BEFORE THE
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Exelon Corporation)
Public Service Enterprise Group Inc.) EC05-43-000

Motion to Intervene of the American Antitrust Institute

Pursuant to the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission"), 18 C.F.R. 385.214(2005), the American Antitrust Institute (AAI) hereby moves to intervene in the above-captioned matter. In support thereof, the AAI states as follows:

1. The AAI is an independent, Washington D.C.-based non-profit education, research, and advocacy organization. The AAI's mission is to increase the role of competition, assure that competition works in the interests of consumers, and challenge abuses of concentrated economic power in the American and world economy.[1]

2. On February 4, 2005, as supplemented on February 9, 2004, Exelon Corporation and its subsidiaries that are subject to the Commission's jurisdiction ("Exelon") and Public Service Enterprise Group Incorporated and its subsidiaries that are subject to the Commission's jurisdiction (PSEG) submitted a filing (the "filing") requesting Commission approval of a transaction that includes: (1) Exelon's acquisition of PSEG and the resulting indirect merger of Exelon's and PSEG's regulated public utilities; and (2) the consolidation of Exelon's and PSEG's unregulated generation companies and corporate restructuring of the subsidiaries of their unregulated generation companies.

3. All communications with respect to this matter should be directed to:

[1] More information on the AAI is available at http://www.antitrustinstitute.org/about.cfm.

Diana Moss
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4. The proposed merger of Exelon and PSEG will affect competition and consumers. The AAI speaks on behalf of the public interest in a wide range of matters involving competition policy and consumer protection in antitrust enforcement and regulation. These matters include mergers that--based on factual analysis of publicly available facts, accepted standards for competitive analysis, and public policy considerations in light of industry restructuring--will harm competition and consumers. This representation is independent of any particular private interest. The AAI therefore moves to intervene. In pursing a public interest mission, the AAI has a direct and substantial interest in this proceeding that cannot be adequately represented by any other party to this proceeding. The AAI, therefore, has a right to participate. The factual basis for the AAI's motion to intervene is set forth in the following sections.

THE PROPOSED COMBINATION WILL HARM COMPETITION AND CONSUMERS

The proposed combination of Exelon and PSEG is the largest electricity merger ever to come before the Commission.[2] Assets of the merged company are estimated at $79 billion. This is about two-and-a-half times as much as *Unicom/PECO Energy* (PECO), which formed Exelon--the next largest merger and predecessor to Exelon/PSEG.[3] The

[2] Dr. Diana Moss, Vice-President and Senior Fellow of the AAI, was the coordinator for merger competition analysis in the Office of Markets, Tariffs and Rates at the Federal Energy Regulatory Commission from the late 1990s through mid-2001.

[3] Assets of Unicom/PECO were valued at $32 billion. "Exelon and PSEG Agree to Merge, Creating the Nation's Largest Utility," *Nukeworker.com*, December 20, 2004. Online. Available http://www.nukeworker.com/forum/index.php/topic,3854.0.html. Accessed April 7, 2005. "Unicom And Peco Energy Agree To Merger Of Equals Combination Valued At $31.8 Billion," Exelon News Release, September 23, 1999. Online. Available http://www.exeloncorp.com/corporate/newsroom/1999/19990923.shtml. Accessed April 7, 2005.

combination would create a utility with the largest generation portfolio in the U.S., resulting from a massive consolidation of generation ownership in eastern PJM, a transmission-constrained and highly concentrated electricity market. The proposed merger puts competition and the welfare of dozens of wholesale (and millions of retail) electricity consumers in the region at risk.[4]

Applicants own analysis indicates that the proposed merger would significantly increase concentration in all of the 30 relevant markets analyzed. These markets include 10 time periods for each of the three geographic markets--expanded PJM, PJM, and eastern PJM.[5] Had Applicants more accurately defined relevant markets on the basis of the zonal pricing system currently in effect in PJM, relevant markets would likely be smaller and increases in market concentration even more significant.[6] As it stands, increases in concentration in all the relevant markets are well-beyond the thresholds set forth in the Commission's *Merger Policy Statement* (the "*Policy Statement*"). The *Policy Statement* explicitly adopted the U.S. Department of Justice (DOJ) and Federal Trade Commission (FTC) 1992 *Horizontal Merger Guidelines* (the "*Guidelines*").[7] In eastern PJM (the smallest relevant market), merger-induced increases in concentration exceed 1,000 HHI points in markets with post-

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[4] Exelon Corporation and Public Service Enterprise Group Inc., *Application for Authorization of Disposition of Jurisdictional Assets Under Section 203 of the Federal Power Act*, Docket No. EC05-43-000, February 4, 2005, p. 4 and 9 (the "Application").
[5] Applicants' economic expert William H. Hieronymus evaluates three relevant geographic markets and 10 products (time periods) within each market, for a total of 30 relevant markets. See Prepared Direct Testimony of William H. Hieronymus in the Application, pp. 48-49.
[6] The Commission expressly accounts for the need to precisely define markets in the *Policy Statement* when it states: "The Commission encourages parties to propose even more precise definitions of relevant products where appropriate." *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 FR 68,595, December 30, 1996, p. 63. Online. Available http://www.ferc.gov/industries/electric/gen-info/mergers/rm96-6.pdf. Accessed April 7, 2005 (*Policy Statement*).
[7] *Policy Statement*, op. cit., at 63. See also U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, April 2, 1992. Online. Available http://www.usdoj.gov/atr/public/guidelines/hmg.htm. Accessed April 7, 2005.

merger concentration of almost 2,500 HHI.[8] Such increases in concentration significantly increase the ability and incentive of the merged company to adversely affect wholesale electricity prices through unilateral or coordinated conduct.

To put the market-concentrating effects of the proposed merger in context, it is useful to look at the merger enforcement experience of the FTC. For example, in over 70 percent of the horizontal mergers with the levels of merger-induced and post-merger concentration witnessed in Exelon/PSEG, the FTC either blocked the transaction through a petition for injunctive relief or settled competitive concerns through a consent decree requiring remedial action.[9] Here, Applicants are asking the Commission to approve a substantially harmful merger by accepting a flawed and inadequate remedy. This is roughly the equivalent of asking the Commission to approve the merger without conditions—or perhaps worse, since it gives the false appearance of providing some protection for competition. This will have two detrimental effects. First, given the substantial market power created by the merger, competition and consumers will be harmed. Second, it will encourage additional mergers of very large utilities that would further concentrate markets, something that public policy has attempted for decades to deconcentrate. Moreover, it will set a damaging precedent for Commission merger policy.

Add to this picture the fact that the proposed merger occurs at a time when industry restructuring has generated more controversy than consensus, and is idling in a protracted and difficult transitional period.[10] Restructuring is marked by limitations on the Commission's ability to pursue initiatives such as standard-market design, mandated RTO

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[8] Hieronymus, op. cit., pp. 48-49, Tables 9-11.

[9] Statistics are based on mergers in all markets from 1996 through 2003. See Malcom B. Coate and Shawn W. Ulrick, *Transparency at the Federal Trade Commission: The Horizontal Merger Review Process 1996-2003*, Washington, D.C.: Bureau of Economics, Federal Trade Commission, February 2005, p. 50 and Table C-3.1.

[10] See, for example, the proceedings of the American Antitrust Institute's 5th Annual Energy Roundtable Workshop "Open Access Revisited," January 11, 2005. Online. Available http://www.antitrustinstitute.org/recent2/380.pdf. Accessed April 7, 2005.

membership, and transmission expansion. A multitude of market power concerns have arisen in quasi-competitive markets, and there are unresolved problems in key policy areas such as the appropriate framework for analyzing competitive issues in market-based cases.[11]

Current conditions in the electric power industry highlight the importance of ensuring that mergers occurring during times of instability and transition do not create or enhance market power. Former FTC Chairman Robert Pitofsky noted cogently in this regard to deregulation in the natural gas industry that:

> "The potential for consumer savings and increased choice is enormous, but it is certainly not guaranteed. . .strong merger enforcement is necessary to ensure that the inevitable restructuring does not result in the accumulation and abuse of private market power."[12]

While Chairman Pitofsky's comments were in the context of antitrust enforcement during the heyday of natural gas restructuring, they are no less pertinent to electricity restructuring and this Commission's leading role in the restructuring process. As the primary author and arbiter of restructuring policy, and charged under Section 203 of the Federal Power Act with finding a merger to be in the public interest, it is incumbent on the Commission to ensure that mergers do not harm competition and consumers. Acceptance of an inadequate or inappropriate remedy would directly have this effect, at the same time it would set bad precedent for the Commission's merger policy. For these, and the reasons discussed in more detail below, the AAI respectfully but strongly urges that the Commission reject Applicants' proposed remedy and establish a forum for resolving competitive issues. This can be done either by convening a series of technical conferences or setting the matter

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[11] See the American Antitrust Institute's comments filed in Docket No. RM04-7-000, Market-Based Rates for Public Utilities, March 14, 2005. Online. Available http://www.antitrustinstitute.org/recent2/392.pdf. Accessed April 7, 2005.
[12] Robert Pitofsky, Chairman, Federal Trade Commission, *Prepared Statement of the Federal Trade Commission Before the Committee on the Judiciary*, U.S. House of Representatives 8, June 4, 1997.

for hearing, but in any event not giving any approval unless and until these matters are satisfactorily resolved.

APPLICANTS PROPOSE A FLAWED DIVESTITURE PLAN TO REMEDY THE DETRIMENTAL EFFECTS OF THE PROPOSED MERGER

Applicants propose to "divest" some 5,500 MW of capacity in order to remedy anticompetitive effects indicated by significant increases in market concentration. These divestitures are designed to reduce merger-induced concentration to levels that do not exceed the thresholds set forth in the *Policy Statement*.[13] Capacity potentially eligible for divestiture is anything that passes the Delivered Price Test (i.e., capacity with costs at or below 1.05 times the market price) for the 30 relevant markets in question.[14] The 5,500 MW package includes 1,000 MW of peaking capacity and 1,900 MW of mid-merit capacity in eastern PJM. The remaining 2,600 MW of nuclear baseload capacity (mostly in eastern PJM) will be "virtually" divested, i.e., sold under contract or swapped, while the merged company retains ownership. Applicants propose to carry out the divestiture plan themselves within 18 months after the merger is consummated. During the interim, Applicants propose to sell baseload, intermediate, and peaking energy equivalent to the capacity from generating assets that will ultimately be sold.

Applicants' proposal raises concerns about every important aspect of divestiture as a merger remedy. These aspects have long been rigorously and intensively debated by the antitrust agencies. The reason for this is that remedy is a critical factor in effective merger enforcement. Nothing in the Commission's significant merger review experience comes close to the magnitude of competitive and consumer harm and need for actual divestiture that the proposed merger presents. The seminal technical and policy issues raised by the

[13] *Policy Statement*, op. cit., p. 75.
[14] Hieronymus, op. cit., p. 66.

proposed transaction and the high stakes involving consumers, competition, and merger policy highlight the need for the Commission to get this merger "right." Given the Commission's limited dealings with divestiture in past merger cases,[15] the AAI suggests that the Commission avail itself of what the antitrust agencies have learned about divestiture as a merger remedy.

A sound divestiture proposal will include a number of important features. Among others, the following are particularly salient to the proposal contained in the Exelon/PSEG merger application:

- Divestiture should create viable, independent competitors in the market so as to replace the competition lost through merger.
- Preserving alleged merger-induced efficiencies with non-standard divestiture proposals must be justified with an analysis of the claimed efficiencies.
- The reviewing agency will have a significant role in:
    - Crafting the divestiture plan to meet specific criteria,
    - Approving buyers of divested assets and carrying out the divestitures (assisted if necessary by an independent trustee) so as to minimize the influence of the merging parties' self-interest on the outcome, and
    - Reviewing the success of the divestiture plan on an on-going basis and adjusting it if significant new facts emerge.

Applicants' divestiture proposal either does not provide enough information to adequately answer the foregoing questions or--even worse--gives the wrong answer. But the Commission anticipates such outcomes in the *Policy Statement*:

> "If an applicant does not propose appropriate remedies to mitigate the anticompetitive impact of a merger, the Commission intends to fashion such remedies during the course of its consideration of an application."[16]

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[15] The Commission has never ordered divestiture as a condition of merger approval and only in a few cases has accepted an Applicants' voluntary commitment to divest a single generating unit. See, for example, American Electric Power Company and Central and South West Corporation, *Opinion and Order Reversing in Part, Affirming in Part, Vacating in Part, and Modifying in Part the Initial Decision*, 90 FERC ¶61,242, March 15, 2000.

[16] *Policy Statement*, op. cit., p. 33.

Thus, the Commission should reject Applicants' proposed divestiture plan and establish a forum for conducting additional inquiry and analysis into an appropriate one. Acceptance of the divestiture proposal as it stands would give the green light to similar flawed remedies in future cases, setting a damaging precedent for the Commission's merger policy and an outcome that is potentially at odds with the decision of the reviewing antitrust agency.

"Virtual" Divestiture Avoids the Real Competition That Actual Divestiture Would Ensure

Perhaps one of the most important features of an effective divestiture remedy is that it replace with real competition that which is lost through the merger. "Virtual divestiture" of 2,600 MW of nuclear capacity (almost one-half of the total capacity to be divested) is a *conduct-based* remedy that—based on the sketchy information provided by Applicants—will not create real competition. Applicants' witness Hieronymus admits as much when he states that sales under the proposed long-term contract may not lead "to as large a number of market participants."[17] While this may not matter in an industry with a large number of thriving competitors, it can mean everything in a highly concentrated market. And nowhere in his testimony does Applicants' witness Sabatino address how the proposed energy sales will supply real *competition* in the PJM energy markets.[18] The substantial market power created by the proposed merger negates any incentive Applicants have to structure the energy contracts to induce real competition.

Under virtual divestiture, the ownership and control of nuclear capacity would be retained by the merged company while it sells (or swaps) the energy to third-party purchasers. Sales or swaps would occur through a variety of contractual mechanisms, to unspecified buyers, for differing contract lengths, and under unseen terms and conditions.

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[17] See Hieronymus, op. cit., p. 9.

[18] See Testimony of Frank B. Sabatino in the Application, pp. 9-10.

This marked lack of specificity regarding the structure of the energy contracts creates a "black box" into which these 2,600 MW will go and only the merged company will have insight into its internal workings.

In the government's case against Microsoft, the DOJ's divestiture proposal emphasized the perils of such conduct-based remedies. These perils are equally applicable in the case of Exelon/PSEG. For example, the DOJ stressed that:

> "There are. . . important limitations on what conduct remedies can accomplish. First, it may not be possible effectively to prohibit certain future misconduct, or to do so without excessive regulatory burden, by conduct remedies. . .a remedy that is likely to restore competition and prevent recurrence of illegal conduct without imposing huge regulatory burdens on the industry must go beyond conduct restrictions."[19]

In the recently-issued *Antitrust Division Policy Guide to Merger Remedies* (the "*Policy Guide to Merger Remedies*"), the Division emphasizes that:

> "Structural remedies are preferred to conduct-based remedies in merger cases because they are relatively clean and certain, and generally avoid costly government entanglement in the market. . .A conduct remedy, on the other hand, typically is more difficult to craft, more cumbersome and costly to administer, and easier than a structural remedy to circumvent."[20]

The creation of viable competition as an objective of merger remedy has long been held by the antitrust agencies to be a key component of merger enforcement. For example, former FTC Chairman Timothy Muris noted his commitment to "a divestiture that will likely create a viable business entity (rather than a creation of lawyers) to resolve the competitive problems posed."[21] In the FTC's 1999 *A Study of the Commission's Divestiture Process* (the "*Divestiture Study*"), the agency staff returns repeatedly to the importance of divestiture in

[19] Plaintiff's Memorandum in Support of Proposed Final Judgment, pp. 7-8.
[20] U.S. Department of Justice, Antitrust Division, *Antitrust Division Policy Guide to Merger Remedies*, Washington, D.C., October 2004, pp. 7-8. Online. Available http://www.usdoj.gov/atr/public/guidelines/205108.htm#3a. Accessed April 10, 2005 ("*Policy Guide to Merger Remedies*").
[21] Timothy Muris, "Antitrust Enforcement at the Federal Trade Commission: In a Word—Continuity," remarks at the ABA Antitrust Section Annual Meeting, August 7, 2001. Online. Available http://www.ftc.gov/speeches/muris/murisaba.htm. Accessed April 5, 2005.

supplying real competition in anticompetitive merger cases.[22] This contrasts with the very real possibility that the buyer of a divested asset simply "cooperat[es] in coordinated interaction or [sits] under the price-setting umbrella of the merged firm."[23] The DOJ considers the restoration of competition the "key to the whole question of an antitrust remedy,"[24] emphasizing that "Accepting remedies without analyzing whether they are sufficient to redress the violation involved *is a disservice to consumers*."[25]

Only in very limited cases have the antitrust agencies fashioned non-structural remedies in challenged merger cases in order to preserve demonstrated, merger-related efficiencies or under special circumstances involving a restructuring or transitioning industry. Rarely, if ever, have the agencies settled upon a remedy such as the sale of output while the merged company retains ownership.[26] The FTC, for example, sought divestiture as remedy in virtually all the horizontal natural gas mergers challenged by the agency between 1962 and 2001.[27]

Applicants' analysis provides no information on how the energy contracts will be structured and what incentives they create for the buyers to engage in hard competition with the merged company, specifically in the context of PJM energy markets. Without such information, it is impossible for the Commission to determine whether the contracts will replace competition lost by the merger or whether it is simply a way for the merged

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[22] Federal Trade Commission, Bureau of Competition, *A Study of the Commission's Divestiture Process*. Washington, D.C., 1999. Online. Available http://www.ftc.gov/os/1999/08/divestiture.pdf. Accessed April 5, 2005 ("*Divestiture Study*").
[23] Albert A. Foer, "Toward Guidelines for Merger Remedies," *Case Western Law Review* 52, 2001-2002, p. 214. Foer suggests that the more critical question is how well divested assets performed over time compared to how they were performing prior to divestiture. Whether the divested enterprise earned operating profits, gained market share, constrained the merged firm's pricing, and contributed to innovation activity are all indicators of real competition.
[24] *Policy Guide to Merger Remedies*, op. cit., p. 4, citing *United States v. E.I. du Pont de Nemours & Co.*, 366 U.S. 316, 326 (1961).
[25] Ibid, emphasis added.
[26] Ibid, p. 18.
[27] David Balto and James Mongoven, "Deregulation and Merger Enforcement in the Natural Gas Industry," *Antitrust Law Journal* 69, p. 527-568.

company to "park" the offending megawatts. On this basis, the Commission should reject the virtual divestiture proposal and either convene a technical conference or set the issue for hearing, in which Applicants would be required to demonstrate how the virtual divestiture will promote real competition. If Applicants cannot do this to the Commission's satisfaction, then it should seek actual divestiture as a remedy.

Applicants' Argument for "Virtual" Divestiture is Based on an Inadequate Efficiencies Analysis

Applicants' rationale for proposing virtual--as opposed to actual--divestiture is that the outright sale of nuclear units would ". . .eviscerate the very operating, efficiency, and reliability benefits that motivate the proposed Transaction."[28] But Applicants have provided the Commission with no acceptable analysis of the efficiencies or other benefits they claim would result from combining Exelon's and PSEG's nuclear assets. The application and testimony of witness Crane provides only general information and lack empirical support for Applicants' efficiency claim.[29] As a matter of crucially important precedent, the Commission must not accept the virtual divestiture proposal without sufficient justification.

Given the flawed virtual divestiture plan and the limited remedy it will provide, Applicants' rationale for avoiding actual divestiture of nuclear capacity amounts to an "efficiencies defense" for the proposed merger. Under such circumstances, an anticompetitive merger is defended on the basis of the efficiencies it will allegedly prove up. This possibility is expressly accounted for in Section 4 of the *Guidelines* (and the *Merger Policy Statement*), which allows for the consideration of *merger-related and cognizable* efficiencies as a counterbalance to a merger's anticompetitive effects.[30] So important is the requirement that

[28] Application, p. 23.
[29] See Prepared Direct Testimony of Christopher M. Crane in the Application.
[30] The Guidelines state that ". . .merger-related efficiencies are likely to be accomplished with the proposed merger and unlikely to be accomplished in the absence of either the proposed merger or another means having

claimed efficiencies are merger-related and cognizable that the antitrust agencies issued a separate clarifying statement in 1997, which is now part of the *Guidelines*.

The antitrust agencies spend considerable time evaluating an efficiencies defense in merger cases. The Guidelines explicitly state that:

> ". . .the merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific. *Efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means.*"[31]

Moreover, a particularly rigorous analysis must support any efficiencies defense in light of the high merger-induced and post-merger HHI levels exhibited by the proposed merger. Efficiencies that outweigh the anticompetitive effects of the merger would have to be very substantial--and lasting. Here, the *Guidelines* emphasize that:

> "The greater the potential adverse competitive effect of a merger--as indicated by the increase in the HHI and post-merger HHI. . .the greater must be cognizable efficiencies in order for the Agency to conclude that the merger will not have an anticompetitive effect in the relevant market. . . *When the potential adverse competitive effect of a merger is likely to particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive*. . .In the Agency's experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great."[32]

The courts have held to this principle. In the Heinz baby food merger (*Federal Trade Commission v. H.J. Heinz Co.*), for example, the court stated that "The high market

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comparable anticompetitive effects. . .cognizable efficiencies are merger-specific efficiencies that have been verified and do not arise from anticompetitive reductions in output or service. Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies." *Guidelines*, §4.0.

[31] Ibid. Emphasis added.

[32] Ibid. Emphasis added.

concentration levels present in this case require, in rebuttal, proof of extraordinary efficiencies, which the appellees [merging firms] fail to supply."[33]

Commission approval of an anticompetitive merger without the requisite efficiencies would run counter to the public interest standard under Section 203 of the Federal Power Act. The Commission should therefore require Applicants to produce an acceptable efficiencies analysis. In scrutinizing the analysis, the Commission should ask the key questions indicated in the *Guidelines*. For example, are the claimed efficiencies attainable only through merger, or could they be gotten through independent actions taken by each company? Are the claimed efficiencies likely to materialize? (Both Exelon and PSEG are already low-cost producers of nuclear energy and most economies of scale in the industry are at the plant or unit level.) It is not clear how adding PSEG to Exelon's operations would result in additional economies of scale or scope. What incentive would a merged Exelon/PSEG have to pass on lower costs to wholesale consumers in the form of lower prices when the merged firm would possess significant market power? If Applicants cannot answer these questions to the Commission's satisfaction, then it should seek actual divestiture as a remedy.

The Merging Parties' Control of the Divestiture Process is Akin to the "Fox Guarding the Henhouse"

Applicants propose to control virtually every aspect of their virtual and actual divestitures, excluding the Commission from *any* role in articulating an acceptable divestiture plan and from procedural oversight. Given the significant incentives a merging company has to avoid divestiture outcomes that will create viable competition and competitors,

[33] *Federal Trade Commission v. H.J. Heinz Co.*, 2000 Trade Case (CCH) P73,090 (D.C. Cir. 2000), cited in 246 F3rd at 720 J. Baker, "Heinz Proposes to Acquire Beech-Nut (2001) in J. E. Kwoka, Jr., and L. J. White, *The Antitrust Revolution* 4rd ed., 2004, pp. 150-169.

Applicants' proposal is akin to the "fox guarding the henhouse." The FTC staff's study of the divestiture process bears this out. For example, buyers interviewed for the study indicated that merging companies not only urged the FTC to divest assets to weak buyers and to propose packages of assets that were too narrow to ensure fully viable competition, but took actions that diminished the viability of the business acquired by the buyer.[34] Applicants' undue and unprecedented control over the divestiture process is evident in a number of key areas.

First, Applicants do not identify the specific mid-merit and peaking units in eastern PJM to be divested. Instead, they provide a "list" of possible generators that could be divested.[35] This violates the Commission's express requirement in the *Policy Statement* that:

> "[r]emedial commitments must specify exactly which facilities are affected by the commitment, e.g., which generating unit(s) will be divested."[36]

Generating units will vary in their locational, operating, reliability, and environmental compliance characteristics. The importance of identifying specific generating assets for divestiture is doubly important in constrained electricity markets where the location of the generator on the network is a determinant of competitive outcomes. A lack of such specification preserves Applicants' incentive to sell units that are least able to compete with the retained assets. The DOJ states in this regard, for example, that:

> "The goal of a divestiture is to ensure that the purchaser possesses both the means and the incentive to maintain the level of premerger competition in the market(s) of concern. . .This requires a clear identification of the assets a competitor needs to compete effectively in a timely fashion and over the long-term."[37]

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[34] *Divestiture Study*, op. cit., p. 16.
[35] Hieronymus, op. cit., Exhibit J-12.
[36] *Policy Statement*, op. cit., p. 83.
[37] *Policy Guide to Merger Remedies*, op. cit. 9.

Second, Applicants will select the buyers for the generating capacity to be sold. But not all buyers are created equal. There is simply no good reason why the Applicants should be allowed to select the buyers of the to-be-divested assets. Without Commission intervention in selecting and approving the buyers of assets, Applicants have every incentive to sell to a weak buyer that will inject the least amount of competitive discipline into the market. Third, Applicants propose themselves to manage the energy contracts from their virtually divested nuclear units.[38] Here, Applicants have every incentive to ensure that contract disputes and operational issues that are the inevitable outcomes of conduct-based remedies work against the buyer.

Finally, Applicants propose that they take up to 18 months from merger consummation to complete the actual divestitures. But to the extent that the interim energy sales do not inject the same competitive discipline in the market as actual divestiture of assets to strong buyers, Applicants have every incentive not only to take their time selling the assets but to degrade their quality so as to undermine the future owners' ability to compete. These perverse incentives would be exacerbated by the absence of an independent, Commission-appointed trustee to sell the to-be-divested assets if the merging companies are unable do so within the Commission-prescribed time period. In giving merging companies only 2 to 3 months to locate a purchaser of an asset on their own, the DOJ notes that:

> "A quick divestiture has two clear benefits. First it restores premerger competition to the marketplace as soon as possible. Second, it mitigates the potential dissipation of asset value associated with a lengthy divestiture process."[39]

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[38] Even the virtual divestiture proposed here falls short of what the Commission has accepted in one other instance. For example, in *Louisville Gas and Electric/Kentucky Utilities,* an independent trustee assumed the role of managing the contracts. *Louisville Gas and Electric Company and Kentucky Utilities*, 82 FERC ¶61,308, p. 17.
[39] *Policy Guide to Merger Remedies*, op. cit. 29.

In virtually every respect, the proposed Applicant-controlled divestiture process contrasts with how the antitrust agencies have pursed divestiture for at least the last two decades. In fact, the proposed divestiture plan more closely resembles elements of the early, and now superseded, divestiture policies at the FTC.[40] The antitrust agencies' divestiture policies have advanced dramatically in 20 years. Based on recent divestiture orders, for example, the FTC's study on the divestiture process finds that:

> "The divestiture must be to a suitable entity–one that can replace the competition lost as a result of a merger–and the Commission must be able to approve both the buyer and the manner of divestiture. This post-order approval process is required because maintaining or restoring competition is as much a function of who the buyer is and the circumstances under which it is acquiring the assets from the respondent as it is a function of what assets are divested."[41]

Among other important findings, the FTC study also states that recent divestiture orders have made the following improvements:

- Reduced time allowed for merging companies to complete their divestiture obligations (the FTC now uses a 6-month working rule) and "up-front" divestitures and to further reduce or eliminate interim harm.[42]

- Required divestiture of related assets to ensure the viability of the divested business and submission of acceptable business plans by buyers of assets.

- Use of auditor trustees to monitor technology transfers to the buyer and technical assistance (provided by the merged company), particularly when the Commission determines that non-optimal divestiture is necessary to preserve merger-induced efficiencies.[43]

Left to their own devices in crafting and implementing a divestiture plan, it is highly likely that the merged company will implement only marginally-effective divestitures. Given

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[40] For example, based on 10 divestiture orders issued in 1979, the time permitted a respondent to divest ranged from one to two years from the time an order became final. None of the orders authorized the Commission to appoint a trustee to divest the assets if the respondent failed to do so within the required period. *Divestiture Study*, op. cit., p. 4.

[41] *Divestiture Study*, op. cit., p. iii. See also U.S. DOJ, op. cit., p. 31.

[42] Ibid, p. 39.

[43] Ibid, pp. iv, 12, and 29. The FTC report notes that the Commission has more recently appointed as auditor trustees individuals with technical knowledge of the industry.

the substantial market power created by the proposed merger, the net result of such an outcome will be harm to competition and consumers. It is therefore incumbent upon the Commission under its Section 203 authority to reject the proposed plan and assume a proactive and integral role in crafting and implementing a satisfactory divestiture plan through technical conferences or a hearing. Much of what the antitrust agencies have learned about divestiture can be brought by the Commission to bear on its own merger policy.

ADDITONAL CONSIDERATIONS

There are a number of other troubling issues raised by the proposed merger that bear directly on its effect on competition. This includes Applicants' dismissal of vertical issues associated with combining a bigger generation portfolio with additional control over transmission on the basis of their membership in PJM. The AAI has elected not to focus on these issues to the extent it has on the seminal issue of remedy in the horizontal context. However, it is clear that it should become increasingly difficult for merger applicants to play the RTO "card" in response to concerns over vertical effects. For example, in late 2001, the Commission issued a show cause order regarding whether Exelon affiliate PECO violated Section 205(b) of the Federal Power Act and the standards of conduct in the Commission's regulations. This order was triggered by evidence that PECO had operated its transmission system in a manner that benefited its generation affiliate by sharing non-public information about the timing and location of maintenance outages.[44] PECO is a member of PJM, a Commission-approved RTO.

Rather than carry out the show cause investigation, the Commission instead decided to require PJM to file new procedures that would ostensibly prevent the type of

[44] Exelon Corporation, PECO Energy Company, Exelon Generation Company, L.L.C., and Exelon Power Team, *Show Cause Order*, 97 FERC ¶61,009, October 3, 2001.

discriminatory behavior PECO pursued.[45] But absent perfect market design and market power mitigation that detects and punishes all anticompetitive conduct, it is not unreasonable to expect that even in an RTO, sellers will still find ways to exercise market power through vertical restraints. The inability to design the perfect conduct-based remedy, of course, highlights the importance of structural remedies in general, and in problematic merger cases in particular. A sound divestiture plan developed for the proposed merger could, of course, do double duty since divestiture removes the incentive for the firm to exercise market power in both a horizontal and vertical context.

CONCLUSION

The proposed merger of Exelon and PSEG presents critical, unresolved questions and problems regarding divestiture as a remedy. In discharging its duty under Section 203, the Commission is responsible for ensuring that for the merger to be in the public interest, competition and consumers are not harmed. Acceptance of Applicants flawed divestiture plan would almost assuredly allow the merged company to exercise the substantial market power conferred on it by the merger. Instead, the Commission should reject Applicants' flawed and inadequate remedy and take a proactive role in crafting and implementing an acceptable divestiture plan through technical conferences or a hearing. This plan should comport with the objectives articulated in the *Policy Statement,* and utilize the valuable lessons learned by the antitrust agencies.

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[45] PJM Interconnection, L.L.C., *Order Requiring the Filing of New Oversight measures and Terminating Investigation*, 97 FERC ¶61,319, December 20, 2001.

Respectfully submitted,

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