1 **STATE OF NEW JERSEY**
2 **BOARD OF PUBLIC UTILITIES**
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5 **In the Matter of the Joint Petition of)**
6 **Public Service Electric and Gas Company)**
7 **and Exelon Corporation)**
8 **for Approval of a Change in Control of)**
9 **Public Service Electric and Gas Company) BPU Docket No. EM05020106**
10 **and Related Authorizations) OAL Docket No. PUC-1874-05**

11 **Surrebuttal Testimony of**
12 **Diana L. Moss**
13 **On Behalf of Intervenor NJPIRG Citizen Lobby, Inc.**
14
15 **December 23, 2005**

16 **I. <u>Introduction, Qualifications, and Purpose of Testimony</u>**

17 **Q. Please state your name, address, and position.**

18 A. My name is Diana L. Moss and I am Vice President and Senior Fellow of the
19 American Antitrust Institute. My mailing address is American Antitrust Institute,
20 P.O. Box 20725, Boulder, CO 80308.

21 **Q. Please summarize your experience that is relevant to this proceeding.**

22 A. A statement of my qualifications is attached to this testimony and exhibit DLM-1.
23 Prior to joining the AAI in 2001, I was Senior Economist and Coordinator for
24 Competition Analysis in the Office of Markets, Tariffs and Rates at the Federal
25 Energy Regulatory Commission (FERC). From 1995 through 2001, one of my
26 major responsibilities at FERC was analyzing the competitive effects of proposed
27 electric utility mergers, overseeing Staff analysis of those mergers, and
28 communicating with FERC Commissioners on the legal-economics of merger-
29 related issues. I was also the inter-agency liaison between FERC, the Department
30 of Energy, the Department of Justice (DOJ) Antitrust Division, and the Federal

1 Trade Commission (FTC) on competitive issues surrounding electric utility
2 mergers. From 1989 through 1994, I specialized in antitrust and regulation at two
3 leading economic consulting firms.

4 **Q. Please describe the American Antitrust Institute.**

5 A. The AAI is an independent, Washington D.C.-based non-profit education,
6 research, and advocacy organization. The AAI's mission is to increase the role of
7 competition, assure that competition works in the interests of consumers, and
8 challenge abuses of concentrated economic power in the American and world
9 economy.[1] The AAI speaks on behalf of the public interest in a wide range of
10 matters involving competition policy and consumer protection. These matters
11 include mergers that--based on factual analysis, accepted standards for
12 competitive analysis, and public policy considerations--will harm competition and
13 consumers. This representation is independent of any particular private interest.

14 **Q. Have you previously participated in this proceeding?**

15 A. No. This is the first time the American Antitrust Institute has participated in this
16 proceeding.

17 **Q. What is the purpose of your surrebuttal testimony?**

18 A. The purpose of my testimony is to respond to Joint Petitioners' witnesses'
19 testimony rebutting the direct testimony of Suzanne Leta and NJPIRG report,
20 regarding Exelon's market power post-merger and the proposed divestiture.
21 Specifically, I will discuss how the divestiture plan proposed by the merging
22 parties fails to adequately address the competitive problems created by the
23 merger. The New Jersey Board of Public Utilities (the Board) must address the

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

1 merits of the proposed remedy in its review of the competitive effects of the
2 proposed transaction. Moreover, the AAI believes that it is vitally important--
3 despite the Federal Energy Regulatory Commission's (FERC's) acceptance of
4 Exelon/PSEG's proposed remedy—for the Board to objectively and
5 independently consider the proposed divestiture plan. In this regard, I have
6 attached as Exhibit DLM-2 an article that I recently published in *The Deal* on
7 multi-agency review of electricity mergers, including the Exelon/PSEG
8 transaction.

9 **Q. Why is the proposed remedy in this case so important?**

10 A. Exelon/PSEG are asking the Board to accept a flawed and inadequate remedy for
11 a substantially harmful merger. This is roughly the equivalent of asking the Board
12 to approve an anticompetitive merger without conditions—or perhaps worse,
13 since it gives the false appearance of providing some protection for competition.
14 This will have two detrimental effects. First, given the substantial market power
15 created by the merger, competition and consumers will be harmed. Second, it will
16 encourage additional mergers of very large utilities that would further concentrate
17 electricity markets, something that public policy has attempted for decades to
18 deconcentrate.

19 **II. <u>Anticompetitive Effects of the Proposed Merger</u>**

20 **Q. Please provide some background on the proposed merger.**

21 A. The proposed combination of Exelon and PSEG is the largest electricity merger
22 ever to emerge in the U.S. electricity industry. Assets of the merged company are
23 estimated at $79 billion. This is about two-and-a-half times as much as

1 *Unicom/PECO Energy* (PECO), which formed Exelon--the next largest merger

2 and predecessor to Exelon/PSEG.[2] The combination would create a utility with

3 the largest generation portfolio in the U.S., resulting from a massive consolidation

4 of generation ownership in eastern PJM, a transmission-constrained and highly

5 concentrated electricity market. The proposed merger puts competition and the

6 welfare of dozens of wholesale (and millions of retail) electricity consumers in the

7 region at risk.

8 **Q. Is the proposed merger of Exelon and PSEG anticompetitive?**

9 A. Yes, the merging parties' own analysis indicates that the proposed merger would

10 significantly increase concentration in all of the 30 relevant markets analyzed.[3]

11 These markets include 10 time periods for each of the three geographic markets--

12 expanded PJM, pre-2004 PJM, and East PJM. As it stands, increases in

13 concentration in all the relevant markets are well-beyond the thresholds set forth

14 in the DOJ/FTC 1992 *Horizontal Merger Guidelines* (the "*Guidelines*") and in

15 FERC's 1996 *Merger Policy Statement* (the "*Policy Statement*"), which formally

16 adopts the DOJ/FTC *Guidelines*.[4] In East PJM, merger-induced increases in

17 concentration sometimes exceed 1,200 HHI points in markets with post-merger

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[2] 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. "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.

[3] See Direct Testimony of Rodney Frame on behalf of Public Service Electric and Gas in the Matter of the Joint Petition of Public Service Electric and Gas Company and Exelon Corporation for Approval of a Change in Control of Public Service Electric and Gas Company, and Related Authorizations, BPU Docket No. EM05020106, OAL Docket No. PUC-1874-05, February 25, 2005, p. 6 and Exhibit RF-6. Based on results using economic capacity.

[4] 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. *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 FR 68,595, December 30, 1996. Online. Available http://www.ferc.gov/industries/electric/gen-info/mergers/rm96-6.pdf.

1 concentration as high as 2,800 HHI. Such increases in concentration significantly
2 increase the ability and incentive of the merged company to restrict output and
3 raise wholesale electricity prices through unilateral or coordinated conduct.

4 **Q. How would a merger that similarly increases concentration in relevant**
5 **markets be treated by the antitrust agencies?**

6 A. To put the market-concentrating effects of the proposed merger in context, it is
7 useful to look at the merger enforcement experience at the FTC. For example, in
8 over 70 percent of the horizontal mergers with the levels of merger-induced and
9 post-merger concentration witnessed in Exelon/PSEG, the FTC either blocked the
10 transaction through a petition for injunctive relief or settled competitive concerns
11 through a consent decree requiring remedial action.[5]

12 **Q. Is it important to scrutinize electricity utility mergers more intensely during**
13 **industry restructuring?**

14 A. Yes. The proposed merger occurs at a time when industry restructuring has
15 generated more controversy than consensus, and is idling in a protracted and
16 difficult transitional period.[6] Restructuring is marked by limitations on federal
17 initiatives relating to market design, RTOs, and transmission expansion; a
18 balkanized system of federal and state oversight; and a multitude of market power
19 concerns in quasi-competitive markets[7]

[5] 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.

[6] 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.

[7] 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.

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

5 "The potential for consumer savings and increased choice is
6 enormous, but it is certainly not guaranteed. . .strong merger
7 enforcement is necessary to ensure that the inevitable restructuring
8 does not result in the accumulation and abuse of private market
9 power."[8]
10
11 While former Chairman Pitofsky's comments were in the context of antitrust
12 enforcement in natural gas, they are no less pertinent to electricity restructuring. It
13 is incumbent on the Board to ensure that mergers do not harm competition and
14 consumers. Acceptance of an inadequate or inappropriate remedy would directly
15 have this effect, at the same time it would set bad precedent for merger policy.

16 **III. <u>Exelon/PSEG's Flawed Divestiture Plan</u>**

17 **Q. What do the merging parties propose for a divestiture plan?**

18 A. Exelon/PSEG propose to "divest" some 5,500 MW of capacity in order to remedy
19 anticompetitive effects indicated by significant increases in market concentration.
20 This divestiture is designed to reduce merger-induced concentration to levels that
21 do not exceed the thresholds set forth in the DOJ/FTC *Guidelines* and FERC's
22 *Policy Statement.* Capacity potentially eligible for divestiture is anything that
23 passes the Delivered Price Test described in the *Policy Statement* (i.e., capacity
24 with costs at or below 1.05 times the market price) for the 30 relevant markets in
25 question.

[8] 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.

1 The 5,500 MW “divestiture” package includes 1,000 MW of peaking
2 capacity and 1,900 MW of mid-merit capacity in eastern PJM. The remaining
3 2,600 MW of nuclear baseload capacity (mostly in eastern PJM) will be
4 “virtually” divested, i.e., sold under contract or swapped, while the merged
5 company retains ownership. Exelon/PSEG propose to carry out the divestiture
6 plan themselves within 18 months after the merger is consummated. During the
7 interim, they propose to sell baseload, intermediate, and peaking energy
8 equivalent to the capacity from generating assets that will ultimately be sold.
9 **Q. Is the proposed divestiture plan acceptable in the context of sound**
10 **competition policy?**
11 A. No. For the reasons discussed below, Exelon/PSEG’s proposal raises concerns
12 about every important aspect of divestiture as a merger remedy. These aspects
13 have long been rigorously and intensively debated by the antitrust agencies. The
14 reason for this is that remedy is a critical factor in effective merger enforcement.
15 No electricity merger in the U.S. presents the magnitude of competitive and
16 consumer harm and need for actual divestiture that the proposed merger of
17 Exelon/PSEG presents. The seminal technical and policy issues raised by the
18 proposed transaction and the high stakes involving consumers, competition, and
19 merger policy highlight the need for the Board to get this merger “right.” Given
20 the Board’s limited dealings with divestiture, the AAI suggests that it avail itself
21 of what the antitrust agencies have learned about divestiture as a merger remedy.
22 **Q. What features should a sound divestiture plan include?**

A. 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;
    - Reviewing the success of the divestiture plan on an on-going basis and adjusting it if significant new facts emerge.

Q. Does Exelon/PSEG's proposal answer the foregoing questions?

A. No. The divestiture proposal either does not provide enough information to adequately answer the foregoing questions or--even worse--gives the wrong answer. Thus, the Board should reject the 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 Board's merger policy and an outcome that is potentially at odds with the decision of the reviewing antitrust agency. In the following sections, I provide more detail on the specific areas in which the divestiture proposal falls short.

IV. **“Virtual” Divestiture Does Not Replace Competition Eliminated by the Merger**

Q. You state above that divestiture should replace the competition eliminated by the merger. Why doesn’t the “virtual” divestiture plan accomplish this goal?

A. Perhaps one of the most important features of an effective divestiture remedy is that it replace the competition lost through the merger with *real* competition. “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 the merging parties—will not create 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. 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.

Moreover, Exelon/PSEG provide 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 Board to determine whether the contracts will replace competition lost by the merger or whether it is simply a way for the merged company to “park” the offending

megawatts. On this basis, the Board should reject the virtual divestiture proposal and require the merging parties to demonstrate how the virtual divestiture will promote real competition. If they cannot do this to the Board's, then it should seek actual divestiture as a remedy.

Q. Is there a general context in which conduct-based remedies are considered to be inferior to structural remedies?

A. Yes. 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."[9]

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.[10] The FTC, for example, sought divestiture as remedy in virtually all the horizontal natural gas mergers challenged by the agency between 1962 and 2001.[11]

Q. Why is the creation of a viable competitor as part of a divestiture remedy so important?

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[9] 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. ("*Policy Guide to Merger Remedies*").
[10] Ibid, p. 18.
[11] David Balto and James Mongoven, "Deregulation and Merger Enforcement in the Natural Gas Industry," *Antitrust Law Journal* 69, p. 527-568.

1 A. The creation of viable competition as an objective of merger remedy has long
2 been held by the antitrust agencies to be a key component of merger enforcement.
3 For example, former FTC Chairman Timothy Muris noted his commitment to "a
4 divestiture that will likely create a viable business entity (rather than a creation of
5 lawyers) to resolve the competitive problems posed."[12] In the FTC's 1999 *A Study
6 of the Commission's Divestiture Process* (the "*Divestiture Study*"), the agency
7 staff returns repeatedly to the importance of divestiture in supplying real
8 competition in anticompetitive merger cases. [13] This contrasts with the very real
9 possibility that the buyer of a divested asset simply "cooperat[es] in coordinated
10 interaction or [sits] under the price-setting umbrella of the merged firm."[14] The
11 DOJ considers the restoration of competition the "key to the whole question of an
12 antitrust remedy,"[15] emphasizing that "Accepting remedies without analyzing
13 whether they are sufficient to redress the violation involved *is a disservice to*
14 *consumers*."[16]

15 **V. <u>"Virtual" Divestiture Should not be Justified on the Basis of Merger-Related</u>**
16 **<u>Efficiencies</u>**
17
18 **Q. Exelon/PSEG claim that "virtual" divestiture is necessary to preserve the**
19 **efficiencies generated by the merger. Is this valid?**

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[12] 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.
[13] 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. ("*Divestiture Study*").
[14] 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.
[15] *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).
[16] Ibid, emphasis added.

1 A. No. Exelon/PSEG's rationale for proposing virtual--as opposed to actual--
2 divestiture is that the outright sale of nuclear units would ". . .eviscerate the very
3 operating, efficiency, and reliability benefits that motivate the proposed
4 Transaction."[17] But Exelon/PSEG have provided the Board with no acceptable
5 analysis of the efficiencies or other benefits they claim would result from
6 combining Exelon's and PSEG's nuclear assets. The application and supporting
7 testimony provide only general information and lack empirical support for an
8 efficiency claim. As a matter of crucially important precedent, the Board must not
9 accept the virtual divestiture proposal without sufficient justification.

10 **Q. Please explain how efficiencies are considered in merger analysis.**

11 A. Under some circumstances, an anticompetitive merger can be defended on the
12 basis of the substantial efficiencies it will likely prove up. This possibility is
13 expressly accounted for in Section 4 of the *Guidelines*, which allows for the
14 consideration of *merger-related and cognizable* efficiencies as a counterbalance
15 to a merger's anticompetitive effects.[18] So important, however, is the requirement
16 that claimed efficiencies are merger-related and cognizable that the antitrust
17 agencies issued a separate clarifying statement in 1997, which is now part of the
18 *Guidelines*.

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[17] Exelon Corporation and Public Service Enterprise Group Inc., before the Federal Energy Regulatory Commission, *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. 23.

[18] 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 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.

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.*"[19]

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."[20]

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

[19] Ibid. Emphasis added.
[20] Ibid. Emphasis added.

1 market concentration levels present in this case require, in rebuttal, proof of
2 extraordinary efficiencies, which the appellees [merging firms] fail to supply."[21]

3 **Q. What types of questions would be important to ask about the claimed**
4 **efficiencies generated by the proposed merger?**

5 A. The Board should require Exelon/PSEG to produce an acceptable efficiencies
6 analysis. In scrutinizing the analysis, the Board should ask several key questions.
7 For example, are the claimed efficiencies attainable only through merger, or could
8 they be gotten through independent actions taken by each company? Are the
9 claimed efficiencies likely to materialize? (Both Exelon and PSEG are already
10 low-cost producers of nuclear energy and most economies of scale in the industry
11 are at the plant or unit level.) It is not clear how adding PSEG to Exelon's
12 operations would result in additional economies of scale or scope. What incentive
13 would a merged Exelon/PSEG have to pass on lower costs to wholesale
14 consumers in the form of lower prices when the merged firm would possess
15 significant market power? If the merging parties cannot answer the foregoing
16 questions to the Board's satisfaction, then it should seek actual divestiture as a
17 remedy.

18 **VI. <u>The Merging Parties' Control of the Divestiture Process is Akin to the "Fox</u>**
19 **<u>Guarding the Henhouse"</u>**
20

21 **Q. How do Exelon/PSEG propose to implement the proposed divestiture**
22 **process?**

[21] *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.

1 A. Exelon/PSEG propose to control virtually every aspect of their virtual and actual
2 divestitures, excluding the Board from *any* role in articulating an acceptable
3 divestiture plan and from procedural oversight. Given the significant incentives a
4 merging company has to avoid divestiture outcomes that will create viable
5 competition and competitors, Exelon/PSEG's proposal is akin to the "fox
6 guarding the henhouse." The FTC staff's study of the divestiture process bears
7 this out. For example, buyers interviewed for the study indicated that merging
8 companies not only urged the FTC to divest assets to weak buyers and to propose
9 packages of assets that were too narrow to ensure fully viable competition, but
10 took actions that diminished the viability of the business acquired by the buyer.[22]
11 **Q. In what specific ways is Exeon/PSEG's control over the divestiture process**
12 **evident?**
13 A. Exelon/PSEG's undue and unprecedented control over the divestiture process is
14 evident in a number of key areas. First, they do not identify the specific mid-merit
15 and peaking units in eastern PJM to be divested, only a "list" of possible
16 generators that could be divested. But generating units will vary in their
17 locational, operating, reliability, and environmental compliance characteristics.
18 The importance of identifying specific generating assets for divestiture is doubly
19 important in constrained electricity markets where the location of the generator on
20 the network is a determinant of competitive outcomes. A lack of such
21 specification preserves the merged company's incentive to sell units that are least
22 able to compete with the retained assets. The DOJ states in this regard, for
23 example, that:

[22] *Divestiture Study*, op. cit., p. 16.

1 “The goal of a divestiture is to ensure that the purchaser possesses
2 both the means and the incentive to maintain the level of
3 premerger competition in the market(s) of concern. . .This requires
4 a clear identification of the assets a competitor needs to compete
5 effectively in a timely fashion and over the long-term.”[23]
6
7 Second, Exelon/PSEG will select the buyers for the generating capacity to
8 be sold. But not all buyers are created equal. There is simply no good reason why
9 the merging parties should be allowed to select the buyers of the to-be-divested
10 assets. Without Board intervention in selecting and approving the buyers of
11 assets, the merged company will have every incentive to sell to a weak buyer that
12 will inject the least amount of competitive discipline into the market. Third,
13 Exelon/PSEG propose themselves to manage the energy contracts from their
14 virtually divested nuclear units. Here, they have every incentive to ensure that
15 contract disputes and operational issues that are the inevitable outcomes of
16 conduct-based remedies work against the buyer.
17 Finally, Exelon/PSEG propose to take up to 18 months from merger
18 consummation to complete the actual divestitures. But to the extent that the
19 interim energy sales do not inject the same competitive discipline in the market as
20 actual divestiture of assets to strong buyers, the merged company has every
21 incentive not only to take their time selling the assets but to degrade their quality
22 so as to undermine the future owners’ ability to compete. These perverse
23 incentives would be exacerbated by the absence of an independent, Board-
24 appointed trustee to sell the to-be-divested assets if the merging companies are
25 unable do so within a prescribed time period. In giving merging companies only 2
26 to 3 months to locate a purchaser of an asset on their own, the DOJ notes that:

[23] *Policy Guide to Merger Remedies*, op. cit. 9.

1 "A quick divestiture has two clear benefits. First it restores
2 premerger competition to the marketplace as soon as possible.
3 Second, it mitigates the potential dissipation of asset value
4 associated with a lengthy divestiture process."[24]
5
6 **Q. How do the antitrust agencies approach control of the divestiture process?**

7 A. In virtually every respect, the proposed Exelon/PSEG-controlled divestiture
8 process contrasts with how the antitrust agencies have pursed divestiture for at
9 least the last two decades. In fact, the proposed divestiture plan more closely
10 resembles elements of the early, and now superseded, divestiture policies at the
11 FTC.[25] The antitrust agencies' divestiture policies have advanced dramatically in
12 20 years. Based on recent divestiture orders, for example, the FTC's study on the
13 divestiture process finds that:

14 "The divestiture must be to a suitable entity–one that can replace
15 the competition lost as a result of a merger–and the Commission
16 must be able to approve both the buyer and the manner of
17 divestiture. This post-order approval process is required because
18 maintaining or restoring competition is as much a function of who
19 the buyer is and the circumstances under which it is acquiring the
20 assets from the respondent as it is a function of what assets are
21 divested."[26]
22
23 Among other important findings, the FTC study also states that recent divestiture
24 orders have:

25 • Reduced the time allowed for merging companies to complete their
26 divestiture obligations (the FTC now uses a 6-month working rule) and
27 "up-front" divestitures and to further reduce or eliminate interim harm.[27]
28
29 • Required divestiture of related assets to ensure the viability of the divested
30 business and submission of acceptable business plans by buyers of assets.

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[24] *Policy Guide to Merger Remedies*, op. cit. 29.
[25] 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.
[26] *Divestiture Study*, op. cit., p. iii. See also U.S. DOJ, op. cit., p. 31.
[27] Ibid, p. 39.

- Used 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.[28]

Q. What is the likely outcome if the merging parties are left to their own devices in crafting and implementing a divestiture plan?

A. If left to their own devices, it is highly likely that the merged company will implement only marginally-effective divestitures. Given 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 Board to reject the proposed plan and assume a proactive and integral role in crafting and implementing a satisfactory divestiture plan. Much of what the antitrust agencies have learned about divestiture can be brought by the Board to bear on its own merger policy.

VII. Conclusion

Q. Please summarize your testimony.

A. The proposed merger of Exelon and PSEG presents critical, unresolved questions and problems regarding divestiture as a remedy. In discharging its duty, the Board is responsible for ensuring that for the merger to be in the public interest, competition and consumers are not harmed. Acceptance of a flawed divestiture plan would almost assuredly allow the merged company to exercise the substantial market power conferred on it by the merger. Instead, the Board should

[28] 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.

1 reject Exelon/PSEG's flawed and inadequate remedy and take a proactive role in

2 crafting and implementing an acceptable divestiture plan.

3 **Q. Does this conclude your testimony?**

4 A. Yes.