal merger at the FTC.

The first thing of course, is -- the question always before us, is whether the merger is likely to reduce competition and lead to higher prices.

One of the things we have to do to answer that question, is understand what is constraining prices, absent

the merger.

You can't very well analyze what effect the merger will have on prices, unless you understand what's going on now. What is it that's keeping the suppliers in the market from charging higher prices right now? That's the thing you have to start with.

So, then what you're doing -- what you understand now, is that this is what's constraining prices now. That's largely what we do in defining the market.

I like to stay away from the jargon of defining the market and think about what the issue really is. We need to understand what's constraining the prices, then the next step in that is, you need to figure out how the merger is going to change things.

How is the merger -- is the merger going to make it profitable for somebody to raise prices for some reason? Is the merger going to make it easier for firms to coordinate, reach an anticompetitive agreement, monitor it, and so forth?

That's really what we do. Then the rest of it is a matter of tools. How do we figure these kinds of things out?

One of the things we always do early on in the investigation, is, we always try to think of some stories -- the fancy name for them is theories of competitive harm --

we always try to think of some stories about how -- sort of hypotheses about how the merger might affect prices.

So, for example, an example of a story would be that the merger is going to make it more profitable for the merged firm to reduce output at that plant over there. Then we analyze whether the merger is going to do that.

Another type of theory would be that the merger is going to make it easier for the big players in the market to reach an agreement that's anticompetitive, and to monitor that agreement and so forth -- coordination.

But we always have a number of theories like that, because that then guides the investigation as to what you need to look for. And then when we present a conclusion about the merger, we always present it in terms of here's our finding, you know, these were the theories we looked at, here's what we found, and, you know, to recommend challenging a merger, based on the likelihood that it will have this particular type of effect.

Okay, you'll notice I haven't even mentioned market share and HHIs yet. It's important to notice where that comes in.

Then we have a big investigation. Basically, the staff is trying to develop evidence to evaluate these theories. The question is, what are our sources of evidence at the FTC?

I think there's three basic categories: One is that we spend a lot of time with interviews and depositions of all the market players, everybody who might know how the market works and so forth. Particularly in a lot of our mergers, it's a really important group of customers.

I mean, obviously, you don't go to the person who buys at the supermarket, but in a lot of industries, there are customers who are sophisticated enough to give you good insight as to whether this merger is likely to make them better off of worse off.

So, some of those interviews are done with the use of compulsory process, where, in depositions, we depose people from the merging companies. The next thing is that we require the merging companies and often other companies, as well, in the market, to provide us with a lot of documents -- market plans and all sorts of confidential documents, which we hold confidential.

This is crucial for our understanding of how the market functions. We want to see what's inside their heads, what's their understanding of competition and so forth.

That's what we use in what we call the Second-Request Process. Once we think there's reason to investigate, we issue, basically, a subpoena for categories of documents.

The third basic category of evidence we look at,

is what we call quantitative analysis of data and so forth. So, the first category there -- one thing we do, is, we delineate markets, we calculate market shares, we calculate concentration measures known as the HHI, and that sort of thing.

The question is, what role does that play? The main role that plays, is that it tells us sometimes that the market isn't sufficiently concentrated to be concerned, and then we can close the investigation.

These market shares and stuff, are not the analysis. We don't sort of -- I mean, once we've decided to launch the investigation, then the market shares go back into the background. They are really used at this point -- is it plausible that there could be a competitive problem, if shares are too low or the concentration is too low?

We look at it and say, there's not going to be a problem and it would be a waste of taxpayer money for us to investigate.

Another kind of thing that we do a lot with data, is to look at what we call natural experiments, which is, we try to look at instances in the market where we can analyze how various events affected prices.

So, for example, we look at the effect of entry on prices. In the electric power industry, for example, you might look at the effect of an outage of a plant, on prices,

to give you an understanding about how the market works, about how other parties respond to these things, who increases output and that sort of thing.

Now, let's quickly go over to comparing this to FERC. One thing of course, FERC's legal powers are different and the process is quite different, but to the extent you can, one thing you might want to think about, is whether there are things that are done at the federal antitrust agencies, that are considered important, which are things that you might be able to do.

A second thing is, because of the unique characteristics of electric power and the availability of data, there are potentials to use computer simulation-type models here. They're expensive, it's hard, but you'll be able to use the model over and over again, so I think it would be worth the investment.

The third question is, what do we make of Appendix A? Well, when FERC adopted Appendix A, they said they were adopting the FTC/DOJ merger guidelines, and then we have Appendix A.

The problem is that Appendix A is totally inconsistent with the merger guidelines. It's inconsistent with economic principles; it's not a reliable way to do the analysis.

It does generate market shares and HHIs, but

those market shares and HHIs, are quite different from the ones you would get if you did a reliable form of analysis.

Just as an example, it doesn't usually make sense to have a bunch of individual destination markets. Generally speaking, if you're analyzing any one sort of market player, there's only going to be one geographic market at a given time. You have to figure out what that is, but you're not going to get a different price effect here and here and here, because you don't have price discrimination, you've got so much arbitrage.

The delivered price test, is not an appropriate method for determining which companies are in the market, or determining their market shares.

The method for allocating scarce transmission capacity, in order to compute market shares, that's used, is not appropriate.

You could say, well, Appendix A is used just as a screen, but at least in the 1990s, that wasn't the case. It was the analysis. Companies would do anything to avoid a hearing on these issues.

The next thing that's often said, is that Appendix A is conservative. Actually, that's wrong, too. Appendix A can find problems that don't exist. It can find -- it can miss problems that do exist.

Also, when you evaluate remedies, designing a

remedy to fix an Appendix A problem, doesn't necessarily get you the right remedy. Thank you.

CHAIRMAN KELLIHER: Thank you very much. I now recognize Julie Solomon, Vice President of CRA International.

MS. SOLOMON: Thank you very much. I appreciate being here today.

Appendix A is, I think it's fair to say, a methodology that everyone loves to hate, but I think there are some good aspects of it. I'd like to talk about them a little bit today.

It is a screen. I don't think it is the end-all and be-all of analysis. The question is, is it a sufficiently effective screen to do what it's supposed to do?

There are many aspects of it, I think, that are conservative, despite what Dr. Frankena says. To the extent you define a market narrowly, you do get a conservative measure of market share and market concentration and HHIs.

I think that there are aspects of Appendix A that attempt to look throughput theories, such as Dr. Bush referred to. You're looking at various points on the supply curve; you're looking across seasons, time of day when outages are scheduled.

It's certainly true that markets can be defined

differently at different times, but, in Appendix A, you tend to look at a range of markets over all periods of time, so you should capture that.

I think it's important to recognize that not all transactions easily pass the Appendix A. There's an intimation that it's easy to pass and easy to solve and mitigation can be designed to solve that.

The fact is that transactions do fail Appendix A. Applicants come in and offer remedies to try to solve the problems.

There are also transactions that fail Appendix A or fail a market power screen or market power test, and they just -- these transactions are never brought before the agencies, because they fail.

It's also important that intervenors have ample opportunity to challenge or create their own analyses relative to what applicants are doing, and all of this is usually sufficient to make a decision, which is, I think, in most parties' best interests.

The parties and the Commission would like to get things resolved. The applicants would like to get things resolved, perhaps not intervenors. They don't want to get things resolved, unless it's to deny the application.

I could go through some of the specifics in the questions. Most people have already addressed those, but I

do think that Appendix A is useful in the RTOs. I don't think there's anything about the RTO, per se, that makes Appendix A inapplicable.

Transmission constraints in RTOs are important, and most applicants, and, I believe, the Commission, have appropriately looked at narrower markets than an RTO. Exelon/PSE&G is one example where it wasn't upon the intervenors or the Commission to say, gee, they didn't look at a narrow enough market. Applicants came in and said, gee, there are transmission constraints here. I'll look at narrower markets.

With respect to generation-only mergers, the fact is that Appendix A has been applied in generation-only mergers. They weren't quite generation-only, because there were jurisdictional assets involved, but, essentially, they were generation-only mergers.

Appendix A, where we're talking about merging long distance utilities or generators, Appendix A can be effective in that regard, because Appendix A will corroborate that there is not so much competition. It does not address potential competition in that regard.

I think that in that respect, one of the important things and one of the current things, is the exemption from filing the full analysis, if you can prove that merging parties don't operate in common markets, or the

extent of their operations in common markets, is quite small.

There are certainly some technical issues in Appendix A, and I'll just go through them quickly, and I'll be happy to answer questions on them: Certainly, defining the relevant market; taking into account, transmission constraints; how to allocate transmission capability, which Mark referenced; who controls generation is always a tension in Appendix A or any analysis.

There's operational control and there is beneficial interest in generating assets that have to be taken care of.

One thing that hasn't been addressed -- and I just want to table it for potential consideration -- is the Appendix A vertical analysis. We've been talking mostly about the horizontal analysis.

As you know, in 642, the Commission decided to apply a similar analysis for vertical transactions. In those analyses, the screen focuses only on the post-merger market structure and market share, HHI, not the change in HHIs or market share in the horizontal analysis.

And I don't want to go into the technical details, but the analysis of the construct in the vertical mergers, is actually quite contrived. In particular, the presumption is that supplier of downstream products, gas

transportation, for example, to upstream products, generation, somehow has control over generation.

Appendix A requires that generators are, quote/unquote, attributed to the natural gas transportation suppliers, for example. There certainly are some questions about the appropriateness of that.

There are lots of different models one can use to analyze mergers. I think that people have certainly mentioned them. I just want to reiterate that any kind of model, whether it's an Appendix A model, a computer simulation model, a behavioral model, requires a lot of maintenance, but we've proven, that with respect to an Appendix A model, that it can be constructed, it can be exercised by applicants and by intervenors.

It can be challenged; it can prove useful; it can be challenged, so that the result requires further analysis. I think that goes back to the fact that where it's a screen, it's not going to answer all questions for all people at all times.

But I think it's a really a very good starting point, and sometimes a good ending point. Thank you.

CHAIRMAN KELLIHER: Thank you very much. I'd like to now recognize the Honorable Clifford "Mike" Naeve, Partner at Skadden Arps and former FERC Commissioner.

MR. NAEVE: Thank you, Mr. Chairman, thank you,

Commissioners, for permitting me to be here today to offer my opinion. I've heard a great many interesting and valuable comments.

There are a few points I'd like to make, just from the perspective of a lawyer who works with many companies who are considering whether they should do merger transactions or not.

One of the most important values of Appendix A, is that it's known; it's transparent. People who are considering mergers, need to have a good appreciation of whether their mergers are likely to be well received by this agency and by the antitrust agencies, as well.

But with respect to Appendix A, potential applicants have the ability to do a preliminary analysis before they even make the decision to go forward with a transaction, and they can determine, under this preliminary analysis, is this a transaction which is workable at the Commission, and how much mitigation might we be required to propose, if we're going to do a transaction, and they can evaluate the cost of that mitigation and make a decision looking forward.

That level of predictability is extremely important.

Failed mergers are not pretty; failed mergers cost a great deal in terms of commitment, investment,

transaction fees, but also effects on the companies.

The companies are tied up in transactions that are before this Agency and the antitrust agencies, for long periods of time. When those transactions fail, they fail at great expense to the company.

They lose personnel, thinking that they may not have jobs in the future company. They put their business plans on hold. A lot of things happen while you're waiting for a protracted period for a merger to be approved.

You don't want to propose that type merger, and it's a tremendous value for this Agency, and it would be great, too, if you could do this with DOJ and the FTC, to have a predictable, transparent process for evaluating transactions, so people will know ahead of time, whether or not their transaction makes sense.

Today, it's a standard procedure, as I mentioned. This also saves you resources, because the transactions that are not brought to you, are the ones that would be the most demanding of your time. They would be the most complicated, and they can tie you up for a great amount of time, and your Staff resources and other resources.

So, having companies being able to self-screen and make decisions, not to bring forward transactions, because they can evaluate them with a transparent process, is extremely valuable.

For that reason, I know you will be considering changes in Appendix A, and I will talk a little bit about that in a minute, but whatever you do, whether you stick with Appendix A, with small modifications to Appendix A to address some of the concerns that are raised, or whether you go to some other methodology, I would strongly recommend that whatever that methodology is or whatever those changes are, that they be in a form that is transparent, that's knowable ahead of time, that will allow people to self-screen these transactions so you aren't presented with a lot of complicated and difficult deals.

I was going to say this later, but let me move to this now. Should FERC become more like DOJ or FTC in the way they do this?

I think, in some ways, having two separate agencies review transactions using different approaches and different methodologies, is not a bad thing, from the perspective of trying to screen out competitively harmful transactions.

There are a lot of ways to think about these transactions, and if you use one methodology and FTC uses a different methodology, it's more conservative and probably more transactions would be screened out, that would otherwise be the case.

So, from the perspective of your concern of

making sure those transactions don't adversely affect competition, they're going to have to pass two different screens in two different agencies, and, again, from that unique perspective of trying to prevent competitive harm, I think you have a double layer of insurance there.

It may be the case, from the point of view of people who want to do transactions, that some transactions would be screened out, that would not be harmful, but nonetheless, because we have conflicting standards or conflicting approaches, some of those may not be able to be propose or get done, but from the point of view of protecting consumers, I'm not sure it's entirely a bad thing.

I also think that some of the differences between the agencies are simply inherent and may not be resolvable. You have different statutes; you have different standards; you have different timeframes in which you have to operate.

DOJ and FTC, in effect, are law enforcement agencies with respect to how they approach these transactions. FERC is more an adjudicative agency. Your decisions have to be more transparent; they have to be made based on the record.

The Department of Justice, on the other hand, its decisions do not have to be based on some public record. Indeed, the statute requires them to keep confidential, the

information they receive.

It's been suggested that you receive all the information that DOJ receives or FTC would receive, presumptively, in followup second requests and so forth. It's much harder for you to keep that information confidential, than it is for them.

Protective orders, quite frankly, aren't that effective, and you have to make your decisions, based on a public record. So I think there are a lot of inherent differences where it would be hard for you to really track their approach.

On the issue of is Appendix A effective, I would just note that in some ways, based on the track record of Appendix A, one might say it's held up fairly well.

It's held up fairly well in the sense that, as Commissioner Kelly pointed out, there have been 69 major mergers and hundreds of small transactions that have been reviewed under Appendix A.

I am, frankly, not aware of a single transaction where people have come back to you and said, you approved this transaction, and it had adverse competitive effects and you should have done something differently.

I think when one steps back and looks at the track record of this Commission and the effectiveness of Appendix A in screening out competitively-harmful

transactions, I believe it's very effective.

One reason is because, in many ways, it is conservative. I respect what Dr. Frankena said, in that there could be circumstances where perhaps it's not conservative. That mainly has to do with market definition.

If I were to have some suggestions for you -- and I will later, if I have time -- on some of the things you could do with Appendix A, I do think the most important thing, when you do any kind of analysis, is to get the markets right.

If you're analyzing the wrong markets, you're not necessarily going to come up with the right results. There are circumstances in Appendix A where you define markets as control areas, for example, where you're outside of RTOs, and those may or may not be the relevant market.

In many cases, it may be only a coincidence, if they're the right market, and that can result sometimes in distorted results. More often than not, I think those distorted results, are more conservative.

As Julie Solomon pointed out, the smaller the market, the greater the potential effect on the market.

Also, it may have some other effects, and suggest that the problems are less than they might actually be, but, typically, that effect is that it makes it more conservative, not less conservative.

But, generally, I think the HHI measures are designed as conservative screens to see if further analysis is possible. At this Agency, as a practical matter, they haven't become the screens; they've almost become decisional factors, partly because people don't present transactions to you, unless they qualify.

Also, there's some concern among applicants that the Commission itself thinks of them today as decisional factors, as opposed to initial screens and say, if these are the cases we need to look at, let's look at them, instead of doing it that way. It because if they fail a screen, they have a problem, when, in fact, the may not.

Further analysis could show that. Again, I think the function is very conservative.

Looking at DOJ and FERC again, let's just look at the Exelon transaction and Public Service Electric and Gas. The Department of Justice, in its analysis, identified about 5700 megawatts of mitigation that they felt was appropriate.

The Commission, applying Appendix A, identified about 6,600 megawatts. This, again, kind of suggests that this may be conservative.

You did come up with different types of generation that should be divested, so you did require more generation, but different types. Also, the form of some of the mitigation, was different.

If there was any more time, I -- I guess I don't have enough time to respond to your specific questions, but if you want to ask me in followup, I'll be happy to respond.

CHAIRMAN KELLIHER: Thank you very much, Mike. We appreciate it.

I'd like to give Commissioner Spitzer an opportunity to make an opening comment, the we can get the questions. We'll do the math after Marc's done, and divide up the time until noon.

I think we should try to end at noon, though, because, otherwise, we'll be eating into a lunch period, and just out of fairness to the second panel, we should start the second panel on time.

With that, Commissioner Spitzer, of course, has been active in this issue at the federal and at the state level.

COMMISSIONER SPITZER: Thank you, Mr. Chairman. In terms of antitrust, I actually had one week in law school, having slept through tax. Maybe it was a personality conflict with the professor. I prefer to think that, rather than my performance.

I apologize for my late arrival. I was giving some remarks at one of these omnipresent transmission summits, and the issue of market power within load constraints and transmission grids, suggests an

interrelationship of all the issues we deal with, which is definitely clear.

Considering all the effort in numerous Orders of this Agency with respect to competitive markets, it's essential that we keep our eye on the ball and focus on competition.

Obviously, the absence of competition undermines everything that we've done in various areas, including those such as OATT reform, largely dealing with transmission matters.

I think we have to be mindful of the Congressional enactment in 2005. It will affect a balkanized industry, as well as an industry subject to needed capital investment, but, at the same time, be mindful that the impacts, ultimately, of anticompetitive forces, are borne by the ratepayers of this country.

Given that we have ten years -- 11 years now, I suppose -- in this area, I was searching for some analogies, and there was one that is actually contemporaneous, which illustrates what I would describe as the fallacy of the stasis, which is the erroneous belief that, as things are, so they always shall be.

That is in the telecom sector, where, in 1996, state commissions were forced to deal, with guns to our heads, these very tedious proceedings, and in wake of the

1996 Telecom Act, there was vigorous litigation between Qwest and AT&T, over the degree to which the Act needed to be applied to the company, based on the presence or absence of competition.

The HHI tests were articulated in 1996, and a lot of money was spent and lawyers were hired. Expert witnesses were hired, and by the time we were deciding these cases in 2002 and 2003, everything had changed.

So, the HHI and all the legal arguments, were based upon the market being define as the copper wire to the house, which might have been a valid undertaking in 1996, but by 20002 and 2003, you had cable, you had fiber, you had wireless, you had cell.

We're arguing about something that was no longer really relevant, and it took several court decisions interpreting the 1996 statute, before we finally realized that we were wasting our time.

It's important not to be wedded to the fallacy of the stasis. The Notice for the Conference, Mr. Chairman, I think articulates the basis for a second look, based upon changed circumstances, which is very important.

So, the benefit of this proceeding is to undertake that, to identify some of those changed circumstances.

The other thing I wanted to point out,

1 particularly while I have my colleague from North Carolina
2 here -- and this is probably more relevant to the
3 proceedings this afternoon or the discussion this afternoon
4 on state issues -- there are some folks, particularly in
5 Washington, who presume or assume inadequacy or
6 insufficiency in state processes and desire the federal
7 process to supplant it.
8 I reject that. As the Chairman pointed out, I
9 presided over a major application for a merger transaction
10 in Arizona. It was a nine-day trial with a voluminous
11 record and a very robust determination.
12 And whether you agree or disagree with the
13 outcome of that particular case, I don't think that there's
14 any question that it was a very robust record in that
15 proceeding, and a very full discussion.
16 Even those who were not satisfied, said they had
17 their day in court, they had due process, they had a fair
18 shot.
19 And if you look at the universe of cases that
20 have arise recently, particularly since the repeal of PUHCA,
21 the states, whether you agree or disagree with a particular
22 result, the states have given far more than the term "due
23 diligence" to this undertaking.
24 So, respectfully believe that we should assume
25 and presume adequacy, it not success with state

determinations and be respectful of those.

With that, I don't have a preconceived view of the outcome of Appendix A, but I look forward to the discussion, particularly with respect to the circumstances that might have changed since 1996, that deserve a second look and revisit.

CHAIRMAN KELLIHER: Thank you. My math suggests 12 minutes each, would suffice. So, why don't we try to do that? Why don't I turn to my colleague, Commissioner Kelly?

COMMISSIONER KELLY: Thank you. It's been very interesting and very enlightening to hear your perspectives. It's rather unique, I think, that we have three agencies involved in undertaking an analysis -- DOJ, FTC, and FERC -- analysis with a similar endpoint, and we do it all differently.

I'd like to focus -- and it's helpful to hear how you do it and some comparisons and contrasts, so I'd like to take my time and focus on that issue.

I know Dr. Bush and Dr. Frankena, really didn't get an opportunity to complete all of the remarks they wanted to make in that time period, and, also, you had speakers come after you, who had comments on what you said earlier, so, I'd like to ask each of you to take about five minutes and let us know, of the remarks that you weren't able to say, initially, what you'd like to add.

And to the extent that Ms. Solomon and Mr. Naeve have comments that you wanted to respond to, just to keep the record full and robust, it would be helpful.

MR. BUSH: Thank you, Commissioner. I spoke really fast, so I was able to substantially complete my remarks.

COMMISSIONER KELLY: That's not what Houstonians are supposed to do.

MR. BUSH: I'm from California. I just did not interject the word, "like."

(Laughter.)

MR. BUSH: There are a couple of things that were mentioned, subsequent to my remarks, and a couple of things I want to add.

Just thinking, as I'm sitting here, while the Appendix A analysis is, indeed, a screen, I kind of wonder what the purpose of a screen is.

If you think of the rudimentary definition for a screen, you think of something that can catch the important things and let the other things wash away.

With Appendix A, there is a risk of both Type I and Type II errors. People who have done Appendix A analysis and who are considering whether or not to submit it to FERC, might erroneously believe that they should not submit to FERC, because it triggers the merger screen.

They could also come through FERC with a proposed mitigation plan that has absolutely nothing to do with any theory of harm whatsoever. You triggered the screen, we propose this remedy, which gets us back out from under that screen, and that may cause the Commission, indeed, in their own analysis, to ignore that here is a harm that isn't captured by Appendix A.

COMMISSIONER KELLY: If I could ask you a followup question on that, are you familiar with the Exelon merger and with the DOJ and FERC analyses? They required somewhat different remedies.

MR. BUSH: Yes, I am.

COMMISSIONER KELLY: Did those different -- do you believe that those different remedies, came about as the result of our reliance on the screen, versus DOJ's different approach? Do you believe that that is an example of what you're talking about?

MR. BUSH: I my humble opinion, yes. The reason is that, as far as what was required to be divested, either virtually or actually, before the Commission, was not specified to the level of specificity that was required by the Department of Justice.

That is because the Department of Justice identified two elements of the transaction that caused the exercise of market power, the incentive to raise prices, and

the ability to raise prices.

The incentive came from base load, intermediary generation, and the ability came from marginal units. So, this is also true with a transaction such as P-Anova, which is somewhat similar.

I have to either divest the incentive or the ability in order to eliminate that market power. If I just have a blanket elimination of market shares, it may do nothing to eliminate the competitive effect.

COMMISSIONER KELLY: Do you think FERC should have gone a little further in its analysis?

MR. BUSH: Indeed, I do. I think, again, that's because the starting point wasn't a theory of harm, and, in fact, when the parties submit the Appendix A analysis, that is the result to get out from under that Appendix A analysis, because of the issues involved at the hearing.

I also experienced this when I was practicing. I have a great cure, I would say, but I don't have a problem yet. I need to have a problem before I have any such cure.

COMMISSIONER KELLY: So you're also saying that just because you violate the screen, that doesn't mean that's something that has to be remedied?

MR. BUSH: Absolutely, correct. Without any sort of determination that there is some sort of competitive harm, apart from just straight market share increases, then

I don't have enough information to make that determination.

I would want to do sort of the analysis that Dr. Frankena suggested and that I suggest.

COMMISSIONER KELLY: Excuse me for interrupting, but, Steve, will you keep track for me, of my time, or are you keeping track? You'll let me know when my first five minutes are up?

MR. RODGERS: I think you're up in about one minute.

MR. BUSH: One other thing that I wanted to point out, is that this quest for certainty that Mr. Naeve had pointed out, I think there is a great deal of certainty in the Department of Justice and Federal Trade Commission analysis.

Certainly, if you go back to the Anova case in 1998, the fuel curve theory of harm has been around for quite some time.

So you can pretty much assure your clients that that would be something that would be examined, and, certainly, you know, a straight sort of traditional horizontal analysis would be examined, retail issues would be examined, vertical issues would be examined, and, I think, it would -- you would be ill-advised to assume that you wouldn't be thinking about those things in light of the way electric utilities operate.

So there is some assurance there, that that's a fairly consistent analysis. Appendix A may be consistent, but not in a way that really helps or hinders the applicants.

It hurts them, because they may have to give up thing they shouldn't have to give up. It helps them, because they may actually have -- their transaction may have a serious harm that's not detected.

COMMISSIONER KELLY: Dr. Frankena?

MR. FRANKENA: Let me go back even further in time. During the early 1990s, before Appendix A and so on, I worked as an expert witness on electric utility mergers.

I was the primary witness for the Intervenors and the Wisconsin Attorney General and the Justice Department on the Primergy merger.

The outcome of that was that the merger wasn't permitted. There were competitive problems.

When I prepared that whole analysis, Appendix A wasn't around. There was an issue of trying to figure out how one would actually analyze this, and we went through, asking the normal questions and presenting different types of evidence and analyses that shed light on those things.

Well, as my practice continued, there was less and less interest on the part of my clients in actually addressing the relevant issues. What happened, was that

after Appendix A came out, then, of course, it said that you can also present an alternative analysis or additional analysis, but the client's view was, how could it possibly help us to say anything else? We've got to satisfy Appendix A and anything else we raise, is just something else.

So, it became, I'm sorry, we don't want to hire you to do anything other than to do Appendix A. You know, we built computer models, made loads of money. It sent my kids to college, but, you know, it was really unsatisfying because we weren't asking the right questions.

I guess, rather than saying, gee, get rid of Appendix A or something like that, I think the primary thing, as far as Appendix A goes, the first step would be to do what Mike suggested, an that is, think really carefully about the geographic market, rather than using these individual ones.

If we start there and then work forward, we can probably make the analysis a lot more useful. There will be other types of things, but from my point of view, the main thing that would be good, is if you could flip that Appendix A, or however it's done, all that market share stuff, if you could put that Appendix A, put that in the right perspective, instead of making that sort of the big thing, and really focus on the question, you know, what's constraining prices before the merger and how does the

merger change this?

What are the theories of competitive harm, and what does that imply about whether we should do something here, and what remedy is implied by this theory of harm?

So we get back to really thinking about the issues, each time. I mean, it's all very well. Maybe there's a role for market share calculations.

In some cases, there may be a role for future simulation models, if we can get a good one. But none of those things should replace the basic sort of it's really an intuitive issue.

All these things are just tools, and we really need to understand what determines prices now, how is that likely to change, and all sorts of evidence is relevant to that.

COMMISSIONER KELLY: For those of us who are not economists, that's very reassuring.

MR. FRANKENA: I went into economics because it was easy, it was common sense.

(Laughter.)

MR. FRANKENA: Some people have a different sense of common sense, but, I mean, I couldn't understand English Literature. I never knew what the author was trying to say.

(Laughter.)

MR. FRANKENA: You know? Is there some message

there? I could never figure it out. Poetry, what's that?

So, the point is, there is a lot that's intuitive, and, you know, I work in an agency where I deal mainly with attorneys. My job is basically to present the economic analysis, work with senior attorneys to explain what this is all about.

I mean, my feeling is, if you can't explain it to an attorney or to a non-economist, there's something seriously wrong. I mean, none of these -- in the end, none of these things are that complicated.

I mean, the theories of harm, aren't all that complicated.

(Pause.)

COMMISSIONER KELLY: Mike, we wanted to hear a little bit more from you, but I have run out of my time. Joe will ask the question.

CHAIRMAN KELLIHER: That's a logical segue, because I actually wanted to follow up on some of this line of questioning about certainty.

I wanted to ask Mike, you know, to react to Dr. Bush's argument that antitrust law does provide a high level of certainty, maybe as much as Appendix A, maybe better than Appendix A, but there's a high level of certainty in antitrust law.

I just wanted to ask you about -- let's take

Exelon, take the Exelon transaction. Was the Justice Department's eventual disposition, was that predictable? Was it a surprise?

What would the lesson of their decision be to future applicants? Would there be some road map of a high level of certainty in the wake of Exelon, on what the Justice Department might do?

MR. NAEVE: I find it much more difficult, in advance of a transaction, to predict with any level of clarity, what the antitrust agencies may do. I'm sure, in their minds, that they have certain tests and questions they want to ask, and they will ask those questions, and they will bring analysis to them, and it should be understandable.

Certainly, we'll hire experts from those agencies. In every major transaction, we'll hire not only someone to do a FERC analysis, we'll hire someone, usually someone who was formerly with those agencies, to help us anticipate what the issues might be.

Certainly, in the Exelon case, we did just that. We anticipated that there it was going to be referred to the Department of Justice.

We asked how might they think about it; we thought they may develop certain types of models to evaluate it -- behavioral-type models. We actually constructed one

of those models to see how this transaction and the mitigations we proposed to FERC, would fare under that model.

Our analysis, based on the model we developed, showed that the FERC mitigation worked just fine. Obviously, they took a slightly different course, but it is kind of relevant to the ability to kind of predict how are they going to think about it, what method of analysis might they use?

It is far more difficult, because it is somewhat mechanical. It is really highly predictive, whereas this other would be certainly much less predictive.

The other problem is, if you're in a world, especially if you have an adjudicative process and if something, say, is referred to a hearing or to an Administrative Law Judge, the Judge has to stop and ask, what is the standard I'm applying here?

If you've got five different intervenors, all of which are proposing different methods, different modeling, different standards, you're going to have to rely on that Judge to be an expert.

At the Department of Justice, they have a lot of experts. All those people are experts, people like Mark, Dr. Bush, and others who do this all day long.

But you kind of need to have some advance

guidance to your Judges and to your staff, as to exactly what are the standards, and, of course, to the parties outside coming in.

One effect of not having very transparent, clear approaches, is, it permits people to come into the case and lay out numerous theories of the case, and some of these theories, you would look at and say, that makes no sense to us whatsoever, but, nonetheless, for all we know, it may ring with somebody at the Commission.

Maybe we have to talk to them and see if we can reach an accommodation. Frankly, a lot of the intervenors will propose theories, mainly so that you will come to them and seek an accommodation.

They want to be bought out of the case. That simply hasn't happened in the last many years since we've had Appendix A, because the standards are clear, and if somebody raises a problem that is a problem under your methodology, it doesn't do you any good to buy them out of the case, because the Commission is still going to respond to that important issue.

If the standards are far from clear, it creates a lot more leverage on the part of the parties who are just looking for some sort of buyout arrangement.

CHAIRMAN KELLIHER: You're suggesting the internal deliberative process of the antitrust agencies, is

more opaque than it is at the Commission.

MR. NAEVE: It's more opaque, but there are other differences, too. You do have the opportunity to sit down and talk to them about their theories, and sometimes they will raise theories, which, you know, we may think those theories are off-base, but you're going to have a dialogue.

You can present data, you can write papers to them, and have further dialogue. It is a real give-and-take.

Often, they will explore some theories, because they feel they have to be explored, but, after a dialogue, they will say, we agree with you on that. Other times, they will not.

CHAIRMAN KELLIHER: Opaque, but more informal at the same time, might have advantages, too.

MR. NAEVE: Right.

CHAIRMAN KELLIHER: I want to ask more than one question, so, please respond. I'm assuming that you want to respond to what Mike just said.

MR. BUSH: I will respond in one minute or less. I think there's a couple of things that make the process at DOJ transparent. I'm not saying it's crystally transparent. In fact, I would hope the FTC and the DOJ would be required to explain why they only take certain investigations, or why they fail to pursue cases, so that we have greater

transparency.

But to the parties, because of this dialogue, I think what the DOJ thinks about certain matters, is pretty clear. They don't hide the ball. That would serve no purpose.

Of course, I'm not speaking for the DOJ, since I don't even represent them anymore.

Also, it's not just the clarity. I've laid out that there is a theory of harm that would typically be utilized. The merger guidelines also provide some clarity, and we also have a remedies guideline, so we can define "competitive harm," based on these theories, and the parties know exactly what we're going to require, which is typically a structural change, per the remedy guidelines.

MS. KELLY: I feel compelled to make two comments: If you do expand your analysis past what I would call the somewhat cut-and-dried recipe approach of Appendix A, and, thus, intervenors in a case are able to submit their own theories of harm, in the way Professor Bush notes, then you have the opportunity to review that and decide whether it's cockamamie or decide whether it's merited.

I think that just the fact that intervenors are allowed to raise theories of harm, is not a bad thing; it's a good thing. It expands your opportunities to decide whether those views have merit, whether they are adduced

just for the sake of a buyout -- and I don't want to go there, but, you know, I think that you can judge those things on their merits, and, I believe, many times intervenors intervene for the right reasons: They have absolutely genuine concerns about the impact of a merger.

The second thing I would note, is that, years ago, I was asked to participate in a FERC-First focus group. You probably remember that era.

Outside consultants came in to find out how FERC could be a more efficient, better-run agency. I was invited in. As a focused person, I faithfully came, and I was asked basically what can FERC better do to, quote, "serve the customer," close quote.

I went apoplectic, because your job is not, quote, "serve the customer," in terms of providing a pre-merger analysis that is easy to apply and people know whether they can meet it, and your job is not to move them in and move them out.

Your job is to assess whether it's consistent with the public interest and whether it will harm consumers. If that makes things a little less clear going in, and it requires a more thoughtful analysis, I say, so be it.

CHAIRMAN KELLIHER: I believe that our Merger Policy Statement pre-dated the FERC-First effort, and it has nothing to do with the FERC-First efforts, and that our

merger requirements are also unrelated to FERC-First.

MS. KELLY: I just have to note that the customer is not the company.

CHAIRMAN KELLIHER: I agree, and we have -- I think the history of FERC-First, are in a contained room down the hallway.

(Laughter.)

CHAIRMAN KELLIHER: So it's not driving the Commission's approach, currently.

Let me talk about administrative ease, which I think is a relevant aspiration, something that should govern us, not wholly different from what you were just touching on.

One reason I think we need some kind of screen, something like Appendix A, is that we have a Congressional deadline on acting on mergers. That was established in the Energy Policy Act.

The way the Energy Policy Act works, a merger is deemed approved in 180 days, unless we deny it or we grant an extension. I think it's a clear sign from Congress, that they want a set statutory deadline.

They want us to act with some dispatch. As someone said, we should set all mergers for trial and have hearings. That is clearly not possible to have a trial-type hearing, concluded within 180 days, so, to some extent, we

need some kind of screen, something like Appendix A, given the deadlines that Congress has established.

That is, I admit, a question -- a statement, rather than a question, but let me get to a couple of questions. How much time do I have?

Sue, you referred to changes that have occurred in the industry since 1996. Would you look at generation market power and transmission market power -- isn't generation market power, less concentrated than it was in 1996, and isn't that true also of transmission?

Certainly, the formation of RTOs, it seems, as a general matter in both areas -- there's been progress that I thought you would see, there's been good progress, less concentration in both.

MS. KELLY: Let me start with transmission market power, and, let me say that I do believe that the Commission has been very diligent in that area. I commend you for undertaking your Order 890 initiative, and I think that will be very salutary, when fully implemented, and mitigating potential exercise of transmission market power, and we obviously look forward to that.

As to the generation market, you know, without a very close study, I don't know if I'm prepared to say that it's a) better; b) worse, or c) some of both.

CHAIRMAN KELLIHER: I think it has to be less

concentrated, because generation between '96 and 2004 -- something like 70-plus-percent of the generation was built by new entrants.

To me -- well, anyway --

MS. KELLY: I understand that, but a lot of those new entrants, are not necessarily around anymore, and some of those old ones have gone back to incumbents.

CHAIRMAN KELLIHER: The ranks have changed.

MS. KELLY: I just note that, that you can't necessarily assume that all the entrants that came in, are still there, and you have to track very carefully, where those units went. Also, with the formation of RTO markets, as opposed to the more purely bilateral markets we had in '96, as I alluded to in my statement, there are opportunities in those types of centralized markets, depending on where the units are on the price curve, depending on --

CHAIRMAN KELLIHER: I'm running out of time.

(Laughter.)

MS. KELLY: The fact of the matter is that you may have a smaller market share and be more effectively able to exercise market power. I can stop right there.

CHAIRMAN KELLIHER: One question with a one-word answer from the antitrust gallery: Say we're talking about horizontal market power. I'm just curious. Which do you

think is the more serious market power problem in the electricity market; is it vertical market power or is it horizontal market power that lends itself to a one-word answer?

MR. BUSH: Yes.

(Laughter.)

CHAIRMAN KELLIHER: It was a "which" question. Horizontal or vertical?

MR. BUSH: As a law professor, I tend to fight the hypothetical. I think the fuel curve issue is very important.

That looks like a vertical issue, but it's really a horizontal issue. Ten percent is vertical. Both are important.

CHAIRMAN KELLIHER: Both equally important, Doctor?

MR. FRANKENA: Choosing between motherhood and apple pie, I don't have any way to say which is more important.

CHAIRMAN KELLIHER: That surprises me. Am I out of time? I'm over time. Thank you very much.

Commissioner Moeller?

COMMISSIONER MOELLER: Thank you, Mr. Chairman. I have a question for each of you, so it leaves about two minutes each.

Commissioner Ervin, you've been appearing a lot in D.C., so thanks for the effort. Again, your suggestion, I want to make sure that I heard it correctly; that we essentially tell states who are deficient in their merger review, that they are such?

MR. ERVIN: No, what I was trying to say -- and I didn't want Steve to follow me, so I was trying to be well behaved -- what I was trying to say, was that, given the age of most state merger statutes -- I don't know what Commissioner Spitzer's statute looked like. I know what mine looks like, the one in North Carolina, and I think it accommodates pretty well, the kind of environment that we've got, because it's written fairly broadly.

Other state statutes are not, and so I'm hearing some expressions of concern from some of my colleagues, that the merger statutes may not allow them to fully review all of the transactions that might actually have an impact on retail service in their states.

What I was attempting to say, and, obviously, not very well, was, it seems to me that one of the ways in which this Agency and state commissions can do a better job of coordinating, is for you all to have a better understanding of how adequate each state thinks its own statute is.

Many states may not feel their statutes allow them to do everything that they would like to do, and they

may wind up looking to you more and say, given that I feel like my statute is adequate, I think that's a determination that ought to be made, not by this body, as it has historically been doing under Appendix A, relying on the state commissions to say whether they think that their ability to review a particular transaction, is adequate.

I don't think it's fair to you all to ask you to look at state law and to make a judgment about whether it permits adequate protection of retail customers. I think that's a determination that ought to be made at the state level, rather than at the federal level. I'm going to flag that as an issue.

Given the changing market structure that we see, where we have many transactions at the holding company level, rather than utility-specific, I'll just flag that as an issue that I think you need to be sensitive to, going forward.

I would be interested to hear what Commissioner Spitzer had to say, because he's not too far from the same environment that I live in now.

COMMISSIONER MOELLER: Sorry, I misinterpreted what you said.

MR. ERVIN: I probably didn't say it very well.

COMMISSIONER MOELLER: Ms. Kelly, thanks for your comments. It seems to me that the undercurrent of your

testimony, is -- and please elaborate, if I don't get this right -- but essentially concern over, going forward, the new players that we have coming into this world, financial players, nontraditional entities entering the markets, and whether Appendix A is appropriate to essentially analyze their impact.

I guess I'd like you to elaborate on that, and if you're comfortable, can you talk about any harm, going backwards in terms of the 69 mergers that the Commission has approved, can you talk about demonstrated harm, where the Commission should have done a better job of analysis?

MS. KELLY: First of all, let me say that the new players coming into the industry, is one of the concerns that I raised, but not the only one. Changes in the industry structure and the market, as well, is another issue, but you're absolutely correct; that is one of the issues identified, that was of concern to me.

I think part of our concern arises from the fact that these new entrants may have different motivations and different abilities than the players that have entered the market and that have been in the market traditionally.

For example, we have financial houses that have major financial trading books and who have many activities in financial markets. When they enter into physical markets -- and I'm not saying I've been able to identify an instance

of this, but I worry about the fact that, as we know, tons of market money can be made and lost by very small movements in financial markets, and if you also have your foot in the physical market and can somehow impact that market, then you may have substantial ability to, you know, trigger secondary effects. It's almost like a vertical problem, but it's not the traditional vertical problem of upstream fuel or something like that.

It's kind of a tangential problem; it's a different market, but there are substantial issues raised by that. Frankly, when I see the same entities that are helping my members sell municipal bonds, who are also doing the financial hedges, who are also buying the plants, who are also in the FTR markets, there are huge amounts of money in FTR markets that are going out of the market into the hands of financial players.

There's all these different rings of the circus. This is just one corner. I think we need to take a holistic look.

And, for example, I can't help but mention what's going on down in Texas at this moment. In theory, that's not going to lead to an increase in concentration, because it's just a player coming in that has no presence in the industry now, buying one set of generation, so there really may not be any increase in market concentration, although I

leave that to the greater heads than mine.

I have not looked at the merger, I'm not opining on it in any way, but the idea of, well, we may be in this market for five years, if conditions don't change, I mean, that's not the kind of attitude we typically see from traditional electric utility mergers, and I think you all need to think about that.

What does that mean? If that entity tries to sell those assets two years later, for twice what they paid for them, those are issues that affect consumers, so I guess that I would just say that.

The second part of your question was the past mergers.

COMMISSIONER MOELLER: We're really tight on time.

MS. KELLY: They are water under the bridge. Going back and trying to get a merger reopened, because you made a mistake, just doesn't happen. Who is going to spend their scarce resources on that?

COMMISSIONER MOELLER: Thank you. Dr. Bush, I also thank you for your testimony. It seems to me, also, that the premise of your testimony is that the screens are necessary, but, ultimately, one should decide -- we should know it when we see it, if there's a problem with concentration going forward, unless I missed your

recommendations for specific changes to Appendix A.

MR. BUSH: I'd like to mention that the reference, "we know it when we see it," is Justice Potter Stewart's reference to pornography. I don't believe that there's any linkage here whatsoever.

The second thing I want to point out, is that I'm not sure the screen is necessary, as it is currently applied. A lot of the commentary by the Federal Trade Commission and the Department of Justice in implementing the merger guidelines, the driving force behind any merger analysis, has to be a theory of harm.

And there are some theories that have proven correct in the past, that act, I think, as filters. And you run the mergers through those filters, and you do that by seeing whether there are relevant markets that exist, that could cause these harms to come to pass.

You use the data that you require and you analyze that data and examine those transactions in light of those theories of harm, which, I think, might be considered. To save you time, I will stop there.

COMMISSIONER MOELLER: Dr. Frankena, I'm curious. With your past experience, as you alluded to, it makes mergers in this area more challenging, especially now. It's relatively difficult to store electrons. You can store them in batteries, but it's not like consumer products like

razors or something like that.

In addition, we're in a period where we're in a rising price environment, and if our focus is just on price, it's more difficult to determine potential harm, given those factors. Your experience in other industries and major successes and failures, as you look back on your career, as to how agencies approached mergers and Appendix A --

MR. RODGERS: Dr. Frankena and Commissioner Moeller, you have two minutes left.

MR. FRANKENA: I don't know how to answer the question on successes and failures of Appendix A. I don't -- my concern with Appendix A is that it sort of drives out the important analysis. I don't have any objection and we use screens at the Federal Trade Commission on a much more informal basis.

If we define a market and it looks as though there are ten equal-sized players in it, we wouldn't generally go forward with any type of antitrust investigation. The only one we could come up with, is that the Justice Department might still have a concern about criminal conspiracy, if they actually found that people were sitting in a room fixing prices, but we wouldn't look at that.

So, we have screens, but the emphasis always is, can we see how this could plausibly have an anticompetitive

effect in the market? That's sort of the first screen.

The market-share screens work more as a safe harbor. If you're saying, well, this merger could lead to increased coordination, increased likelihood of collusion, well, if there are ten equal-sized players and HHI is a thousand, therefore, we would tend to say that we don't need to investigate that, because our experience is in markets that are as un-concentrated as that, we never find anything, so it's a screen in terms -- but, to go forward, you still need to have other theories.

Particularly, you ask the question about vertical. There are many, many more horizontal problem that we detect, than vertical problems, if you look at the economy as a whole.

In the vertical cases, we have to have a story, because vertical issues, in general, are very complicated. Vertical mergers typically have efficiencies, so the screen, again, becomes much more, can we sort of see how this might work out, then check it out, go through the analysis.

MR. RODGERS: Dr. Frankena, we need to move on to the next Commissioner.

CHAIRMAN KELLIHER: Commissioner Spitzer.

COMMISSIONER SPITZER: Thank you, Mr. Chairman. Sue Kelly, I didn't understand your answer to Commissioner Moeller, with regard to harm. Just to rephrase the

question, you've had a number of transactions approved since 1996.

With respect to those approvals, has any harm arisen?

MS. KELLY: What I was getting to, was, in effect, the point that had been made earlier by Mr. Naeve, that nobody had come back in and challenged that a particular merger had, in fact, had competitive harm.

I guess the point I was making, is, in the short time I was going to be allowed to make it, was, why bother with that, just as a matter of scarce administrative resources? If I were still in FERC practice and I had somebody come to me and say, you know, I really guessed wrong on Merger Y that was approved by the Commission and it's killing me now, what do I do, Ms. Kelly, you know, I guess I would say, you can bring a Section 206 complaint.

I just don't think, in the big scheme of things, that that's a good use of that entity's money. Once the merger is approved, FERC's track record on going back and redoing them, or, in some cases, I will say, the conditions that were placed on them, are, once it's done, it's water under the bridge.

The market has been formed and the structure is what it is, post-merger. People in that market pretty much have to live with it.

COMMISSIONER SPITZER: But that's not the question.

MS. KELLY: I'm sorry I got it wrong.

COMMISSIONER SPITZER: You're addressing the procedural remedy. My question is really more fundamental. In these cases, where's the beef? Is there any beef?

MS. KELLY: Are you saying, has the market become more concentrated as a result of this?

COMMISSIONER SPITZER: Have any adverse impacts on consumers arisen?

MS. KELLY: I, unfortunately, don't know the answer to that question. That would require an antitrust-style analysis by the antitrust-style agencies.

I will say that my members are finding it increasingly difficult to obtain the type of power supplies that we need, especially in RTO regions. We feel that our supply options are less than they used to be.

If that's the definition of competitive harm, I think the answer is yes.

COMMISSIONER SPITZER: That could be from circumstances other than approval.

MS. KELLY: I'm not going to say that that arises directly from the Commission's approval of Merger X. I'm not going to say that, but is the road steeper for us? The answer is yes.

CHAIRMAN KELLIHER: It could be from divestiture of generation; it could be from an action with regard to concentration.

MS. KELLY: Or the fact that generation has been divested to an unregulated affiliate who now charges market-based rates. You know, there's a whole -- these things are extremely complex, and I don't think you can trace it back to Merger A and Merger B, but if your question is, are we finding it tougher slogging, in terms of competitive supply options now, the answer to that question is yes, and that's of great concern to us.

COMMISSIONER SPITZER: That may be true, but it may have nothing to do with Appendix A.

MS. KELLY: I'm not going to say that there's any direct cause and effect between merger A and B and the experience we're having now, but I'm just saying that the competitive structure of the market is an increasing concern to us.

CHAIRMAN KELLIHER: So there's no past merger that we've approved, that's a rallying point like the Alamo; there's not a remember-the-Alamo kind of resonance about one of the 60-some mergers that clearly, here's where the Commission got it wrong, and the consumer suffered as a result, and we can't ever let it happen again.

MS. KELLY: I can't think of one of those.

CHAIRMAN KELLIHER: I was just curious about the perception.

MS. KELLY: I would say that there was one lesson learned by merger applicants, which was, if you are going to offer intervenors specific goodies, to leave the table, you'd better make sure that they don't get them, unless the merger is consummated. That was a teachable moment.

COMMISSIONER SPITZER: Commissioner Ervin, you addressed some of the federalism issues, and the concern of, potentially, the Congressional mandate imposing on the FERC the burden of ascertaining the bona fides of state statutes, which is kind of tough.

A different take on this. In your region of the country, there is a tradition of regional and multistate operations, and the history of that seems to be a cultural issue. New England, different circumstances. In the West, I'll tell you, in the Tucson case, we had the dowager princess come in and testify that she was more comfortable. The intermediate entity was the LLC. Someone from Phoenix was chosen to be the president, in their wisdom, and this lady said, I trust the New York folks more than the guys from Phoenix.

There you have extreme parochialism. So you have these differences. In terms of state issues, we have, of course, a mandate for uniform treatment under the federal

system, yet you have these pretty vast differences in outlook. What do you see as the proper accomodation and balancing of those?

MR. ERVIN: That's actually what I did think about in the Raleigh Airport last night. It's a difficult one, but I think the first step is, if you continue to require including in the merger analysis, something like provision in Appendix A that inquires as to what's the effect on state regulation, making sure that comes in, I think the question then becomes the one that Commissioner Moeller and I talked about a little bit, which is, can the states adequately deal with that question themselves?

If the answer to that question is yes, I think that ends the inquiry, and you would never get to the question that Commissioner Spitzer raises.

If the answer to the question, is state regulation adequate, and you answer that, either in whole or in part, negatively, which, I realize that there's not a history of that with the Commission, but if you then proceed to try to say, what do we need to do to adequately protect state regulation, given that state regulation cannot protect itself, then I think you do need to come to grips with the question Commissioner Spitzer asked.

If it were me, and I were to ask the question, I think I would try to balance what you knew about the

conditions in a particular area, as best you could. I think you find yourself, in some places like mine, where most of the power that's sold to the retail customers, that is used, is generated by those entities themselves. It's not, for the most part, bought on the wholesale markets.

There's a fair history of how mergers like that are dealt with, and you can look at some state orders in representative areas, to make a determination of the kinds of things that state commissions are typically interested in.

Then, if you're dealing with a state commission in an organized market area, I think you're more likely to see a different set of questions, which go to the types of market power considerations that you were talking about this morning.

I think you can get some information from that. I don't think that most state commissions, in the course of such an inquiry, would truly expect you to start talking about the kinds of parochial considerations Commissioner Spitzer was talking about.

I certainly have tried, in my own review of mergers that we do, not to look at that particular issue, but, rather, to look at the transaction as a whole, and determine whether it is in the best interest of the customers, either as proposed or as a condition. That's

about the best answer I can give you.

COMMISSIONER SPITZER: Several states have been in their own proceedings where they have, in some cases, rejected the transactions and have spoken on other issues.

MR. ERVIN: At least our experience has been, that we have some very good intervenors that look at these transactions carefully and bring a plethora of issues in front of us. It sounds like your experience is similar.

I have been pretty comfortable with the merger orders that we issued. I think it's clear that state commissions take these types of proceedings seriously.

I think, for the most part, we can look out for ourselves, but there's a subset of cases where that may not be true.

COMMISSIONER SPITZER: Mr. Naeve, while we're talking about intervenors, you raised this issue of certainty. In all the years that I practiced law, I pretty uniformly refrained from giving any certain answers to any clients.

(Laughter.)

COMMISSIONER SPITZER: It was just too perilous. I also, in my legislative capacity, and, later, as a Commissioner, while conducting hearings at 2:00 in the morning, making sure everybody who has filled out a slip, got to speak, to some in audience, particularly the

applicants, I would say, democracy is sometimes messy.

The Chairman alluded to a temporal problem with the deadlines. That being said, why shouldn't, given the importance of the results, ultimately, shouldn't it be messy? Why should we try to impose certainty where we have certain matters that are open? What's the matter with the hearing process?

MR. NAEVE: I guess I have a couple of comments. First, of course, there's never certainty. Today, we have relative certainty, because we know the methodology and we can predict how it works, at least at the Commission.

There are several I think benefits to the Commission: The first is, you receive lots of 203 applications. Your system will be overloaded if you had to set every one of those for hearing, so you need some method for ferreting out which ones, potentially, can lead to competitive harm, and which ones do not, so you can pass the other ones through on a timely basis, let that happen, and the ones that need to be reviewed, get reviewed.

That's what your Appendix A screens were originally intended to do; to be conservative, to identify the ones that require a second look, and have a hearing.

If they require a second look, as a practical matter, I guess there are two relevant questions: One is, are they adequately conservative, or do they sometimes let

applications go through that should have been caught in the screen?

I think, as a general matter, they have been adequately conservative, because, again, your process, so far, at least, hasn't, I don't think, produced any duds. Maybe some day it will.

It is possible, I think, with any screen, that the screen is not perfect, because of improper market definitions and other things. Maybe something could get through the screen that shouldn't have, but we're going to need a screen, I think, just because you have to decide what goes to hearing and what doesn't. That's what the screens were intended.

I do think the practical effect today is, generally, the FERC process is going to identify problems, because it is conservative, that might not be identified at DOJ or FTC, and, consequently, some transactions may not get done, just because they can't get through the FERC process, or you may require mitigation, or they won't.

I think that happens more often than not in the transactions we look at. Often, our strategy is actually to file a DOJ or FTC, first, and wait for it to get approve, before we file at FERC, because we'll say, we don't see any real problems here, but we somehow flunked the screen, so let's let it go through the other agencies and try to get an

early termination and the file it at the Commission and have you receive early termination at these other agencies, and maybe they will listen to some story other than just simply looking at the screen.

So I think the process should be, let's have a conservative screen, take out the ones that don't present problems, and let those go. If they do present a problem, I do think you should look at them carefully, have a hearing, and do what you need to do.

I think a lot of the transactions that are caught in a conservative screen, nonetheless may go through, if you give them a more careful look.

COMMISSIONER SPITZER: Let me very briefly raise the issue of temporal issues, and tell me if I'm wrong; don't be bashful.

The distinction between the FERC analysis and classic antitrust -- I worked in antitrust trials. It was a pretty straightforward, static analysis, SCM vs. U.S.

With the dynamics of the electricity market, with the intent of capacity to create new generation, and the intent of RTOs to create new transmission, isn't the temporal nature -- shouldn't the FERC continue to apply the forward-looking, and what challenges does that raise, and is it different for DOJ in an antitrust analysis?

MR. FRANKENA: We always -- the question we

always ask, is, what difference is the merger going to make? In other words, it's not a question of comparing now to after the merger; it's a question of comparing our prediction of the world without the merger and our prediction of the world with the merger.

So we often face a problem in many of these sorts of newer markets, that are in the economy. You know, we get things where the market didn't even exist two years ago, and it's changing.

Then the question really gets to be difficult to figure out, how to look at it.

COMMISSIONER SPITZER: Even classic antitrust analysis incorporates the post hoc.

MR. FRANKENA: We're always trying to do that. It is, of course, difficult, but, certainly, that's what you should be doing; you should be looking ahead.

COMMISSIONER SPITZER: There's no question. There's adjustments in the rates. That's the sine qua non.

MR. BUSH: Just really quickly, because I know we're almost out of time, but the statutory requirement for mergers under the antitrust laws, is, does the merger tend to lessen competition, which is an incipient standard that is, in part, forward-looking, so we are engaging in a forward-looking analysis and trying to predict, exactly as Dr. Frankena has said, what would happen, absent the merger

and with the merger.

CHAIRMAN KELLIHER: I want to thank all the panelists for participating this morning. We really appreciate your help.

I think Jon Wellinghoff will enjoy watching us. We met that high standard.

(Laughter.)

CHAIRMAN KELLIHER: We have lunch upstairs, and the Commission is operating under a continuing resolution, so we have certain economies, so your hostess today is Commissioner Kelly. Commissioner Kelly invites all the panelists to go upstairs for lunch. We will resume promptly at 1:00.

(Whereupon, at 12:05 p.m., the Technical Conference was recessed for luncheon, to be reconvened this same day at 1:00 p.m.)

A F T E R N O O N S E S S I O N

(1:05 p.m.)

CHAIRMAN KELLIHER: We're going to resume. The second panel is up. I appreciate that.

Let me recognize our first speaker, Mark Hegedus, an attorney with Spiegel and McDiarmid, and on behalf of TAPS. Mark?

MR. HEGEDUS: Thank you, Mr. Chairman. On behalf of the Transmission Access Policy Study Group, I want to thank the Commission for organizing this technical conference and inviting TAPS to participate.

Like APPA, TAPS urges the Commission to undertake an examination of the adequacy of its merger review approach, in light of changes in the electricity industry in the ten years since the Commission's adoption of the merger policy.

In responding tot the three sets of questions posed on this afternoon's agenda, TAPS urges the Commission to make the following changes:

One, incorporate an analysis of competitive effects into merger analysis, including those effects that are not apparent from an assessment of concentration measures.

Two, enlarge the scope and types of information required to be filed by merger applicants, including

documents merger applicants already must file under Hart-Scott-Rodino.

Three, consider limited notice period of discovery, so that the Commission has the benefit of a larger body of facts when ruling on a merger.

Four, use the Commission's procedural flexibility to examine controversial mergers more closely, via technical conferences and Track I-type hearings.

Five, develop regional models to analyze mergers, taking advantage of the development of the proposed regional approach to analyzing market-based rate authorizations and the Office of Enforcement's expanding capabilities.

Turning to the questions regarding the merger policy factors, TAPS does not propose that the Commission change the factors that it uses to assess mergers. It does believe that there should be revisions in the focus of those factors, particularly regarding the competitive effects factor.

The central problem is that the Commission does not assess a proposed transaction's effect on competition itself, but, rather, looks at whether or not the merger passes the Appendix A screen, which, as we have heard this morning, is not a competitive effect.

While the Appendix A purports to be based upon the merger guidelines, the analysis begins and ends with the

first step, which is looking at the calculation of market shares and HHI, and ignores the other steps.

The Commission typically does not express why a particular transaction, will or will not lead to higher prices, for example, and when intervenors articulate harm theories that are not dependent upon HHIs, the Commission's response is often a claim that the proposed mitigation addressed by the intervenors or by the applicants, returns the HHI to the pre-transaction level.

Such a response, however, does not address competitive effects unrelated to HHIs in the first place.

Turning to other factors, the merger policy examination of a merger's effects on rates, is generally not problematic, but is affected by Commission decisions in other areas.

Concerns can arise, to the extent customers or the Commission's ability to police hold-harmless clauses and the like, is impaired by lack of access to relevant data.

Effect on regulation concerns can arise, to the extent that the Commission refrains from remedial actions, out of concern for potential overlaps with state regulation. Overlaps, however, will not arise where a state lacks authority to review certain kinds of mergers, or where the Commission's authority is exclusive.

Turning to questions about accommodating ex parte

rules, investigation time limits, and coordination with other agencies and states, the questions suggest that one way to deal with these issues, is the information exchange among agencies, but it is not clear that that can be accomplish, consistent with the Commission's ex parte rules, the procedural requirements of the APA and other agencies' obligations to maintain confidentiality of information.

While TAPS believes that interagency coordination is beneficial as a means to learn from each agency's best practices, coordination should not necessarily lead to identical outcomes. Under the Clayton Act's Section 7, the Antitrust Division of the Federal Trade Commission, assesses mergers to determine whether the might substantially lessen competition.

Under the FPA, the Commission must determine whether a merger is consistent with the public interest, which is a broader standard.

More importantly, the Commission must understand why its decisions are different from other agencies, and that the reasons for these differences, be justifiable.

For instance, the Commission's failure to consider some kind of merger harms, simply because they do not fit within the Commission's HHI-centered analytical framework, would not be a justified difference, given the concentration metrics' known limitations.

On the other hand, the Commission's requiring a more extensive merger remedy than one mandated by the Antitrust Division, would be justifiable, to the extent necessary to ensure that a transaction is consistent with the public interest.

In light of the foregoing and to ensure that the Commission has information needed to fully analyze mergers, TAPS suggests the following:

One, that the Commission can reduce the need for trial-type procedures, by requiring that additional relevant and preexisting information and data, be submitted as part of the initial Section 203 application.

Applicants should submit the transition background information that they must already prepare for the antitrust agencies under Hart-Scott-Rodino, and talk about the initial submission, not a second request.

Secondly, applicants should also submit all datasets examined, but not used by them in preparing an analysis.

Third, particularly if the Commission does not expand the kinds of information that it requires applicants to submit, consideration should be given to a limited right to discovery during the initial notice period.

Fourth, the FPA and APA provide the Commission with significant flexibility to structure proceedings,

including to have technical conferences, for example.

Finally, I'd like to address a question about modeling. The Commission should not address this question in isolation from other proceedings where market power questions are relevant, like market-based rates.

TAPS sees no reason why the proposed modeling that's been discussed for the market-based rate proceedings, could not be applied in the merger context. Further, the issue of modeling, specifically in competition analysis, generally is tied to the Commission's retaining merger authority.

While EPAct expanded the subject matter of the Commission's merger review, others continue to advocate that federal electric merger review, be the exclusive domain of the antitrust agencies.

The Commission's enhancing its ability for sound assessment of competition, would lend support to its retaining this merger authority in the face of these calls for removal, not should the Commission lose this authority. No other agency has the Commission's obligations to protect consumers from exploitation by noncompetitive utilities, or the Commission's resources for fulfilling those responsibilities.

The antitrust agencies, the Department of Energy, and the states, are not in a position to fulfill this

function, rather, the responsibility and the opportunity is the Commission's. Thank you very much.

CHAIRMAN KELLIHER: Thank you very much. I now introduce Dr. Diana Moss, Vice President of the American Antitrust Institute. Welcome.

MS. MOSS: Thanks, Mr. Chairman, Commissioners, and Commission Staff, for having me here today. As you might know, AAI is a Washington, D.C.-based nonprofit Institute.

We engage in education, research, and advocacy in many aspects of competition. Our mission is to increase the role of competition in the interest of the consumers in U.S. and world economies.

The merger policy is really a key component of a broader competition policy, as you know. I'd like to speak today to a couple of issues, primarily involving coordination amongst agencies that review electricity mergers.

Mergers directly affect the competitive landscape of any industry. It's particularly important, because consolidation is likely to be occurring against this backdrop of changing market institutions, changing market dynamics, that can really alter key competitive strategic variables such as where, how and when firms invest in infrastructure and how they conduct themselves in the

marketplace.

So, reviewing mergers in this changing environment, is really a challenge, and it's very important to properly scrutinize a merger's effect on competition.

A second reason why merger policy is particularly important today, is because mergers are subject to multiple review by numerous state and federal regulatory and antitrust agencies. The full force of this multi-agency review, I think, is coming at us, has already come at us, and there may be more of it in an era where you have large mergers like Exelon/PSE&G that leave these large horizontal and vertical footprints in the regional electricity markets.

So relatively little coordination between agencies, increases the probability of different analytical outcomes, potentially conflicting remedies, all of which raises uncertainty and detracts from the predictability and transparency of decisionmaking on the merger front.

I'd like to talk about three particular issues, but, before that -- and I think my statistics square with Commissioner Kelly's -- so I will just give you a lay of the land on what's happening in the industry as far as mergers in the last ten years.

There have been about a hundred mergers proposed from 1992 to 2006 in the electric industry. Two-thirds were electric-electric combinations; one-third were electric-gas

combinations. Eighty of those mergers were FERC-jurisdictional, so I think the 69 approved mergers squares up with that.

In 90 percent of the mergers consummated, the antitrust agency has imposed remedies, which is a far higher percentage than we would see across, as an average, for industry. In the Commission's case, you imposed remedies or accepted remedies proposed by applicants in 6 percent of cases.

So now to these few major differences between antitrust and regulatory review that have some important implications for the Commission.

One is that in the Merger Policy Statement, which officially adopted the guidelines, Appendix A of the Merger Policy Statement, focuses, really, on a very small part of the guidelines' framework.

That framework has five major components: One is relevant market definition, product and geography; the second is evaluating market concentration; the third is positing theories of competitive harm, which you have heard a lot about today; the fourth is evaluating ease of entry; and the fifth, of course, is looking at merger-related efficiencies.

Appendix A really takes up the first two of these steps, defining markets and determining if market

concentration exceeds the thresholds in the guidelines. If it does, then applicants are encouraged to propose remedies, as opposed to moving on.

Therefore, the Commission gives great weight to these first two steps, but relatively less weight to theories of harm, to entry, and to efficiency.

That's not all bad, because the tricky part of merger analysis in electricity, is defining markets. They're difficult to define.

Product markets have time dimensions, geographies, very much determined by transmission constraints, et cetera.

So, it's a difficult part of the analysis, and it's better that Appendix A focuses on that particular part, but market concentration is really just a screen. The full story of a merger's competitive effects -- good or bad -- is really told by the totality of the guidelines, not just the first two factors.

Theories of harm or the market power story, as I like to call it, can include unilateral effects such as a dominant firm with holding capacity. It can include coordinated effects such as multiple firms tacitly colluding on price or output.

The role of entry is important; generation and transmission, and whether entry can discipline post-merger

price increases; merger-related efficiencies of scale, scope and coordination economies, are also important to consider in the balance of these guidelines factors.

Much of this focus on market definition, is really driven by this reliance on publicly-available data, and, while publicly-available data is really very serviceable for defining markets, it doesn't provide a whole lot of support for theories of harm, for looking at entry, and for inefficiencies.

Much of what the antitrust agencies uncover in their confidential discovery, really goes to those factors, but the Commission's analysis, using publicly-available data, does not, so, not giving due consideration to all these guidelines factors, increases the probability of incomplete analysis, different outcomes based on different agency review, potentially mismatched remedies, just a less transparent and predictable decisionmaking process.

So there are no quick fixes, obviously, but there are a couple of things the Commission might want to consider: One is to encourage more frequent periodic interagency meetings between the FERC and the antitrust agencies and the states, to discuss all the guideline factors, either in a generic context, but probably not in a case-specific context.

A second thought is to issue data requests in

merger proceedings, where additional information that can get at theories of harm, entry, and efficiencies, can be uncovered.

The second major issue that emerges in contrasting antitrust and regulatory review of mergers, is how economic analysis is handled. The antitrust agencies perform their own inhouse analysis, but the Commission really relies heavily on applicants.

This lack of internal analytical corroboration, introduces a problem. I recently concluded a study that reviewed merger filings at the Commission from 1997 to 2004, and I found that in a number of cases, several of the same relevant geographic and product markets, were analyzed, but the levels of concentration in any given market, varied widely.

In other words, several different merger filings come into the Commission and you pick one market, such as Ameren or Cinergy or a number of others, and you would find that levels of concentration in those markets, vary wildly from filing to filing.

This is not caused by generation entry, expanding boundaries of markets due to RTOs, or legitimate market conditions. It can only be explained by variations in modeling, data, and assumptions used by the economic experts that perform these analyses. This type of inconsistency

really should be of grave concern, particularly since, if the Commission is relying on it, it potentially introduces analytical error into the decisionmaking process.

The AAI suggests that an appropriate fix for the problem, is to develop an inhouse model that the Commission can use to corroborate applicants' analyses, or to perform the analysis using applicant-provided data, which would allow you to detect bias in important data and analytical issues, and perform the types of sensitivity analyses that are important.

Finally, I'd like to address the third difference between regulatory and antitrust review, which is the issue of remedies. As you know, the antitrust agencies favor structural remedies, as opposed to conduct-based remedies.

Divestiture, for example, is a one-time fix that permanently reduces or eliminates the ability and incentive to adversely affect prices through the exercise of market power.

FERC has traditionally favored conduct-based remedies such as RTO commitments, virtual divestiture, market monitoring. It may be inherently a more comfortable approach for the Commission, but it does require ongoing monitoring and enforcement for all the parties. The concern is, in a system with multi-agency merger review, remedies imposed in different jurisdictions, can potentially be

duplicative or conflict with one another, imposing unnecessary additional costs on both the Commission and the applicant.

The Commission then might want to consider structural remedies, or, if they are able to coordinate better with states and the antitrust agencies in developing some sort of interagency guidelines, to look at merger remedies in merger cases.

In sum, I'd like to note that despite very different standards of review, procedure, and institutional preferences, we live in a world where there is multi-agency review. There's nothing wrong with that.

What I'm attempting to propose, however, is an increased level of coordination to harmonize and improve the consistency of competitive analysis that comes out of merger filings, and I think these efforts for more consistency, predictability, and credibility, would really further the goal of promoting competitive electricity markets. Thanks very much.

CHAIRMAN KELLIHER: Thank you. I'd like to now recognize Dr. Mark Niefer, a Trial Attorney with the Antitrust Division of the U.S. Department of Justice. Welcome.

MR. NIEFER: Thank you, Mr. Chairman and members of the Commission, for giving me the chance to participate

in today's conference. I'm a trial attorney at the U.S. Department of Justice Antitrust Division, where our work includes analyzing wholesale power mergers under Section 7 of the Clayton Act, which prohibits mergers that attempt to lessen competition and raise prices to consumers.

Today I'd like to briefly discuss certain aspects of the process and substance of our merger review in the electric power industry. I hope my remarks on process, will shed some light on the question of coordination between the Commission and our agencies, in particular, coordination with the Antitrust Division.

I hope my remarks on substance, as illustrated by analysis of the Exelon and PSEG merger, will inform the Commission's decision as to whether it needs to revise its analysis of mergers and merger remedies.

Before I get started, I'd like to state that my remarks today are my own and do not represent the opinions or the positions of the Division.

First, I'd like to briefly discuss process and the extent to which the Division is precluded from sharing much of the information it gathers to analyze a merger.

The are two statutes that give the Division the authority to collect information from merging parties and others: The Hart-Scott-Rodino Antitrust Improvement Act, usually referred to as the HSR Act; and the Antitrust Civil

Process Act.

The HSR Act requires merging parties of a certain size, to provide the Division, basic information regarding their transaction. It also allows the Division to issue a so-called Second Request for Additional Information from the merging parties, if the Division has concerns about the merger.

The Antitrust Civil Process Act permits the Division to seek oral or written testimony or documents from the merging parties or from others, regarding the merger.

Except in very limited circumstances, information provided to the Division pursuant to these two statutes, may not be disclosed to others, without the consent of the producing party.

These two statutes are the primary tool used to gather evidence concerning the competitive effects of a merger, and it is often the case that the data, documents, and testimony we gather under these statutes, form the basis for our decision to challenge a merger under Section 7.

This presents two problems: First, the Division typically cannot share much of the information it relies on, and, secondly, because such confidential information often forms the basis of its opinion, the Division can have only limited conversations with others about its analysis of a merger.

Merely discussing the analysis may reveal confidential information. Thus the Division is required to be extremely cautious about discussions of the merger with others.

Indeed, these statutory limitations will limit what I can say today about the Exelon merger.

I'd like to turn now from process to substance. There are two broad topics I'd like to discuss: First, our assessment of a merger's likely competitive effects; second, our assessment of our merger remedies.

Our analysis of competitive effects is guided by our horizontal merger guidelines. There are two aspect of this analysis I'd like to mention briefly, with respect to the Exelon merger.

First, I'd like to touch on market shares and concentration. In the case of the Exelon merger, capacity-based HHIs were high in markets of concern to us, and the merger produced notable increases in the HHIs, raising antitrust concerns.

However, the HHIs were only the starting point of our analysis of competitive effects. As is generally understood, variation in the cost and operating characteristics of generating units, may allow a generator to exercise market power, even if the market is relatively un-concentrated.

As a result, we're also engaged in a detailed analysis of competitive effects, focusing on the characteristics of the portfolio and generating assets owned by Exelon, post-merger. Let's now turn to that more detailed analysis:

In the case of the Exelon merger, we posited a fuel curve theory under which the combination of generating assets owned by Exelon and PSEG, would increase the merged firm's ability and incentive to exercise market power, post-merger.

Without getting into the details of the Exelon merger, we typically consider a wide variety of qualitative and quantitative evidence to help us assess competitive effects.

That qualitative evidence may include: Documents and testimony from the merging parties or others, about how generating units are offered into the market; the quantitative issues we rely on, may range from simple market shares and HHIs, to pivotal supplier and residual supplier indexes, to simple models of the cost and benefits to a merged firm, to highly complex models of the decision by a firm to operate a generating unit into the markets at issue.

The wide range of evidence we consider, helps assure us that our conclusions regarding the likely competitive effects of the merger, are addressed.

In the case of the Exelon merger, quantitative and qualitative evidence led us to conclude that competition was likely to be substantially reduced, post-merger, consistent with our fuel curve theory.

Next, I'd like to turn to our analysis of potential remedies. Our analysis of any potential remedy, is guided by the Antitrust Division Policy Guide to Merger Remedies.

The Remedies Guide lays out three principles that are important to our remedy in the Exelon merger: First, structural remedies; that is, the immediate, fully-executed change in competitive conditions, post-merger, through the sale of physical assets, are to be preferred to conduct remedies that have to be monitored and administered over time to be effective.

Second, a remedy should restore competition to pre-merger levels, not merely return the markets to per-merger concentration levels.

Third, a remedy should flow from a theory of harm, in order to assure that the remedy would be effective in alleviating the identified harm.

These three principles led us to a proposed remedy in Exelon, calling for divestiture of identified assets that would restore competition to our markets of concern and under our fuel curve theory of harm.

The remedy eliminates, substantially, all the merged firm's ability and part of its incentive to exercise market power, post-merger, assuring that there would not be a substantial harm to competition.

I'd like to conclude by emphasizing that there is typically not a single silver bullet that determines whether we will challenge an electric power merger as anticompetitive. When faced with a merger that presents substantial concern, the Antitrust Division will conduct a very detailed, case-specific investigation, utilizing a wide variety of evidence and tools to assess the effects of the merger and the efficacy of a remedy.

Much of the evidence we rely on, however, is protected by statute from disclosure to others, including other federal agencies, which may limit the extent to which we an coordinate or exchange information with others.

I've only scratched the surface of our review, but I look forward to your questions.

CHAIRMAN KELLIHER: Thank you. I'd like to now recognize Jonathan Baliff, Managing Director, Global Energy Group, Credit Suisse.

MR. BALIFF: Thank you, Mr. Chairman. I want to also thank Commission Staff for inviting me to this Technical Conference.

I can't say that I'm an expert on Appendix A, but

what I can say, is that I did run a fairly scientific survey when I found out Monday that I was going to be at this Technical Conference.

I started out on my Rolodex at A and started calling pretty much every investor that I could think of, about what they thought of 669, Appendix A. I guess, after Citadel Capital, a number of them said basically the same thing; I don't know what 669 is; I don't know what Appendix A is, but I do know this: I know that, in general, when we have been looking at mergers in the past, most of the investors have felt that the FERC has done a very good job.

It's kind of self-serving, giving that to FERC, but, in general, I've also testified in Virginia and a number of other places and said the same thing. Investors, in general, feel that the Federal Energy Regulatory Commission, and, broadly, most of the regulatory agencies at the federal level, are not the problem when it comes to looking at different market power concerns.

There's a fairly certain process, both historically and especially in the new -- I would call it 669 regime -- and many investors, although they don't know the specifics, do know, on a relative basis -- and this is important -- on a relative basis, that it's really the states that have been the issue, and have created uncertainty among many of the mergers, whether it be at the

wholesale level in generation, or whether it's also been vertically-integrated models.

Credit Suisse has been involved in many of the transactions that have been in the headlines over the last six to eight months. Many of them also have been already approved by the Federal Energy Regulatory Commission and a number of other processes.

Today, we have, in fact, the TXU leveraged buyout that is going to be coming in the coming months. For sure, when I talked to most of these investors -- and, again, I stopped at C, because everybody said the same thing -- they are not familiar, necessarily, with the a number of the specific processes in Appendix A, but they do believe that if you look at the three questions in front of this Technical Conference, should the Commission retain the factors or change the factors, I would say, overwhelmingly, most of them said you should keep it the way that you have it right now, that the competition rates in regulation are fairly well known by the investor base, both from the equity an debt sides.

What they really worry about, is elongated timeframes for changes, that create uncertainty at both the federal and state levels. Again, most of the time, the investors think more about the states in these merger approval processes, and the uncertainty associated with

them.

When you're talking about -- I think one of the reasons investors like what the FERC has been doing over the past ten years, it's because there is a sense that there is a concern on timing, much more so than at many of the states levels.

That, by the way, is not universal across all the states. I think there are a number of states that set timing and it's important, but, on a relative basis, for sure, they feel that FERC has a very intense effort or sense of urgency in its processes, not even associated with its expedited processes.

That gives, again, a level of certainty that most of the investor base and the issuers like to see.

I think the biggest issue is the coordination. I can't say that I have all the answers. I would, again, defer to what investors think, but, again, I think the coordination between the state and federal agencies, is probably the key, in investors' minds, especially the elongation of time periods.

I think many investors feel, whether it was Exelon/PSE&G or other mergers, that these conclusions could have come to, let's say, a faster conclusion, as opposed to being a little bit more elongated.

I think the third question in front of the

Commission as part of this Technical Conference, is, can you use some form of a model? We would love to see a model that could specially reconcile or give more clarity to, especially, locational power issues associated with transmission constraints.

The HHI Index, I think we all understand, both the pros of it, at least from the investors' standpoint. One of the significant pros is that it's very easy to do. On my desktop, I have a spreadsheet that I can call up and start plugging in different generation from different clients, or investors can do it, and try to figure out what different mergers might look like. It's very easy.

With that simplification does come some of the other challenges, which I'm sure my fellow panelists can talk about. If you were to input some type of a model, it would be very difficult, unless the model was generally accepted, and would be something that I'm sure would be a boon to the modelers themselves, who have this particular model, but it would have to be well dispersed and well agreed upon, so that everybody could use it, and so that people could not wait until the end game, until you're actually in front of the Commission or the other regulatory bodies, to actually figure out what it looks like or whether your particular transaction works.

I think, in conclusion, I want to give the

Commission a bit of a sense on what is going on today in the capital markets, because there's been a lot of volatility over the last two or three weeks in the equity markets and the debt markets.

The one way I can put the discussion in context, is that there's still -- I had one investor who said a wall of liquidity, a wall of capital that wants to find a home in, broadly, the energy space, but, very specifically in the electric utility space, today, most utilities are trading, not at their 52-week highs, even with the fall off in some of the equities, broadly in the S&P 500, the electric utilities have enjoyed an almost highwater mark as far as their valuation.

I would put it another way: They have about the lowest cost of capital that we've seen, at least in my industry, in 15 years on Wall Street, and I think most of my senior bankers would also agree with me, maybe in 20 years. Today, a utility, even following all the market volatility, enjoys a cost of capital, on average, of 5.5 percent, pre-tax. On an after-tax basis, that is very low debt cost of capital to be able to invest in transmission, generation, and other infrastructure that I think the Commission knows is sorely needed.

So, what we are worried about, as far as Wall Street, is that there is a view from investors, that there

are companies that do certain things well. Those companies that do things well, whether it be a regulatory competitive advantage or investing in transmission competitive advantage, these companies, in order to enjoy that low cost of capital, need to grow in scale.

They'd like to see some of these companies grow in scale, obviously in a way that complies with all of the federal agencies. I think what they are worried about, is that this wall of investment can't get into the right managers, because of uncertainties associated with the states and the coordination that federal agencies would have with the states as we move forward.

I look forward to answering your questions.

CHAIRMAN KELLIHER: Thank you very much. I'd now recognize Douglas Green, a partner in Steptoe and Johnson. Welcome.

MR. GREEN: Mr. Chairman, members of the Commission, and Commission Staff, thank you for inviting me here today. I did represent Public Service in the Exelon merger before the Justice Department and in the State of New Jersey, and have been involved in a number of other mergers, but I am here today addressing only my own views, not those of my law firm or any other clients.

I'd like to start first by saying that I think Congress made it clear when it enacted the Energy Policy Act

in 2005, that it was not intending that this Commission's review, merely be a redundant duplication of what goes on at the Department of Justice and FTC.

The Commission's standard, consistent with the public interest standard, was preserved and reconfirmed, and the review authority was expanded to cover generating facility acquisitions.

It's inconceivable that Congress did this, expanded the Commission's authority and preserved its standard, if all it wanted was a carbon copy of what happens at DOJ.

To accentuate that, I put out the numbers 180, 30, and 455; 180 days is what Congress has directed the Commission, generally, to try and get mergers completed in. DOJ normally completes its review in 30 days. Under Hart-Scott, it has 30 days to clear a merger, and only if it issues a second request, does it then get into the comprehensive investigation that we've heard about here today.

In the Exelon case, it took 455 days for that investigation to conclude, and other major mergers where DOJ has investigated, to a similar extent, the same timeframe was basically what has happened. So, you have, on the one hand, a completely confidential review that is either very summary or incredibly comprehensive and gets into even the

areas where this Commission has no jurisdiction.

On the other side, you have this Commission's review, which is on the record and which should inculcate the policies and the expertise and the market oversight which this Commission alone has.

We've heard about structural versus conduct remedies. Well, just to take one example of how this Commission's expertise, I think, makes a difference, in the APCSW merger, which I was also involved with, among other things, the Commission required that AEP, after that merger, enter into an arrangement with an independent monitor, so that their determination of available transmission capacity, was no longer done by the Company, but was done independently and was monitored to make sure there was no favoritism in transmission.

That was a conduct remedy. Was that a bad thing? I'll let the facts speak for themselves.

Now, we've also heard a lot about Appendix A. If it's used as more than a screen, if it's used as the end-all and be-all, at least in theory, one could sweep too broadly in some cases, and too narrowly in others.

Although there aren't any examples anybody can identify, where that has really happened, it certainly, conceivably, could happen.

What should the Commission do about it? I don't

1 think that the way to respond to that, is to require all
2 merger applicants to submit to the Commission, all the
3 materials that it submits to the Department of Justice or
4 their work product into Appendix As.
5 As Mr. Naeve indicated, protections for cases
6 involving multiple intervenors, is not a very good way to
7 proceed. And Congress, when it enacted Hart-Scott, made it
8 confidential, made those submissions confidential, for a
9 reason.
10 But I do think that the suggestion that has been
11 made, that in a complex case where the Commission has some
12 concerns about whether the remedy that's been proposed,
13 will, indeed, solve any competitive effects that may be
14 indicated by the screen, it would make sense, I think, for
15 the Commission to hold a technical conference to invite the
16 applicants in, have the Staff in to see it, go through the
17 applicant's application, have questions, and find out if
18 there's data or information that the Commission ought to
19 consider, that would facilitate its review and allow it to
20 do a competitive-based analysis.
21 I'd like to say, quickly, a word on models: I
22 don't think there is a magic bullet, as Mark Niefer said, in
23 any particular model, any regional model.
24 Interestingly, when you give the Department of
25 Justice -- and they do all these complicated analyses --

they don't show them; you never see them.

If you want to see their models, their analyses, you've got to go to court and challenge them. That's probably one of the reasons they don't show them to you.

But, in any event, the modeling world is a complex world where there are disagreements among even the greatest experts about concepts and implementation, disagreements about whether you use the supply punctuated equilibrium model, which models the prices that participants bid, as you do in an auction market.

In California, very well known experts have said we should use a Cornell model, which models the output of market participants, not their bid prices. In the Exelon hearings in New Jersey, one of the market participants submitted a dominant-firm model of the merger, where the merged firm exercises market power and the other firms are price-takers.

Then it turns out that that model showed that the merger reduced prices, and, of course, the proponent then changed the model and came up with a different model.

So, with these models, there's no great agreement on how to do them. They can be a tool that's usable to analyze competitive effects in cases where a very detailed inquiry is necessary, but they require a degree of art to design, to apply, and to interpret, and they require an

enormous amount of data as to operating costs, startup costs, and transmission constraints.

We need a benchmark that compares the no-merger, versus the post-merger conditions. If you use historical data for the benchmark, you need to normalize whether there are transmission failures or generation outages.

In Exelon and PS, the Justice Department asked us to walk through our hourly sales of the physical and financial contracts. Why financial contracts? Because, if you're doing one of these models and trying to model incentives, you need to know whether the participant is long or short on generation in an hour.

If he's long, he has an incentive, but, if he's short, he's hedged all the way out into the future. He has a disincentive to raise prices.

It took us hundreds of manhours to develop that data and walk the Department through it, and that was just for one company in one market, and we would have to update that constantly, if you wanted to have a comprehensive model of that type to be ongoing.

Moreover, if you were going to have a model, if you were going to use a model to inform your judgment, you'd want it to be, as Mr. Baliff said, you'd want it to be publicly available. It's going to have the most competitively-sensitive data that there is, but you'd want

it to be publicly available, so that potential merger applicants could use it and could evaluate whether or not they could pass your standards.

These decisions here need to be on the record. I think we're not really at the state of the art where we would have a model as a substitute for screening, especially a screen that seems to be working pretty well, but it could be used as an analytical tool in the appropriate case.

Lastly, on coordination, I wish I knew a magic potion to facilitate coordination, particularly among the states, but, like my predecessors on the last panel, I can tell you that the Exelon merger did not fail because of lack of coordination.

Here at the Commission, we had five rounds of paper hearings with submissions by the New Jersey Commissioners, consulting by the market monitor, per invitation, by economists on all sides, eminent economists; we had live hearings in Pennsylvania, and a decision based on those hearings; and we had the decree issued by the Justice Department in a whole separate order, the Competitive Impact Statement, and communications between New Jersey and the Justice Department, and a live hearing in New Jersey, and still that merger failed.

It wasn't because it lacked coordination; it was because the New Jersey regulators believed that their

statute and policies required a different result, and then there are all these other agencies that have approved the merger. Thank you.

CHAIRMAN KELLIHER: It looks like we have enough time, certainly, for questions by my colleagues and myself, and hopefully we'll have time for Staff questions, since I would hazard that they are more expert on these matters than we are.

Let me start off with Mr. Green's last comment about coordination, something a number of you raised. I agree that there certainly are limits to coordination, and we've already heard Dr. Niefer talk about how those limits from the Justice Department's perspective on what they can share, even with FERC.

We are not going to be able to get perfect coordination. We are going to have multiple coordination, we are going to have multiple decisionmakers. I don't really quite agree with Mark about the risks that FERC will lose its merger review authority. That was something, I think, that came up in the Energy Policy Act.

It was in legislation that was proposed, and Congress consciously decided against that. I think, actually, Justice probably opposed those proposals to eliminate FERC's major review authority in favor of the Justice Department.

I think the Justice Department actually opposed that. We were going to have multiple decisionmakers applying different standards, with different outcomes. We may have the prospect of mismatched remedies, as Diana mentioned, in part, because we have different tools.

FERC does have the authority to order divestiture on both generation and transmission. It's natural for antitrust agencies to prefer the structural remedy, for philosophical reasons -- I won't say theological; I'll say philosophical -- but in terms of the regulatory authority, we have ongoing authority over the merged entities.

But it's the one opportunity to, quote, get it right. The one preferred approach of a structural remedy, we have a structural remedy, as well, and we have other remedies. Hopefully, we'll continue to raise the prospect of mismatched remedies. It's also difficult, in concept, to see how we coordinate between all the state decisionmakers.

There are something like 48 states that have merger review authority. I don't know how you would try to put up some constancy of approach. I mean, the fate of the Exelon merger -- how many states approved the Exelon merger?

MR. GREEN: Pennsylvania and I believe there may have been an approval in Illinois.

CHAIRMAN KELLIHER: A number of states approved it, one rejected it and one was sufficient to reject it. I'm only aware of one real classic case of coordination and state review of a merger, and that would be the PacifiCorp acquisition of Utah Power & Light, partly because of the company structure, it was not a holding company with a utility.

They set up a special committee composed of state regulators from each of seven states and that was one classic structural approach coordination and it's the only one that has occurred in the past quarter century.

So those are more in the form of statements rather than questions, I suppose but Diana don't you agree that mis-matched remedies were a problem that you identified, but don't you agree that it's actually unavoidable given the different decision makers, applying different legal standards, not just using different methodologies and different kind of analysis, but applying different legal standards and actually protecting different customers?

MS. MOSS: I agree completely. Again, I don't have any quick fixes for this either. I think it's a really complex problems. There are different standards, different

procedures, different preferences on remedies; regulatory versus antitrust. All of that is a given.

I guess what I'm advocating is, to the extent possible to work within those confines, the multi-agency review, the whole differing package of approach that each agency has, there is a room for some improvement, I guess that's what I'm saying. There is room for some harmonization, particularly on the competitive analysis front.

That's really what I think is worth spending some time thinking about, and that's largely where my comments went. I guess I would ask people to think about instances in Pacific Northwest, for example, if Exelon had succeeded as a merger and the FERC remedy went into place, as well as the DoJ remedy had gone into place, what do we do with situations like that?

For example, DoJ would have required that a divestiture of 5600 megawatts of fossil fuel generation. FERC remedy would have required or accepted some actual divestiture but also some virtual divestiture.

If both of those remedies go into place, much like in the Pacific, even though that merger with DoJ when required divestiture of two fossil generation plants or owned by Southern California Edison but FERC had imposed same time capacity disclosure rules to prevent foreclosure

in that market.

If both those remedies go into place in both of those merger cases, I guess my question is, not to some extent duplicative and duly not impose additional cost on the company. Cost of compliance, cost to the Commission to oversee a remedy that has been imposed by two agencies when maybe one remedy might have done the trick.

CHAIRMAN KELLIHER: First of all, let's assume you have two federal actors, two federal agencies acting. We decide how political case, we would decide on different remedies. I think the applicant would look at the remedies and see are the inconsistent, are they just different or are they contradictory to some extent, or are they burdensome, consistent but burdensome and perhaps if you overlap the two, some of it doesn't seem necessary, they could appeal to either of the decision makers, refer to the other agency's action, and say, would you reconsider some of the remedies in light of the second agency's action?

That would seem to be something that the merging applicant would seek to do and I don't know why either of the two federal actors in that hypothetical would dismiss the possibility, offer some remedies in light of the other agency's action.

And that may result in the Agency A and Agency B and the applicant ask Agency A to revisit some of its

remedies. Agency A may disagree and say no. Applying our law, we think the remedies we approved earlier are necessary, and then the applicant ultimately may think the combined remedies of the two agencies are somehow excessive.

They have the option, of course, not to ultimately consummate the merger. I think a question, Mr. Baliff referred to this, one think that struck me after the Energy Policy Act was enacted, with the repeal of the 35 Act, it was a refrain that I heard many times and it puzzled me each time.

Somehow appeal to the Holding Company Act, the 35 Act, limited the state role in reviewing mergers. I thought that was very puzzling to me. I thought state law was completely unchanged. You still need the state approval to get mergers with that 35 Act.

In the fate of the Exelon merger, shows that states can block a merger if so disposed. I assume you agree.

MR. BAILIFF: I would say even more so.

CHAIRMAN KELLIHER: Is that the unpredictable state action/

MR. BAILIFF: I would say that it's the states that investors are worried about. It's not so much the unpredictability of a specific state. I think it's just the nature that many of the mergers that you could see

especially in the coming future with this, there is a lot of money coming in and they be big mergers, they be multi-states. So it's a layering of states as opposed to maybe just one specific state.

I think they're referring -- and still when I heard the same thing that you just mentioned has been replaced by this referring of now we actually have an incentive, PUHCA being repealed. We have 50 individual PUHCAs that more is -- what we'll call the rallying cry or anything of that nature. It's just I think the nature of how people feel the current merger approval authority from the state's standpoint, that's the stance that most people think about.

CHAIRMAN KELLIHER: I wouldn't argue that the state merger review is somehow inherently less predictable than federal but there probably is some variability in state review. Some state review is probably more predicable than FERC or the Justice Department, other states perhaps less predictable.

MR. BALIFF: I wish there were some science to it, but you know Wall Street -- expectations are everything. I think there is this embedded expectation with the removal of PUHCA that because so many of the participants, investors, issuers had lived underneath it, that all of a sudden it's like somebody who's been, for lack of a better

word, constrained for two or three years, now all of a sudden, they're unconstrained to run around.

I think there is this view that things are going to become easier only because people have lived a little bit more constrained before.

CHAIRMAN KELLIHER: I think the common wisdom was wrong that in the Energy Policy Act somehow the state's role had been eliminated and I think the common wisdom now that somehow the state role is dominant, is probably also wrong.

MR. BALIFF: And if everything is about expectations, just like anything. If you don't meet an expectation, either one I would say is not rational, you get a little bit of a panic reaction.

CHAIRMAN KELLIHER: I have two more questions and I'll turn to my colleagues. One is the question of the regional model. Do we really have one model that would work in the different regions that we're looking at. Do we have one regional model that could assess the effect of a merger in MISO and the same model could be used in the western United States? Southern United States?

I'm not an economist, but it just seems like those regions are actually very different. We're just questioning whether you can actually have one regional model at least nationwide and very different power markets are regulated.

MS. MOSS: I'll respond to that. A good model -- economists will give you different opinions on what gives you a good model. Some will say good models are generic enough to be but will handle different parameters, different data inputs.

I don't have the answer but my suspicion is that it might be possible to build a generic model to apply using different assumptions and data inputs for different regions of the U.S., okay?

It's also true that given different methods of price determination in different regional markets, that you might in fact need different models depending on how good your model builder is and how flexible he wrote this model. I think it could go either way.

I think the bottom line is there is so much to support, based on what I've said and what I've seen, there is so much to support the commission doing this undertaking, the development of a regional model or models.

If you need two types of models that it would pass the cosmetic test, I think, to do that. The types of models Markus talked about and I talked about as well are used in an antitrust investigation. Obviously, there are numerous modeling approaches. The questions you're trying to answer may dictate the need for one model or another model.

I think what we're talking about for the Commission is that if it continues with Appendix A and the screening approach are not those types of models, it is a model that would implement the delivered price test here in a structural context or even a simulation model. There I think it's possible to have fewer models that are much more manageable.

CHAIRMAN KELLIHER: Thank you. Mark.

MR. HEGEDUS: On the model I think I agree. You want to incorporate specificity within the regions. For example, some regions are marked by retail choice. Other regions are marked by continued traditional regulations that's going to make a difference in the incentives of a company to exercise market power.

Our review of the model is that you're not going to have one tomorrow but that's something you should be striving for and perhaps be engaged with the industry in developing one. The resources that are being built up in terms of your market monitoring through the market enforcement, I would encourage. But we continue to commit resources in that area.

In the meantime, I think we can go a long way in investing our concerns if we actually required or you required companies, applicants to address this competitive effects factor, posit a candidate story of harm and tell you

why you shouldn't have to worry about it, and also give intervenors an opportunity to tell a candidate story of harm in their protests and address those candidate stories of harm in your orders on the transactions, including maybe reasons why the HHI doesn't predict that particular harm theory. That would help an awful lot until we get to the day when we have a model that could help us with our predictive powers.

CHAIRMAN KELLIHER: Mr. Green, do you have a comment?

MR. GREEN: Yes Mr. Chairman, I'm reminded a little bit of the story my mother used to read to me when I was a child about the little boy who went to the zoo with his nurse and he ran away from his nurse and was eaten by a lion. The moral on the tale is, always keep a hold of nurse for fear of finding something worse. And that's what I think about when I hear the idea of these models.

Aspirationally, as I said, they are a tool that can be used if there is a question about competitive effects. They're not a screen. I don't think they are a substitute for Appendix A. I think they would be a lot worse. All of us who have seen litigation in this industry have seen what happens when you litigate about models. You get into a battle of the models. You get a lot of very smart, very sophisticated people making small adjustments in

the model to produce large adjustments in the result.

In the hands of people like Mark Niefer, who spent their days and their career analyzing competitive effects, they understand what you can and can't do with these models. They know how to fine tune them and adjust them to particular situations. How to make judgments about where they're used.

In an informal and confidential process, I think they can make a lot of sense. I do think that if you start to use them in proceedings like this, you may quote an official model that is difficult for people to challenge. The chances of it developing misleading results are high.

The HHI market screen is a market screen that has been used in the antitrust field now for many decades. It's incorporated in the guidelines. Mark Frankenna told us that the FTC uses these as an initial screen themselves. It's a screening device that has shown over the years these results. I think if these models were still of the early stages, some evolution of models.

CHAIRMAN KELLIHER: I want to talk to something you said earlier and then I'll turn to Mark. I just want to be clear on something you said earlier. I don't want to be critical of the Justice Department, but you said that the Justice Department uses a model, a proposed merger and the model shows negative outcomes.

They informed the applicant, the merger applicant but the merger applicants perhaps told what the outcome is but not the particulars of the model.

MR. GREEN: That's correct, that's been my experience. I haven't been involved with every one of these mergers reviewed by the Department by any means, but in my experience, both in this industry and in other industries, when the Justice Department does a competitive effects model, they will sit down and tell you very much what Mark said earlier, that they see the problem as a combination of base load axis, incentive axis and here is their idea of how to solve the problem, but they will not show you the model.

In this industry, the ability of an applicant to say to them, we're going to take you to court. It's limited frankly in the PSEG, Exelon, we thought if we are able to do that, we had a good chance of winning in court. But we still had the New Jersey Commission with an approval that was outstanding and we didn't think going to court and winning was going to help us at all with New Jersey. It might have a counter effect.

That historically has always been true in this industry because historically you have the SEC as the final word on mergers and the SEC was not about to approve a merger that the Justice Department found problematic.

I don't know what the policy is, but when I have

asked Justice we see your model, we'd like to sit down, we'd like to have the experts join together, I have been told our policy is not to do that. I don't know whether in some cases they have, but I can tell you, in the Exelon case they didn't.

CHAIRMAN KELLIHER: So your response is to come up with a model to try and model the same problem or test the same theory but somewhat blindly not knowing the particulars of Justice's model?

MR. GREEN: I would say that in Exelon, and we did that, as Mark said we submitted our own White Papers and analysis but in Exelon, we didn't disagree in theory with what the Justice Department said the problem was.

We thought the FERC remedy solved that, so we divested in FERC under virtual divestiture contractual arrangements that lasted for the life of the unit. We divested nuclear energy 24/7 all around the clock. We thought that was a divestiture, a contractual divestiture of nuclear energy.

The Justice Department, as a matter of policy said, we consider that to be conduct remedy. We would rather do a structural remedy and if you rule that out, if you rule out a virtual divestiture, you can only deal with the fossil asset, of course your divestiture is going to have a lot more fossil than the FERC had.

CHAIRMAN KELLIHER: Cindy, on the question of mis-match remedies. Did Exelon file with us after the Justice Department action to try to eliminate or try to reduce the mismatch? Did they file or did we anticipate a filing from them?

MS. MARLETTE: I don't recall.

CHAIRMAN KELLIHER: Do you gentlemen remember?

MR. HUNGER: I think it would have to come in after divestiture and show that they met the standards we would allow, so we would need to approve what the Justice Department told them to do.

CHAIRMAN KELLIHER: I think it was addressed in the mis-matched issues? I don't know if they actually came in because New Jersey might have intervened.

MR. HUNGER: You know, Mr. Chairman, we did have an obligation, as Dave says, to submit a compliance filing after divestiture to confirm that we solved the Appendix A screen failures. There was no filing made to further reconcile.

MS. MOSS: One other example, in the Pacific and other cases, I believe the California Commission in reviewing that merger, in the interest of calmity, I think differ to the FERC remedy, if I'm recalling correctly.

CHAIRMAN KELLIHER: Which merger?

MS. MOSS: The Pacific and NOVA.

CHAIRMAN KELLIHER: Mark.

MR. HEGEDUS: I just wanted to address what sometimes I hear is a theme that maybe the antitrust division is more expert at competitive analysis, because gee, that's what they do all the time. TAPs doesn't share that view.

In fact, we were active in making sure that the Commission continued to have merge authority. In the EPAct process, I personally was involved in talking with DoE, trying to convince them of the reasons why Justice alone was not sufficient in the electricity industry. That's not to say I don't respect my former colleague, Mark Niefer. They do a wonderful, but there aren't that many of them.

The Commission now is involved in competitive analysis in many aspect of what it does in the electricity industry. I think you're very capable of being experts as well in the merger area. I think that by pointing to what DoJ has done, at least my interest is to try to make that better, even better.

So I'm excited by the prospect that this process that what's going on now in the Office of Enforcement can lead to more improvements. I don't agree with this idea that somehow our secondary agency when it comes to competitive analysis.

CHAIRMAN KELLIHER: Thank you for that. There is

no payment for that statement.

(Laughter.)

CHAIRMAN KELLIHER: I just wanted to go on the record for that. I appreciate the vote of confidence.

MR. HEGEDUS: If I might just follow up on that. The reason why I brought up the issue about losing the merger authority is that since the passage of EPAct, there continue to be hearings of the Antitrust Modernization Commission and still as esteemed bodies of the antitrust section of the ABA, I find comments saying you shouldn't have merger authority anymore. That's what alarms me. That's why I wanted to bring it that before you.

CHAIRMAN KELLIHER: I have one last question. I'm very appreciative of my colleagues' indulgence. That's financial sector entry. That's one reason Mr. Baliff is here, but the financial sector has certainly entered in a big way into the generation business. I think most capacity of generations have been transferred for years and years to the financial sector. The financial sector is also in the wires business, both in American and their acquisition of PacifiCorp.

We've had some other failures. If there is something inherently, weird or inherently troublesome in connection with increased financial sector entry into the wires business. I'd like to ask Dr. Niefer that. Is there

something inherently good about it or if it's not obviously good or bad or is just has been modeled?

MR. NIEFER: I don't think it's inherently good or bad. There are benefits to be had from having financial players in interstate power markets and related markets. They often increase liquidity, they often increase arbitrage. They often promote efficient outcomes in many cases.

To that extent, they're a good thing. Of course, any action taken by a financial player or physical player in power markets we'll look at under the antitrust laws to see if their actions do violate the antitrust laws, so we treat them as any other market participant.

CHAIRMAN KELLIHER: Thank you. Dr. Moss, comment?

DR. MOSS: To look back around here, to something Doug said, I just think, for the record, it is important to clarify what kinds of models we're talking about. There are several steps in a guidelines process. The five factors we talked about, and jump in here Doug if I'm mis-characterizing what you say.

The types of models he's talking about really enter when looking at theories of harm, at evaluating that third step, which is the market power story. That's where these models are very useful that he is referring to in the

Exelon case.

The model that I'm talking about, and the need for FERC to develop an in-house model really goes to the first step, which is defining markets and evaluating this effect on market concentration.

At this point, FERC relies on models that applicants come up with as opposed to having their own models to corroborate what applicants are telling them, which I think is a very marketable think for FERC to do, to have some sort of benchmark or way to corroborate and test the validity of what the applicant's assumptions are and what the outcomes are.

I just wanted to make sure that we're talking about the same thing in terms of where the models are entering this very complicated picture. And I felt like I needed just to say that.

CHAIRMAN KELLIHER: What about with the respect to financial sector and trade, do you have any comments?

MS. MOSS: No I don't. Sorry.

CHAIRMAN KELLIHER: I think I'm done. Colleagues.

COMMISSIONER MOELLER: Thank you Mr. Chairman. First I'll start off with a question. Commissioner Kelly asked me to ask you, Dr. Moss, it's my understanding, you are here at the Commission when the merger policy statement

was developed and were part of that process.

She would like, and I'd be interested in your perspective, if you're comfortable, you had a different role than you have now, but in the 10 to 11 years, your thoughts on the implementation.

MS. MOSS: I actually did not have a hand in writing the merger policy statement. I was out on maternity leave with my first daughter who is now 12, so it has been a while. I would say before the policy statement was issued, and I was involved in about six of the merger cases when I was here at the Commission. I can give you a long answer but I'll give you a short answer.

When FERC entered the whole market power game analysis in the merger arena, they were pretty new to the story. The lingo was even very different between the antitrust side and the regulatory side. Things like vertical foreclosure in antitrust lingo are referred to in regulatory lingo as discrimination, a classic case of cutting off your competitors from access to the transmission grid so that you can make the sales to the customers, as opposed to you.

So at that point, mergers, the whole merger wave was starting to build and a lot of these competitive issues were just getting under the FERC's radar screen. There is really a tremendous amount of learning inside the

Commission. A lot of reading and consulting with the antitrust agencies on a generic level to sort of get up to speed.

As I said earlier, really the common thread in merger analysis for electricity mergers then and all the way through to today, is defining those markets. That's really one of the biggest pieces. Because, like I said, they're very complex because they're defined by transmission constraints because they are time differentiated products.

You need to define any number of different product markets. That's really the big analytical part of the story and FERC rightly so, back then and now, got up to speed very quickly on defining relevant markets. But I think in all of us, learning has occurred, comparing antitrust versus regulatory approach was what the states were doing, it's now become apparent that there is more than just market definition of concentration.

So the next natural step, the next natural push I think for the Commission is to really expand their command of the competitive effects portion of the analysis, which is really telling the story of how these merged companies are going to exercise market power after the merger is consummated and whether entry and efficiencies play a major role in the balance of those factors.

I think it's been a natural progression. There

has been a tremendous amount of flux in the market. Data has burgeoned and we now have multiple data sources. It's been a lot to keep track of, and I think the Commission has done a fantastic job of keeping track of that and assimilating it and keeping on top of it, but I do think there are some natural next steps that need to be taken.

COMMISSIONER MOELLER: Thank you. I guess now, for my time. I thank the panelists and staff for bringing the panelists together. Another excellent set of testimony. It's not easy to make this interesting, but you all have. I recognize that the focus is on Appendix A, a prospective look, but I'm still struck in the larger picture by maybe a lack of look-back on whether mergers were harmful or on the flip side, beneficial to consumers.

That's kind of my perspective taken from today, a lack of look-back, and I guess I'd like all of your perspectives on that. But specifically, Mark, thank you. That was great testimony because of your very specific recommendations.

But given TAPS, and the fact that it's focus on transmission access, again I'm not trying to put you on the spot, but can you look back and see whether it was demonstrated harm to transmission access based on various mergers that were approved by the Commission. Would you want to take time to answer later?

MR. HEGEDUS: Yes. We can take time to take a look at that. Part of my answer though would be building off of what Sue Kelly said this morning. My clients are in business and once you act, they have to move on. Life is short and they have to figure out what their next commercial arrangements are going to look like. So they don't pay me, they don't pay us to take a look back. But if I want to give that some thought.

CHAIRMAN KELLIHER: Let's speak to Dianne or something.

(Laughter.)

MR. HEGEDUS: What I was thinking about is that in this discussion, maybe an academic student out there looking for a PhD thesis topic would take it up.

In terms of this morning's discussion and Commissioner Spitzer's question about, is there an Alamo out there, that really is not an accurate in PSEG Exelon. Without FERC's having identified a fuel curve theory, the divestitures that resulted from that case might have been the wrong ones, if they had been the wrong ones, the merger harm might not have been prevented. In the end the merger didn't go through.

I think that's one of the majors of not having that theory of harm at the outset. You have a hard time determining what is the right solution. They're not going

to get a chance to do that.

CHAIRMAN KELLIHER: Just to be clear, there has been a suggestion that Exelon had unfetted discretion to identify, to divest, but I thought our order required them to make a subsequent filing and that subsequent order would have determined which units have to be divested both physically and virtually. They didn't have complete discretion in the matter.

MR. HUNGER: There actually were base load units that had to be divested and virtually divested.

CHAIRMAN KELLIHER: We would have been citing specific units that had to be divested.

MR. HUNGER: They identified a class of units, say mid merit, really all along the supply curve, all along the fuel curve, and they identified a set of plants that met those specifications.

So we had a pretty good idea -- we may not have known it was going to be the Lindon plant or another plant somewhere in New Jersey, but it was very clear what types of plants were going to be divested. They would have to come back and show that under the various seasonal conditions, the concentration was reduced to pre-merger levels.

CHAIRMAN KELLIHER: Thanks. On the schedule we have concluding remarks from 2:40 to 3:00 o'clock. I didn't think we would have 20 minutes of concluding remarks. I'm

assuming questions and answers will go into that period. Thank you for your forbearance.

COMMISSIONER MOELLER: Again the same question. Diana Moss.

MS. MOSS: That's a good question. I don't think there's an Alamo, but I think there are reasons for that. Economists are very willing and able to tackle these look-back issues. They've done them in a number of different areas. Much came out of the seminal study of whether mergers are generally efficiency enhancing. They did a long-time series and there is a whole lot that came out in the '70s and the mid '80s.

Economists now have better techniques to do these analyses and determine whether mergers have actually resulted in net benefits. Not only for shareholders, but also for consumers which is more the focus of the Commission. I think there has been a reluctance to do the look-back study in part because the landscape is shifting in electricity and there are so many changing factors and so many variables to control for.

The economists sort of blanch when they see the shifting landscape, they start thinking, oh you know, how am I going to handle all that stuff?

A study needs to be done, things of sort of settled down. We're out in the last merger wave. We just

have to entice the right economist to do the study. A sort of a counter example -- in doing a literature review, I uncovered 15 studies of petroleum mergers that look at merger-related price effects and, of course, economists will battle themselves to the death picking apart the models and the results and that sort of thing, but nonetheless, that sector has been exhaustively analyzed in the look-back kind of way.

So I think the shifting landscape has made economists a little bit reluctant to look at this. I also think there is probably a sense among economists that much of the first wave of consolidation in the mid '90s may well have been efficiency enhancing. Why? Because these markets were really determined by government fiat, because they were jurisdictional franchised utilities, and merging with your neighbor, if you want weren't already contracting the benefit is off the table, merging with your neighbor might well have been in a small utility case, might have been efficiency-enhancing.

So it's clear, these mergers that are coming in, in the last few years, very large mergers, the vertical, horizontal, around 1999, 2000, we might be a little more suspicious of, in terms of anti-competitive effect.

COMMISSIONER MOELLER: We do have the most concentrated refining market share of all economies.

MS. MOSS: Absolutely. I think the reason why these studies have been done is because the FTC has been put in the position of defending their merger review methods.

COMMISSIONER MOELLER: Dr. Niefer.

DR. NIEFER: Just generally. I think everyone would agree that looking back at past policy decision is obviously you should be improving future policy decisions. Both the FTC and the Department of Justice have substantial interest in doing those types of studies.

I personally have never been involved in any of them but I think Diana is right. There are a number of problems in trying to do these studies. In the electric power industry, one industry is just remarkably complicated from vending models to predict merger effect so formulating models to predict the effect of a merger that it's gone through in the past is just a very complicated analysis.

COMMISSIONER MOELLER: It seems to me it's almost easier to do it forward because you have read data you can plug in.

DR. NIEFER: You do but there are additional complications. As Diana mentioned, very often there are changes in these markets and the particular changes in market rules changes in future related markets, changes in FTR markets that may affect power markets, changes in capacity markets that will affect power markets. And

controlling for all those things, I think would be a very difficult exercise.

That's not to diminish the use of that exercise or the usefulness of that exercise, but simply to say it's a daunting process.

COMMISSIONER MOELLER: Thank you.

MR. BALIFF: I'm only going to respond, given that this is a common question that gets asked by both directors as they're trying to convince the Board to do it.

So my best answer, that is not a sales pitch, but there have been studies on merger synergies associated with utility mergers, whether it be the small ones or the large ones in which a number of accounting firms have looked back at both what was promised and also at what was delivered, which can be measured, depending on the nature of the jurisdiction and the nature of how the company might have changed.

Those are actually, I don't know if they are published rules. You can try and see if you can get a hold of them, but certain accounting firms have them.

COMMISSIONER MOELLER: Mr. Green.

MR. GREEN: The only think I would say in addition to all of these very excellent remarks, is I do take issue with the notion that PS, Exelon might have been an outlier. I think actually it would have provided a lot

of benefits to the consumers of New Jersey and the eastern United States.

CHAIRMAN KELLIHER: It would be the biggest divestiture ever ordered by orders of magnitude. It, I think is pretty significant on that ground alone. Before then, the largest divestiture associated with a merger was AEP/CSW, that was 400 megawatts. So we're going from 400 to 6600, it's pretty significant.

MR. HUNGRY: That was required by the state and they coordinated on that one. The big problem that this Commission found was with the vertical.

CHAIRMAN KELLIHER: It's kind of interesting, one looking back, why couldn't you put AEP/CSW, there is no harm from that merger. Anyway I realize there are variables in complicated markets, organized markets, but others you'd think you should be able to look at progress -- Carolina Power and Light, Florida Power Corp. Is there harm that resulted from that merger?

COMMISSIONER MOELLER: Well, the last point I'd make for Exelon is, it a so points out the obvious which is that the last energy that says yes has the most power. It's problematic in your case. Anyway thank you.

CHAIRMAN KELLIHER: Commissioner Spitzer.

COMMISSIONER SPITZER: Thank you very much. Given the new perspective on federal/state mergers.

CHAIRMAN KELLIHER: You have merger decisions other than Unisource, right?

COMMISSIONER SPITZER: We had AT&T, SPC. They were wonderful cases.

CHAIRMAN KELLIHER: Alamo has been mentioned.

COMMISSIONER SPITZER: Unisource was somehow notorious. I may get to that in a moment. Mr. Hegedus, first, I really was impressed by your paper and I appreciate it very much. Comprehensive and very specific.

I have just one question that I think can bring up something extremely positive and then I have one matter that really dovetails with what Commissioner Moeller was discussing that's more irksome maybe, I don't know. Which one do you want to start with?

MR. HEGEDUS: We'll start with the irksome and end on a high note.

COMMISSIONER SPITZER: Okay. You stated on page 2, the central problem with the Commission's current approach in Appendix A is that it does not assess the proposed transaction that effect on competition. Passing the theory on Appendix A screen is not a competitive effect. Examples of competitive effect include higher pricing, reduced output and price discrimination, none of which Appendix A requires to be analyzed.

I find that very well put. However, I don't mean

to flag the dead horse again, but in the questioning this morning, I was able to, we collectively were able to extract from Sue Kelly the view that her members are having trouble in the current market on the transmission side, but was unable to establish any cause and effect after the fact.

I agree with Commissioner Moeller. If it's problematic to identify the matters that you describe at page 2 going forward, certainly you have a better chance of establishing those competitive effects from past history, yet whether it's but for causation or a proximate cause, this is proximate cause and probable causation, either way we ignorantly seem to be bereft of causation.

So if we can't establish even rudimentary causation for transactions that have been completed and you have a record of 10 years of subsequent facts, how on earth can then we satisfy what we advocate on page 2?

MR. HEGEDUS: Two parts to my answer. The first part of it is, this is solely my own view. I have not had a chance to talk to any client about this in terms of causation.

Commissioner Kelliher brought up the Progress Energy transaction. This company has never joined an RTF. Those companies have some of the most constrained transmission systems in very constrained transmission regions and one might analyze whether there is a cause and

effect there.

In terms of the absence of progress on transmission and not going through what the Commission thought at that time was necessary to make that transaction consistent with the public interest, this is off the top of my head. I guess I haven't had a chance to go back and study it.

CHAIRMAN KELLIHER: It normally shows progress. It seems there has been less dynamic change in that region, those regions because I think Florida would be a separate market from the Carolinas than in others. But that was part of Diana's argument.

It's hard to back out what the effect of a merger might be with many other market changes. That was the point in deciding that one, that there has been relatively fewer market changes that would have to be factored out.

MR. HEGEDUS: I think that perhaps might be fewer but I think there would still be a number that would have to be examined just to see what type of role. I think the enterprise can be difficult, but in terms of focusing on whether or not there is a beef here, a central beef here is that without doing their analysis from the perspective of having a competitive harm story that you're focused on, you do risk getting it wrong.

To go back to the Exelon example, yet it's true

the Commission had a requirement that Exelon come back to present the actual divestitures for Commission approval. The Commission standard I think for that are the companies that we should have argued that the standard for divestiture approval though would have been, does it reduce the HHI back to the pre-merger level and does it represent a divestiture of assets from throughout our portfolio?

But suppose the actual merger harm was within a particular load pocket in some part of PJM and let's say you needed to divest one of the plants specifically identified by the DHA to do that? If on that subsequent order FERC said, well Exelon we think you need to divest in plant X.

Exelon might have come back and said, well you said all we had to do was divest something to get us back down to HHI levels pre-merger and from throughout out portfolio of resources. Without that, sort of the unified competitive harms theme, the Commission in that subsequent order might not have been able to actually require the divestiture of the plants that were the real source of harm.

CHAIRMAN KELLIHER: But we have different tools in the Justice Department to deal with that market based rates and that load pocket. Part of your Alamo theory is, we would have ultimately been wrong to a large extent on the particular units that would be divested, then harm would result.

If we assuming wrong across the Board instead of divesting it, who will assume the Alamo, but if we get it wrong across the Board with rate market based rates.

MR. HEGEDUS: In terms of your present approach to market based, grants in RTOs.

CHAIRMAN KELLIHER: If we get it wrong on the generation, and we do nothing about the accumulation, we allow a mitigated market power exercise in load pockets. It seems like we were so complimentary earlier today.

COMMISSIONER SPITZER: If I made the assumptions underlying the failure subsequent market failure, then the harms would continue, I wasn't here. There is a disposition of that case, but I would not feel constrained to impose myself if a remedy was necessary to go further. I don't think that is really the analytical problem. The willingness of this body to embark upon a different course upon different analysis from the Department of Justice Antitrust Division, I think the analytical problem I had was this language on the competition factor is very legitimate and in my view meritorious.

The problem is there is a degree of scientific rigor inherent in this exposition than in the real world I think we can't even define harms in all the cases.

So I don't think it's the willingness of the entity or the hypothetical that somehow we have harms that

are not being remedies. I think it's identifying the harms to be remedied as the more striking problem.

MR. HEGEDUS: I made an attempt to identify some past harms. You can agree with those or you won't. I meant what I said in terms of wanting the Commission to do well and believing they have the capability and duty to do well but that doesn't mean I shouldn't push forward.

CHAIRMAN KELLIHER: Exelon might have become an Alamo but I think there are just some really big assumptions in there. I think the one advantage we have over the antitrust, respectfully, is that we do have ongoing authority over the merged entities. So if for some reason we approve a merger and it does allow the accumulation of market power, we can ask the rate-making authority to prevent the exercise from market power.

As I mentioned earlier, that's one reason we don't have the same institutional preference for structural remedies.

MR. HEGEDUS: You also said in the Ameren case, maybe a couple of years ago, two or three cases, your responsibility really was, if you thought you saw a problem to take care of it at the two or three level.

CHAIRMAN KELLIHER: I agree. At the point of merger, we don't act to allow, we don't authorize the exercise upon mitigated market power in the 203. But if

we're wrong, we can act later on with our rate-making authority to bring the exercise of market power that might have been accumulated earlier.

COMMISSIONER SPITZER: On the positive side, and maybe this is the remedy to the first problem, which is, in your recommendations also on page 2, recommendation 4, use the Commission's procedural flexibility to examine controversial measures more closely via technical conferences and Track I-type hearings. It seems to be an interesting effort to deal with the time deadline.

Why don't you explain your history with that process and how, if it can be applied, in these types of transactions.

MR. HEGEDUS: Within the European Union, the competition authorities have clear differences in the way the procedure by which they analyze mergers. The actual use of antitrust economics and the way we do is pretty much the same. There are time limits on the European Union's assessment of mergers at different stages.

If they decide to go to a more intensive investigation, it has to be concluded within a particular framework period of time.

During that period of time there is a process of discovery where the European Commission and the Competition Director General is soliciting evidence, basically, doing

interview of market participants, doing internal analyses that culminate in a hearing, a technical conference really, it's not a hearing, before an Administrative Law Judge.

It's a setup closer to something like this, although with many more people in the room and there are reports prepared in advance. The merging parties are allowed to address the reports. There are intervener who are allowed to present at that technical conference.

COMMISSIONER SPITZER: Transcribed and any question?

MR. HEGEDUS: Yes. Based upon that, the European Commission makes the decision. Actually the DG of Competition makes the recommendation and it's really done by the full European Commission.

The process, in terms of getting input from market participants can be used here. They sort of have the announcement and the process of protest. The questions can be asked through the staff here, having the ability to ask questions.

Parties could put together a presentation and present a witness for your questioning to build up a record. That would fit within the time frame that is now permitted and required by the Federal Power Act.

Yes people are going to complain about what would probably be fairly strict turn around time for something

like that but it would be an opportunity to get facts on the record, enlarge the record if you're looking to make a decision and the industry and intervenors would work with those tight time frames, I'm confident of that.

COMMISSIONER SPITZER: Mr. Baliff. You flew the F4G. Is that the Weasel?

MR. BALIFF: Yes. The old office.

COMMISSIONER SPITZER: Given that it's a combat related aircraft?

MR. BALIFF: Yes. Been there before.

COMMISSIONER SPITZER: You discussed the reactions of Wall Street, particularly in some of the recent state decisions. I guess expectation is fine as long as these expectations are reasonable and I have to tell you, I hit the electric circuit during and then after the Unisource transaction.

I had the responsibility of presiding over that matter and there was one conference in Houston call "The Coming Gold Rush Mergers and Acquisition." So the Wall Street guys were there and I told them, your problem, this is all anticipating repeal of the 35 Act. I said your problem is not in DC. Your guys problem is in the States. But they didn't apparently listen to me.

MR. BALIFF: No and as the advisor to the KKR, and this body, this is also exactly in the same time, by

coincidence, advisor to TPG in the Portland case. I think what is very interesting, though it actually gets comments about financial sponsors.

If you are looking at what's going on with TXU right now in which you basically have the same two entities going ahead and doing the largest leverage buyout in history with a specific utility, you see that the level of knowledge has gone up when you talk about financial sponsors, being in the space, is that good or bad for mergers?

I think what's very interesting is, in general, having more liquidity in the marketplace, whether it be assets for generation or assets anywhere is good for the market. But I think what's interesting is how it's changed the financial sponsor space. How those two cases in particular change the way the KKR and TPG thought about investments in the utilities. If you know the investments right after that was the Texas Genco generation case.

Right now you're seeing the culmination of the knowledge base that they've learned. We can be as good an owner as a strategic buyer. But what we've learned is the sensitivity to the states. A coordinated response ahead of time that listens to the Commissioners as opposed to maybe listening to advisors or their lobbyists.

The big thing I got out of both of those is that you don't have to get lobbyist and consultants. You just

call the Commission to call you. You can call the Commissioners.

COMMISSIONER SPITZER: Calling state senators is not a bad thing, is it?

MR. BALIFF: They've learned a lot too. It's made the market a much more, I would say sensitive and sophisticated price as we move forward.

COMMISSIONER SPITZER: My comment would be in the way of being helpful, not an admonition. Mr. Green pointed out the State of New Jersey reached a different conclusion than the Commonwealth of Pennsylvania. Different facts, different circumstances. There is a lot of debate in Arizona as to whether the net benefit or the no-harm rule has to apply.

It turns out that Mr. Chairman and my colleagues decided that the prevailing law was whatever three Commissioners said, but that I think the different states have different organic laws, different states have different interpretations of some of those laws and then the atomic environment is going to be different. It's not unexpected. That's part of our federal system. We need securities laws, insurance laws, tort law, workmen's comp, virtually every area of the law.

The states substantive law not only governs but sets the playing field for expectations of those who invest.

Insurance companies may feel they get treated differently in Mississippi than in Nebraska.

Not only is it not uncommon, it's almost to be expected and there is a recognition on the part of the states and this occurs in garden variety rate cases where the public service commission is perceived as being hostile to the utility when the investment community will take due recognition and those folks vote with their feet. I don't think it's untoward or uncommon, and certain states are going to be viewed as more hospitable to investment. Whether it's private equity in a large company, private equity in a Genco or garden variety debt and equity in a utility.

So I guess given that framework, number one, it shouldn't be a surprise that these battles are fought in the states ultimately, and that there will be variances among and within the states and between the states and not only is it unsurprising, but it shouldn't be used necessary as a negative.

MR. BALIFF: I don't think it's viewed necessarily as a negative. What is viewed as a negative is the multi-state jurisdictions. They have to go three, four, or five states, complicates a merger that people are already thinking about integration of people and they are sensitive to that. Integration suppliers and other sources when you

actually have these multi-state regulatory processes.

That's what I would say, because of the uncertainty and the length of time, there is also this fear that they might also be competing with each other. There is no doubt that Portman Saul is going on in Arizona, and both are monitoring each other. That makes things a lot more difficult for a merger and it doesn't matter who the financial sponsor is.

COMMISSIONER SPITZER: Are you suggesting that there are some lessons learned from these other transactions and that the proponents are now coming in in advance and making some cases to state governors and legislators as to the potential benefits to mitigate the problem?

We have five states and all five not only have their hands out, but in conflicting requirements.

MR. BALIFF: That's right.

COMMISSIONER SPITZER: That last work has the work for solution.

MR. BALIFF: They've also voted their return expectation. I'll say that's probably one of the biggest things that has happened over the last two to three years. The financial community that is investing, whether it be in generation, has a baseline, return expectation that's lower. I think they truly believe five, ten years ago that investment in utility was like investment in any, let's call

it more stable industrial, even though there is highly regulatory element to it.

Now I think they have fundamentally changed their view, and not only that, there is room in their portfolios. There is this wall of liquidity coming and there is room in their portfolios for a lower return investment that is stable.

COMMISSIONER SPITZER: Thank you.

CHAIRMAN KELLIHER: Staff, questions?

MR. RODGERS: I have just a couple of questions. Cindy? I had a question for Dr. Moss. I wonder if you have any ideas regarding what the costs might be of developing some internal model both in terms of financial costs as well as the manpower that might be involved to develop and maintain the model?

DR. MOSS: That's the million dollar question. It could well be a million. I would note, and Steve you were around when I was around, and I think David was shortly around after this happened, but in the early merger cases FERC actually had an internal model.

It was a little SAS model which was a program that implemented the delivered price test using a constrained linear programming approach. It consisted of nodes and links that had transmission information. It had demand load information, there were prices at that point for

system lambda, marginal costs as a proxy for market prices, which are now abundantly available. But we actually ran that model in the LG&E KU case and then I believe Ohio Edison.

The results of that model were not cited in FERC orders, I don't believe, but we did run it as a check on what the applicants were providing and sometimes we came up with really different answers.

I do not think that that model -- that model was sort of a brain child of some economists, a couple of economists who were working in the Office of Economic Policy at that time. It was a relatively duplicative model compared to what applicants were coming in with at that time. But it sort of did the job. It at least provided some internal way to corroborate.

I think the model you're looking at now is very different because markets are more complex. They're more data requirements, etcetera, etcetera. But I would think that a few economists put on this, given the Commission's experience to date, given access to data that the Commission has, given the expertise, I would think that developing a little task force in coordinating with the agency, and with some industry people, some outside economists, the states even putting together a little task force to do that, wouldn't be an overly costly endeavor.

I can't put numbers on it, but I would think within six to eight months, there could be something useful to put in the sort of a pilot test phase.

MR. RODGERS: Dr. Niefer I had just one of two questions for you. I know the Antitrust Division of the FTC divide between themselves which agencies are responsible for reviewing certain types of mergers. It is my understanding that the Antitrust Division nearly all the time handles the electric mergers, is that fair?

DR. NIEFER: That's generally correct.

MR. RODGERS: So between the two agencies, certainly it would be true that your agency would have the greater experience on horizontal issues that would pertain to electric mergers, is that correct?

DR. NIEFER: Generally that's true, yes. In the course of the investigation the FTC have put that horizontal mergers and in the course of our investigations, we looked at vertical mergers as well. I'm sure there are some overlap in expertise there. Generally I think it's safe to say that we have more experience in horizontal mergers and they have more experience in vertical mergers.

MR. RODGERS: How many relevant product markets do the Antitrust Division look at in the Exelon merger?

DR. NIEFER: Without getting into the details of the Exelon merger, as you know wholesale power markets have

a number of layered markets, including capacity markets, FTR markets, ancillary service markets and typically take a look at all of those.

Not only to determine whether they are individual markets in and of themselves, but also to understand the way those markets affect wholesale power markets, which typically are the primary focus in our investigation, simply because economically they're very important.

So, typically both ancillary services and capacity markets are implicated at looking at horizontal mergers.

MR. RODGERS: I appreciate knowing that because I think in that regard, that's very similar to what the FERC is doing because we're also working on a multitude of product markets in most mergers and quite often that ranges from 10 to 12 different product markets.

I think sometimes people out there have the perception that we aren't very sophisticated in looking at very many product markets. That's not true. I think we look at quite a number, too, and it sounds like you do as well.

DR. NIEFER: If I can just add something. One of the reasons these mergers are so complex and take so long to analyze is, there are a vast number of product markets potentially to be analyzed. So gathering information to

analyze those markets takes time, analyzing markets take time.

MR. RODGERS: The DoJ measure on model for potential competition.

DR. NIEFER: Generally potential competition is of concern to us. It's mentioned in -- depending on how you look at it. As our horizontal merger guideline and in our non-horizontal merger guidelines, the Department of Justice does examine, when appropriate, the effect of potential competition, the acquisition of the potential competitive, whether natural or perceived. We do take that into account.

MR. RODGERS: That is taken into account by following the process that you have in the DoJ, FTC market guidelines?

DR. NIEFER: Yes.

MR. RODGERS: That's what I have Mr. Chairman.

CHAIRMAN KELLIHER: How about the lawyers?

MS. MARLETTE: A process question to follow up on what Mr. Green and Mr. Hegedus said. Mr. Hegedus, you had earlier in your comments mentioned that you would like the opportunity for some type of information discovery during the comment period and Mr. Green talked about a recommendation particularly for complex cases about having some sort of technical conference.

You never had a technical conference where two or

three application? I'm a little bit intrigued as to whether it's a process expediters worth considering that might also help protestors weigh in on what types of additional information they think the Commission might need to look at.

I think Doug you had mentioned a staff-led conference. Do both of you think that's a good idea to pursue given the directive in 203 that we'd have to act within 180 days and there is not an opportunity for extension.

The reason I'm intrigued with it is going through an ALJ proceeding on a complicated merger which was very difficult to complete and get Commission decision even within the year. Do you both think that's a good evil perhaps and at what point would it make the most sense to have a technical conference, to look at the information issues?

MR. HEGEDUS: It strikes me that it would be a promising vehicle. One possible way of having it play out would be maybe after the initial protest period the Commission could make a determination that this is appropriate for a technical conference.

Maybe a sign in ALJ for the sole purpose of arbitrating under the period of discovery and have all that discovery be filed to the record possibly. Maybe have in the short time there later have parties able to submit some

prepared affidavits that then could be examined in the course of the technical conference where the questions might be posed by staff.

And then I imagine you would have to have one of those situations where you would invoke your additional 180 days to make this particular process play out.

But that technical conference would be sort of the last step before the Commission wrote its decision on the transaction.

MS. MARLETTE: In your view, would be more applicable where we would have the full year of very complex mergers because I do use the two or three amendments as a very clear directive to the Commission that in exchange for FERC keeping its merger authority, it has to get these things done very, very quickly and I view the 180 day extension as being for the rare cases. So Doug.

MR. GREEN: I see this maybe a little bit differently, but similarly to the way Mark does. I see it as an avenue for the Commission to get information from cases. I think you still want to see cases where the applicant is going to come in and say, here are proposed divestitures or other remedies that's all in the Appendix A problems and I think in cases where you have a question like the question that has been raised here today, are there possibly lurking competitive effects, notwithstanding

divestitures, and maybe divestitures were not clearly addressed.

This would be an avenue for the commission to ask questions of the applicant. To get clarity as to what their analysis does and doesn't do. Then lead to an information request from the Commission to the applicants for further information.

I haven't thought through procedurally the steps as to whether this could be done in order to meet the 180 day deadline. When I originally thought about it, that's what I thought would make the most sense because if you're going to do this in a number of cases, you can slip over the 180 days. I think you're not going to be doing what Congress had in mind.

So this maybe something that the staff would do through sua sponte hit. Maybe something that's based on the way the submissions came in, you'd be prepared to do right after the protest came in then after the applicants came in in a very short time after that for a technical conference.

Make it tough on the applicants. Make them respond to it in 10 days so that people could respond and meet the 180 day deadline. I would think it would be most advantageous if you could figure out a way to use it in 180 day period.

MS. MARLETTE: Do you see it also as an

opportunity for state commission to often participate in our proceedings here as well as in their own proceedings, as an opportunity for the coordination. We've been hearing that we would like to get more coordination with states. Would that be an opportunity as well?

MR. GREEN: It could. I must say I'm kind of have two minds on this. On the one hand, you would think if there is a way to get the states into these cases earlier and to get them involved, they'd be more satisfied with the results. On the other hand, I still remember the old days of the Southern California Edison San Diego Gas and Electric merger where we have hearings here with one ran all summer and all fall.

And the people from the state were involved to some extent. Everybody in California was involved and nonetheless, we went through the exact same process. Down at Rancho Bernardo as in California, because the states often have statutes that raise questions like Commissioner Spitzer was talking about, do you have a net benefit or no harm standard, do you have particularly local policies of interest involved, I don't think you can ever procedurally come up with a mechanism to make that go away.

MR. HEGEDUS: I agree it is an opportunity to involve the states to present a forum where there could be some coordination.

CHAIRMAN KELLIHER: I was just going to make some brief closing remarks then turn to my colleagues if they would like to say anything. But I think it's been a very interesting panel. I'm confident that Jon Wellinghoff will be watching at least through this point of the conference. Maybe when he hears us, he'll sign off and not listen to our concluding remarks, but in terms of one of the big questions was the Appendix A analysis. To what extent should we still rely on it?

To make the argument to change it has to somehow make the case that it somehow has failed for the past 10 years. To me it could have failed in two ways. False positives, false negatives, as opposed to the extent. I suppose to the extent there is false negatives, I don't really know much about that universe.

Appendix A could arguably, presume that a transaction would fail, may not arguably come before us in the first place. In terms of the merger we might have approved onto the Appendix A analysis, we haven't really been able to identify any of the 60 odd mergers.

No one has suggested that any other mergers that we have approved in the past resulted in consumer harm. Someone said it might be hard to prove but there doesn't seem to be a stirring example of a merger the Commission's approved under its current analysis that has resulted in

clear consumer harm.

We have other remedies available to us that are not available to the antitrust agencies to prevent exercise of market power if it were to result from a merger. The mere passage of time by itself I don't think leads us to any conclusion that we have to change our current analysis. It's a bit different from the old reform rule. The rationale for reforming the open access transmission tariff wasn't merely the passage of time. It's the passage of time plus a realization that the open access tariff was inadequate and allowed an opportunity for undue discrimination that ultimately led the Commission to reform the tariff. Here we had that passage of time, but we don't have the same kind of demonstration that the current approach allows the accumulation of market power.

It doesn't mean that there isn't room for improvement. There isn't room for some changes. The more open process and analysis that can improve. I think we've head some interesting proposals. I think the technical conference idea merit some further look. We've used it other context. Just in recent months we used it in MRTU, we've used it with the MISO transmission cost allocation scheme.

So we do use technical conferences from time to time as part of the record to help us develop a full record

to make a decision. I think we can look at some of the ideas we've heard today for revisions and improvements, but I haven't been persuaded that there is a fundamental flaw in our current approach.

And I do want to thank the panelists. Both this panel and the earlier panel for the help they've given us. Let me ask my colleagues if they have any comments that they'd like to make.

COMMISSIONER SPITZER: Mr. Chairman I think I agree with your sentiments and maybe add a few observations thereto. I don't think the case has been made that Appendix A is not working or failure, or has caused harms to rate payers.

On the other hand, I think this is in part illustrative of the distinction between the remedies at DoJ and those at FERC, the regulated entities and their attorneys are reluctant to provoke the wrath of their regulators.

It seems to me I don't know who said it, I don't think I was responsible for that. The Chairman who invoked Davy Crockett, the presence of the continued regulation of the entity is, to me, a very serious restraint. If issues arise, they can be dealt with, a very substantive distinction.

There are a lot of temporal issues here, timing

issues, the fact that the Justice Department is a remedy in continued oversight disappears. What is important to those who represent the rate payers is that they have a day in court, that they have a meaningful opportunity to participate and we have hearing in a case FERC doesn't have the resources to deal with these types of things.

I think the FERC recognizes the relatively small universe of very controversial transactions and can apply its resources appropriately to those transactions and not involve all the transactions for which there is no dispute and which the resources can not meet the need.

The concept of the technical conference where intervener have the opportunity to appear and pose questions, if there is a lack of expertise, reliance on the very fine FERC staff to pose questions and raise matters provides not only the appearance but the reality of meaningful day in court and due process.

I think that's a very important aspect that I think ought to be pursued and given the opportunity for that type of meaningful participation and the lack of a demonstrative defect of the status quo. That seems to be at least a proper and appropriate remedy. But I will leave with you all these materials.

I thank the staff for its hard work on this as well as those presenters. Mr. Chairman it's been a very

worthwhile day.

CHAIRMAN KELLIHER: I want to thank the staff for excellent work. They were very well prepared. The conference was well organized and the speakers well chosen. Thank you for helping us today.

(Whereupon, at 3:10 p.m., the technical conference was concluded.)