UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

National Grid plc — Docket Nos. EC06-125-000
KeySpan Corporation — and EL06-85-000

ORDER AUTHORIZING MERGER AND DISPOSITION OF JURISDICTIONAL FACILITIES AND GRANTING PETITION FOR DECLARATORY ORDER

(Issued October 20, 2006)

1. On May 25, 2006, National Grid plc (National Grid) and KeySpan Corporation (KeySpan) (together, Applicants) applied under section 203 of the Federal Power Act (FPA)[1] for authorization to merge and to undertake an associated disposition of jurisdictional facilities. Under the merger, KeySpan would become an indirect, wholly-owned subsidiary of National Grid. The merger would result in the disposition of jurisdictional facilities that include electrical interconnection facilities, books, records and rates that are associated with wholesale sales of electricity by KeySpan.

2. The Commission will authorize the merger and disposition as consistent with the public interest and as otherwise meeting the requirements of section 203.[2] The Commission will also confirm that, after the merger, KeySpan's utility subsidiaries may pay dividends out of funds that had been retained earnings, as discussed below.

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[1] 16 U.S.C. § 824b (2000), *amended by* Energy Policy Act of 2005 § 1289, Pub. L. No. 109-58, 119 Stat. 594, 982-93 (2005) (EPAct 2005).

[2] *See* Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act, 61 Fed. Reg. 68,595 (1996), *reconsideration denied*, 62 Fed. Reg. 33,341 (1997) (Merger Policy Statement); Revised Filing Requirements Under Part 33 of the Commission's Regulations, 65 Fed. Reg. 70,984 (2000), *order on reh'g*, 66 Fed. Reg. 16,121 (2001); Transactions Subject to FPA Section 203, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, 71 Fed. Reg. 28,422 (May 16, 2006); *order on reh'g*, Order No. 669-B, 71 Fed. Reg. 42,579 (July 27, 2006).

I. Background

3. National Grid is a United Kingdom-based holding company whose subsidiaries provide utility and non-utility services in the United Kingdom and the northeastern United States. In the United Kingdom, National Grid engages, through subsidiaries, in the transmission of electricity, the transmission and distribution of natural gas, and wireless network services.

4. National Grid operates in the United States through National Grid USA. National Grid USA directly or indirectly owns: (1) Niagara Mohawk Power Corporation (Niagara Mohawk), which owns and operates electrical transmission facilities and engages in the distribution of electricity and natural gas in New York State; (2) four companies that own and operate electrical transmission facilities in New England, including New England Power Company, New England Electric Transmission Corporation, New England Hydro-Transmission Corporation, and New England Hydro-Transmission Electric Company, Inc.; and (3) four companies that engage in the distribution of electricity in New England, including Massachusetts Electric Company (Massachusetts Electric), The Narragansett Electric Company, Granite State Electric Company and Nantucket Electric Company. National Grid USA expects to acquire the Rhode Island natural gas distribution facilities of New England Gas Company in 2007. Subsidiaries of National Grid USA also engage in various non-utility businesses.

5. KeySpan is a United States-based holding company whose subsidiaries provide utility and non-utility services in the northeastern United States. Through subsidiaries, KeySpan: (1) operates electrical transmission and distribution facilities that are owned by Long Island Lighting Company dba Long Island Power Authority (LIPA); (2) owns generation facilities on Long Island and in Queens, New York; (3) holds interests in 411 miles of interstate, natural gas pipeline; (4) holds interests in companies that are expected to construct an interstate natural gas pipeline and to engage in the interstate transportation of natural gas; (5) holds investments in natural gas and liquefied natural gas storage facilities in Rhode Island and New York; and (6) owns six companies that engage in the distribution of natural gas, including Brooklyn Union Gas Company, KeySpan Gas East Corporation, Boston Gas Company, Colonial Gas Company, Essex Gas Company, and EnergyNorth Natural Gas, Inc. Subsidiaries of KeySpan also engage in various non-utility businesses.

6. Under the merger, National Grid would pay cash for each outstanding share of KeySpan's common stock. The payments would be allocated to KeySpan's subsidiaries and are likely to reflect an acquisition premium (payments in excess of the book value of the subsidiaries' assets).

II. Notice of Filing and Responsive Pleadings

7. Notice of Applicants' filing was published in the *Federal Register*, with comments, protests or interventions due on or before July 21, 2006.[3] The New York State Public Service Commission (New York Commission) filed a notice of intervention. Timely motions to intervene were filed by: Astoria Generating Company, L.P.; the New York City Economic Development Corporation (including supplemental comments); Public Citizen, Inc. (Public Citizen); LIPA; New York Association of Public Power; Saint Regis Mohawk Tribe (Saint Regis); Consolidated Edison Company of New York, Inc.; Energy East Corporation; County of Suffolk, New York; Multiple Intervenors (an unincorporated association of fifty-four industrial, commercial and institutional energy consumers in New York State); County of Nassau, New York; and Northeast Utilities Service Company. Timely motions to intervene and protests were filed by: Utility Workers Union of America, AFL-CIO and related local unions (UWUA); Town of Norwood, Massachusetts (Norwood); and the Attorney General of the Commonwealth of Massachusetts (Mass AG).

8. On August 7, 2006, Applicants filed an answer to the motions to intervene. On August 11, 2006, Public Citizen filed a motion for leave to protest out of time and an accompanying protest. On August 16, 2006, Applicants filed an answer in opposition to Public Citizen's motion. On August 17, 2006, Public Citizen filed an answer to Applicants' answer. On August 22, 2006, Nancy C. Gardner filed comments.

III. Discussion

A. Procedural Matters

9. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2006), the notice of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. We will also grant Public Citizen's motion to protest out of time given the early stage of this proceeding and the absence of any undue burden or delay.

10. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), prohibits answers to protests and answers to answers unless otherwise ordered by the decisional authority. We will accept Applicants' and Public Citizen's answers because they have provided information that has assisted us in our decision-making process.

[3] *See* 71 Fed. Reg. 32,994 (2006) (corrected by errata notice issued June 6, 2006).

B. Standard of Review under Section 203

11. Section 203(a) of the FPA requires the Commission to approve a merger if the Commission makes two determinations. First, the Commission must determine that the merger or disposition will be consistent with the public interest.[4] The Commission's analysis of whether a merger or disposition will be consistent with the public interest involves consideration of three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.[5] Second, the Commission must determine that the transaction "will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest."[6] The Commission's regulations establish verification and informational requirements for applicants that seek to determine that a merger or disposition will not result in cross-subsidization or pledge or encumbrance of utility assets.[7]

C. Analysis under Section 203

1. Effect on Competition – Horizontal Market Power

a. Applicants' Analysis

12. In analyzing the effect of the merger on horizontal market power, Applicants identify three relevant power products across the geographic markets affected by the merger: short-term, non-firm energy; capacity and long-term energy; and ancillary services. They conclude that the merger will not harm competition when changes in market concentration take into account native load obligations (*i.e.*, Available Economic Capacity).[8]

13. Applicants identify the New York Independent System Operator, Inc. (NYISO) and the ISO New England, Inc. (ISONE) as separate, relevant geographic markets using the approach described in Appendix A of the Merger Policy Statement. They also identify four relevant submarkets or zones within the NYISO control area: West Zone,

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[4] 16 U.S.C.A. § 824b(a)(4) (as amended by EPAct 2005).

[5] *See* Merger Policy Statement, 61 Fed. Reg. 68,595; Order No. 669, FERC Stats. & Regs. ¶ 31,200.

[6] 16 U.S.C. § 824(b)(a)(4) (as amended by EPAct 2005).

[7] 18 C.F.R. § 33.2 (2006) (as amended).

[8] Exhibit J at P 53.

Hudson Valley, New York City, and Long Island. Applicants treat PJM East, Hydro Quebec, and Ontario as the only first-tier markets that can deliver power into ISONE and NYISO.

14. For their analysis of short-term, non-firm energy, Applicants use Economic Capacity and Available Economic Capacity, as defined in the Merger Policy Statement, to represent a supplier's ability to participate in the market.[9] They use the Delivered Price Test to evaluate the effect on competition in the relevant markets for fourteen time periods from summer super-peak hours to off-peak hours in the four traditional seasons. Applicants use a range of prices from $309 per megawatt hour (MWh) for Summer Super Peak[10] in Long Island to $42 per MWh in Spring Off Peak in West Zone.[11] They estimate fuel costs as the product of the unit's heat rate and projected fuel prices for 2007, the test year for the analysis. Applicants' estimate for coal, oil, and gas fuel prices uses historical data from between 2005 and 2006, which are escalated to 2007. They estimate nuclear and other fuel prices using either FERC Form 1 or FERC Form 423 data using the historical rate of price changes between 2003 and 2004, which are escalated to 2007.[12]

15. Applicants use measures of transmission capability based on studies undertaken by the NYISO in December 2005.[13] Applicants determine simultaneous import limits for the NYISO market under two options: (1) the whole of NYISO (assuming no transmission constraints) and (2) the four NYISO submarkets (assuming transmission constraints) as separate control areas. The simultaneous import limits in the competitive analysis for the major NYISO interfaces are 1,600 megawatts (MWs) for the PJM-JK Group Interface, 6,000 MW for the Total East Interface, 925 MWs for the New England-

[9] Each supplier's "economic capacity" is the amount of capacity that could compete in the relevant market given market prices, running costs, and transmission availability. "Available Economic Capacity" is based on the same factors, but subtracts the supplier's native load obligation from its capacity and adjusts transmission availability accordingly. Merger Policy Statement at 30,132.

[10] Applicants define Summer Super Peak as the highest 50 hours of hourly spot prices likely to be observed in a destination market in summer. *See* Exhibit J at P 41.

[11] Exhibit J at P 90.

[12] *Id.* at P 79.

[13] *Id.* at P 102

New York Interface, and 1,520 MWs for the LI Sum Interface.[14] Applicants allocate transmission capability on an economic basis, arguing that it is more realistic than a *pro rata* allocation in locational marginal price markets.[15]

16. Applicants state that the effect of their combined ownership/control of generation on competition is small because National Grid neither owns nor operates generation in New York City or Long Island, where all of KeySpan's generation is located. They note that most of KeySpan's generation is committed under long-term contracts to LIPA[16] and that its remaining generation is under the control of NYISO. They state that National Grid purchases its capacity under long-term contracts from unaffiliated suppliers in New England and upstate New York, where KeySpan neither owns nor controls generation. Applicants state that most of National Grid's capacity is committed to retail delivery and provider of last resort (POLR)[17] customers.[18]

17. Applicants state that because renewal of KeySpan's Energy Management Agreement (EMA) with LIPA is uncertain, they performed the Delivered Price Test under two scenarios: (1) the EMA contract is renewed (With EMA) and KeySpan is treated as controlling the units whose capacity is sold to LIPA under long-term contracts and (2) the EMA contract is not renewed (Without EMA), in which that capacity is controlled by LIPA. Applicants state that this is consistent with Commission practice of treating any long-term contract that might confer control over the contracted capacity to the buyer as part of the market share of the buyer.[19]

18. Applicants found no failures of the Competitive Analysis Screen[20] for Available Economic Capacity under the With EMA or Without EMA scenarios in any relevant

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[14] Table 3, Exhibit J.

[15] Exhibit J at P 105.

[16] Under an Energy Management Agreement with LIPA, KeySpan is responsible for bidding the capacity into NYISO for the benefit of LIPA. The contract expires in December 2006, unless renewed. *See* Exhibit J at P 21.

[17] POLR service refers to the supply of bundled generation, transmission, and distribution of electric power to customers who do not take service from unregulated providers. *See* Exhibit J at n.4.

[18] Exhibit at P 20.

[19] *Id.* at P 23.

[20] Merger Policy Statement, Appendix A at 30,128.

geographic market. Applicants state that this is because National Grid is a net buyer of spot power during all hours for its POLR load and has zero Available Economic Capacity.[21]

19. For Economic Capacity, Applicants found screen failures in two of the NYISO submarkets: New York City and Long Island. There are three screen violations each under the With EMA and Without EMA cases in the New York City submarket (HHI[22] changes range from 51 to 85 points)[23] and 10 screen failures under the With EMA case in the Long Island submarket (HHI changes range from 51 to 383 points).[24] Applicants submit that the screen violations in the New York City submarket result from the high degree of concentration in the market pre-merger, which ranges from 1,975 points to 1,990 points, rather than from any change in competitive conditions due to the merger.[25]

20. Applicants argue that the screen violations for Economic Capacity will not have an adverse effect on competition. Because most of their Economic Capacity is committed to serving POLR and LIPA loads during most periods, that capacity is not available to compete for sales to wholesale customers. Applicants argue that given these commitments, they would have neither the ability nor the incentive to raise prices on wholesale power sold or to withhold capacity. Their ability to withhold is further constrained by state oversight of National Grid's POLR obligations and the ability of

[21] Exhibit J at P 25.

[22] The Herfindahl-Hirschman Index (HHI) is a widely accepted measure of market concentration, calculated by squaring the market share of each firm competing in the market and summing the results. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases. Markets in which the HHI is less than 1,000 points are considered unconcentrated; markets in which the HHI is greater than or equal to 1,000 but less than 1,800 points are considered moderately concentrated; and markets where the HHI is greater than or equal to 1,800 points are considered highly concentrated. The Commission has adopted the Federal Trade Commission/Department of Justice Horizontal Merger Guidelines, which state that in a horizontal merger, an increase of more than 50 HHI in a highly concentrated market or an increase of 100 HHI in a moderately concentrated market fails its screen and warrants further review. U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, 57 Fed. Reg. 41,552 (1992), *revised*, 4 Trade Reg. Rep (CCH) ¶ 13,104 (April 8, 1997).

[23] Exhibit No. PFP 12, Exhibit J.

[24] *Id.*

[25] Exhibit J at P 27 and P 112.

LIPA and NYISO to observe KeySpan's actions under the EMA. Applicants state that their incentive to withhold is further constrained by National Grid's inability to profit from any generation sales and the incentive provisions of the EMA. [26]

21. Applicants state that even though the State of New York operates competitive retail markets, Available Economic Capacity is a more appropriate measure of the competitive effects of the merger because it reflects National Grid's significant POLR obligations and related position as a net short-term buyer in the spot market. Under this measure, Applicants found no merger-related change in market concentration in any relevant market in any time period.[27]

22. Although Applicants contend that the merger will not result in any harmful horizontal competitive effects, they nonetheless propose mitigation measures to eliminate the conditions causing the screen violations if the Commission will not approve the transaction without further mitigation. Applicants will seek Commission authorization before making any bilateral sales of power from the upstate generating resources National Grid purchases under long-term contracts into the New York City or Long Island submarkets. If they do not receive authorization, Applicants will make that capacity available to the NYISO.[28]

23. Finally, Applicants analyze the effect of the merger on capacity[29] and ancillary services markets in the ISONE and the NYISO. They conclude that given the locational nature of the products, there are insufficient overlaps in the product and geographic markets to raise competitive concerns.[30]

b. Comments and Protests

24. The City of New York and the New York City Economic Development Corporation (New York Parties) challenge Applicants' argument that Available Economic Capacity rather than Economic Capacity is a more significant indicator of the merger's effect on competition. New York Parties note that the Applicants' analysis of Economic Capacity results in thirteen screen failures, which Applicants claim are due to conservative assumptions and the existence of POLR obligations in upstate New York and Long Island. New York parties challenge that claim, stating that KeySpan's 2,450

[26] Exhibit J at 29.

[27] Exhibit No. PFP 12, Exhibit J.

[28] Exhibit J at P 127.

[29] Applicants state that their analysis also includes long-term energy, which is a good substitute for capacity markets. Exhibit J at P 128.

[30] Exhibit J at P 31.

MW Keyspan-Ravensworth facility is under no POLR obligations similar to those borne by LIPA and KeySpan under the EMA, or those imposed on National Grid/Niagara Mohawk in upstate New York. Rather, the facility operates on a merchant basis.[31] Moreover, New York Parties state that this facility has more than a quarter of New York City's installed capacity, making KeySpan a pivotal bidder in the New York City market. Thus, New York Parties argue that the Economic Capacity test is an appropriate measure of potential market power in the New York City markets.[32]

c. Applicants' Answer

25. Applicants disagree that Economic Capacity rather than Available Economic Capacity should be used to measure market power in this case. Applicants state that it is not realistic to assume, as the Economic Capacity product measure requires, that capacity committed under contract could be remarketed. They reject New York Parties' argument that, because the Ravensworth station has available capacity, the results of the Available Economic Capacity measure are not valid. Applicants state that they did include the available capacity of the Ravensworth station under the Available Economic Capacity scenarios, with no resulting screen failures.[33] New York Parties do not address the most relevant question, which is how much of Applicants' other available capacity, including POLR capacity, should be treated as available for remarketing. Moreover, Applicants state that if the Commission is concerned about the screen failures identified in the Economic Analysis, they have proposed conditions that would mitigate any competitive concerns raised by the screen failures.[34]

d. Commission Determination

26. Applicants have adequately demonstrated that the combination of their electric generation resources is not likely to harm competition in any relevant energy market.[35] There is little overlap between KeySpan's generating resources located in New York City and Long Island and National Grid's limited generation resources in Upstate New York

[31] *Id.* at 4-5.

[32] *Id.* at 5. *See also* Multiple Intervenors' Protest at 2; Norwood Protest at 2-3 (expressing concern that the merger will adversely affect competition).

[33] Applicants' Answer at 10.

[34] *Id.* at 12.

[35] The Commission agrees with Applicants that NYISO and ISONE are separate relevant geographic markets because they are separate ISOs/RTOs and because the transmission ties between them are very limited and are often constrained. As noted above, Applicants have also analyzed several submarkets or zones within the NYISO market.

and New England. Applicants have analyzed the effect on competition using both Economic Capacity and Available Economic Capacity measures. They found no screen failures in any relevant geographic market using Available Economic Capacity and have offered adequate mitigation to address the specific possible harm to competition related to the Economic Capacity screen failures in the New York City and Long Island markets. In this case, because New York State has retail competition but utilities retain significant POLR obligations, both Available Economic Capacity and Economic Capacity can provide useful information in analyzing the effect of the merger on competition.

27. However, regarding the AEC analysis, we have previously found that, where applicants have significant native load obligations, Available Economic Capacity provides a more accurate measure of the effect on competition than Economic Capacity.[36] Here, while New York State has retail competition, National Grid has and will likely continue to have significant POLR obligations,[37] and all of its generation resources are dedicated to serving those obligations, thus removing that generation capacity from the wholesale market. Therefore, National Grid will have no Available Economic Capacity that would increase the market concentration in any relevant market. In addition, most of KeySpan's generation is committed under long-term contracts to LIPA Available Economic Capacity takes into account the fact that not all generation capacity that is owned by the merged company will be available for wholesale sales, *i.e.*, that the merged company will not be able to use that portion of its capacity to exercise market power. Here, the analysis shows no screen failures for Available Economic Capacity, indicating that the merger is not likely to result in an increase in market power in wholesale markets.

28. This conclusion is also supported when Economic Capacity is used to measure the effect on competition. The screen failures under that analysis, specifically with respect to the New York and Long Island markets, are based on the unlikely assumption that Applicants could withhold capacity that is already committed by KeySpan under long-term contracts or that is already committed to retail customers of National Grid through its POLR obligation. The limited screen failures and the unlikely circumstances in which those screen failures would arise are further evidence that the transaction is not likely to harm competition. Moreover, Applicants have committed not to make bilateral sales from upstate New York generating resources into New York City or Long Island without prior consent from the Commission. We accept that commitment to address any remaining concern about the effect on competition.

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[36] *See Nevada Power Co.*, 113 FERC ¶ 61,265 at P 15, 18 (2005); *Kansas City Power and Light Co.*, 113 FERC ¶ 61,074 at P 30, 35 (2005).

[37] Application at 29.

2. Effect on Competition – Vertical Market Power

a. Applicants' Analysis

29. Applicants state that the Transaction does not enhance either the ability or incentive of the Applicants to use their transmission facilities to exercise vertical market power. They state that the combination of generation with transmission assets will not harm competition because the transmission facilities owned by National Grid are under the operational control of the NYISO or the New England Regional Transmission Operator.

30. Applicants also address the effect of combining their natural gas transportation and electric generation assets on vertical markets. They point out that the Commission has concluded that both the upstream and downstream markets need to be highly concentrated in order for a merger to create or enhance vertical market power.[38] Applicants analyze the upstream market and define the relevant product as delivered natural gas and the relevant geographic markets as (1) New England; (2) New York City and Long Island, and (3) Rest of New York (New York State outside of Long Island and New York City). For the New England and Rest of New York upstream markets, they report that the markets are not highly concentrated and conclude that the merged firm would not be able to use control of upstream natural gas resources to harm competition in the relevant downstream wholesale electricity markets.[39]

31. Applicants do report that the New York City and Long Island upstream market is highly concentrated; however, National Grid does not have any natural gas transportation capacity or contractual rights that would enable it to serve gas-fired electric generators in the market. In addition, National Grid does not control any electric generating capacity in the New York and Long Island market that would be combined with KeySpan's natural gas transportation assets in the market. Applicants conclude that the merger will not change anything regarding the New York and Long Island natural gas and electric generation market.

32. Applicants state that the Transaction will not enable Applicants to erect other barriers to entry by competitors because they do not control potential electric generating sites.

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[38] Order No. 642 at 31,911.

[39] Exhibit J at P 175.

b. Comments and Protests

33. New York City argues that the combination of KeySpan and the various National Grid companies is a conglomerate merger in which separate lines of business are brought together under common ownership. It states that the Commission should be concerned about the potential ability of the new company to exercise a high degree of control across multiple, and in many instances functionally overlapping markets.[40]

34. Multiple Intervenors argue that the proposed reacquisition of significant electric generation assets by National Grid (after National Grid had divested generation under direction of the New York Commission) would be inconsistent with the efforts by the New York Commission to unbundle generation and transmission assets. Multiple Intervenors request that the Commission condition its merger approval on KeySpan divesting all of its generation, reasoning that a merger that combines National Grid's transmission facilities with the generation assets of KeySpan is inconsistent with the New York Commission's Policy Statement Regarding Vertical Market Power (1998 Policy Statement).

35. Multiple Intervenors also argue that the transaction could change the balance of voting strength among sectors participating in the governance of the NYISO. According to Multiple Intervenors, if the transaction is approved as proposed and National Grid acquires substantial generation facilities in New York City and Long Island, National Grid's voting interests at the NYISO may shift from that of a transmission owner to a generation owner.[41]

36. The New York Commission urges the Commission to examine the potential vertical competitive effects of the transaction. It notes that the Commission has stated that competition can be adversely affected if a merger increases the merged firm's ability or incentive to exercise vertical market power in wholesale electricity markets. It further state that because the merged firm would own generation capacity in the transmission-constrained New York City area along with transmission facilities in the upstate New York area, it may be able to influence the amount of electricity that may be transmitted into New York City and the prices in that market. It recognizes that because the transmission and generation assets are in different regions, there may be no vertical market power issues, but it urges the Commission to analyze the potential for merger-related harm to competition.[42]

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[40] New York City Protest at 8.

[41] Multiple Intervenors' Protest at 9.

[42] New York Commission Comments at 3.

37. Mass AG argues that the transaction would give the merging companies an opportunity to organize themselves as energy services companies that supply a total package of energy rather than separate gas and electric products. Once merged, National Grid and KeySpan will control a combined electric and gas distribution network in their overlapping service areas in Massachusetts and can use their combined electric and gas distribution network and acquire the necessary electric and gas supply to dominate the retail market.

c. Applicants' Answer

38. Applicants assert that the merger creates no vertical issues associated with electric transmission because National Grid, the one company that owns electric transmission facilities, makes those transmission facilities available under the open access tariffs of the NYISO and ISONE. They state that the Commission has found that turning over operational control of transmission facilities to an independent system operator (ISO) or regional transmission operator (RTO) mitigates the ability to use transmission assets to harm competition in wholesale electricity markets.[43] They state that no intervenor has identified a reason for the Commission to reach a different result in this proceeding.

39. In response to Multiple Intervenors' argument that the transaction could change the balance of voting strength in the NYISO, Applicants state that the transaction will not increase the Applicants' share of voting power in the NYISO; on the contrary, it will reduce their combined voting shares. The transaction will not allow National Grid to exercise more than the five percent of the total voting shares that it now has in the Transmission Owner sector, and KeySpan's voting power in the Generation Owner sector will be lost. Applicants argue that Multiple Intervenors are merely speculating about how National Grid will vote on NYISO matters in the future and that such speculation has no bearing on the public interest concerns the Commission considers under section 203.[44]

40. Applicants also respond to protests regarding the combination of delivered natural gas and electric generating capacity. They state that their analysis shows that upstream natural gas markets in New England and in New York State outside of New York City and Long Island are not highly concentrated. Since the Commission has consistently held

[43] Answer at 13, citing *Exelon Corp.*, 112 FERC ¶ 61,011 at P 198; *Ameren Corp.*, 108 FERC ¶ 61,094 at P 61 (2004).

[44] Answer at 32.

that both upstream and downstream markets must be highly concentrated for a merger to create or enhance vertical market power, the transaction cannot raise vertical competitive concerns in those markets.[45]

41. Applicants state that in the one case in which both the upstream and downstream markets are highly concentrated, New York City/Long Island, National Grid holds no firm pipeline capacity rights that could be used to deliver natural gas to generation suppliers in New York City or Long Island and does not trade natural gas or own generation in those markets. They conclude that because National Grid does not participate in the upstream natural gas market that supplies generators in New York City and Long Island, the transaction cannot raise vertical market concerns in this market either.

42. Applicants challenge Multiple Intervenors' request that the Commission condition its merger approval on KeySpan divesting all of its generation. They state that the Commission has held that it will only impose a mitigation condition on a merger to address specific harm to competition that could result from a transaction and that Multiple Intervenors have failed to identify any harm to competition that would result from the transaction that could only be remedied by complete generation divestiture.[46] They further state Multiple Intervenors' portrayal of the New York Commission's policy is misleading. They point to the New York Commission's intervention in this proceeding, in which the New York Commission states that its 1998 Policy Statement does not create an absolute bar to a transmission and distribution utility's acquisition of generating assets. Instead, the 1998 Policy Statement creates a rebuttable presumption that a transmission and distribution utility's ownership of generation would unacceptably increase the potential for vertical market power. They contend that Multiple Intervenors have not even considered whether the facts of this case would rebut the New York Commission's presumption against the combination of transmission and distribution and generation assets.

d. Commission Determination

43. In mergers that combine electric generation assets with inputs to generating power (such as natural gas transmission or electric transmission assets), competition can be harmed if a merger increases the merged firm's ability or incentive to exercise vertical market power in wholesale electricity markets. For example, the merged firm could impede entry of new competitors or inhibit existing competitors' ability to discipline or

[45] Answer at 14, citing Order No. 642 at 31,911; *Exelon Corp.*, 112 FERC ¶ 61,011 at P 200; *Engage Energy Am., LLC*, 98 FERC ¶ 61,207 at 61,750-51 (2002).

[46] Answer at 15, citing *Exelon Corp.*, 113 FERC ¶ 61,299 at P 59; Merger Policy Statement at 30,136; and *Entergy Services*, 64 FERC at ¶ 61,013.

undercut an attempted price increase in the downstream wholesale electricity market by denying rival firms access to inputs or by raising their input costs. In this case, as discussed below, Applicants have shown that the transaction does not raise any of these concerns.

44. Applicants have shown that the combination of natural gas transportation and electric generation assets will not adversely affect competition. For a merger to create or enhance vertical market power, both the upstream and downstream markets must be highly concentrated. Applicants' witness analyzes the upstream market and defines the relevant product as delivered natural gas and the relevant geographic markets as (1) New England; (2) New York City and Long Island, and (3) Rest of New York (New York State outside of Long Island and New York City). The New England and Rest of New York markets are not highly concentrated, so the merged company would not be able to use control of upstream natural gas resources to adversely affect competition in the relevant wholesale electricity markets. The New York City and Long Island upstream and downstream markets are highly concentrated, but the merger will not combine natural gas transportation assets and electric generation assets as might create or enhance market power in those markets; National Grid neither holds firm pipeline capacity rights that could be used to deliver natural gas to generators in New York City or Long Island nor owns or controls any generation in the New York City and Long Island market.

45. Similarly, Applicants have shown that the proposed combination of electric transmission and generation assets will not adversely affect competition. We reject protestors' assertions that the merger would create vertical market power by consolidating control over electric generation facilities and transmission facilities and that the merged company should be required to divest its generation facilities. Turning over operational control of transmission facilities to an independent entity eliminates any concerns about transmission-related vertical market power because it eliminates the ability for the merged firm to use its transmission system to harm competition in wholesale electricity markets. In a number of cases, we have stated that both the ability and incentive to exercise vertical market power are necessary for a merger to harm competition.[47] Here, Applicants have turned over control of their transmission facilities to two independent entities – the NYISO and the New England RTO. Therefore, there is no need to impose vertical market power mitigation.

46. With respect to Multiple Intervenors' assertion that National Grid's ownership of generation assets might change the balance of power in the NYISO, Multiple Intervenors do not explain how the change would happen or how that change, which would be

[47] *See, e.g., American Electric Power Co.*, 90 FERC ¶ 61,242 at 61,788 (2000). and Order No. 642 at 31,911.

consistent with the NYISO's rules, would be inconsistent with the public interest as relevant to our analysis under section 203. Multiple Intervenors are also merely speculating on how merged company might vote in the future.

47. We reject Mass AG's protest concerning the bundling of retail gas and electricity products in Massachusetts. As we stated in the Merger Policy Statement, "in cases where a state commission asks us to address the merger's effect on retail markets because it lacks adequate authority under state law, we will do so."[48] The Massachusetts Commission has made no such request in this case.

48. Finally, the New York Commission is the appropriate body to determine whether the merger is consistent with the New York Commission's 1998 Policy Statement.

3. Effect on Rates

a. Applicants' Analysis

49. Applicants contend that the merger will have no adverse effect on rates charged to wholesale power and transmission customers. They commit to hold these customers harmless from any rate increases resulting from costs related to the merger for a period of five years, to the extent that such costs exceed merger-related savings. Applicants argue that the requirement of the Public Utility Holding Company Act of 2005 (PUHCA 2005) that they and their associate companies make available to the Commission and to State regulatory authorities their books and records relating to costs[49] provides further assurance that the Applicants' commitment will prevent an adverse effects on rates. Applicants submit that these requirements enhance the ability of the Commission to monitor the Applicants' compliance with their "hold harmless" commitment and ensure that State regulators will have the information necessary to oversee the rates of the Applicants' utility subsidiaries providing state-jurisdictional services. [50]

b. Comments and Protests

50. The Mass AG argues that allocation of an acquisition premium to KeySpan's affiliate Massachusetts Electric would be inconsistent with Massachusetts Electric's commitment not to recover any more premiums in retail rates.[51] The Mass AG notes that, under a 1999 rate plan: "[Massachusetts] Electric shall . . . be precluded from including any new acquisition premiums or transaction costs from any other transaction in its

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[48] Merger Policy Statement at 30,128.

[49] EPAct 2005 §§ 1264 and 1265.

[50] Application at 36-37.

[51] *Massachusetts Electric Company*, D.T.E. 99-47 (2000).

distribution rates."[52] The Mass AG asks the Commission to investigate whether, in light of that limitation, it is consistent with the public interest for National Grid to enter into an arrangement that would involve allocation of an acquisition premium to Massachusetts Electric.[53] The Mass AG further argues that the Commission should require evidence on the method used to determine the fair value of the assets, the amounts attributable to each subsidiary, and the qualifications of the third party that would estimate the fair value.[54] The Mass AG requests that the Commission find that the Commission's approval of the merger will not preempt any state commission from disallowing the recovery of associated costs through retail rates.[55]

51. Multiple Intervenors argue that the merger raises several issues about rates to National Grid's New York customers. They cite Applicants' claim that the merger will result in approximately $200 million in gross, annual savings, to be apportioned among the merged company and its customers. According to Multiple Intervenors, there are open questions about precisely what savings would be realized and how the savings would be apportioned. Multiple Intervenors argue that all issues concerning National Grid's rates to New York customers, including determination of those customers' share of the savings, should be decided by the New York Commission.[56]

c. Applicants' Answer

52. Applicants state that Massachusetts Electric, as a subsidiary of National Grid, will not recognize an acquisition premium on its books as a result of the transaction, so there will be no conflict with the retail settlement cited by the Mass AG. Moreover, the Mass AG's concerns about the retail rate recovery of an acquisition premium would be addressed by the Massachusetts Department of Telecommunications and Energy (Massachusetts Department), not the Commission, should Massachusetts Electric ever seek to recover an acquisition premium in its retail distribution rates, if one is recognized on its books in a different transaction.[57] Applicants state that the valuation of the assets of KeySpan and its subsidiaries will be conducted by an independent third party before

[52] *Id.* (Settlement § I(C), p. 25).

[53] Protest of the Massachusetts Attorney General at 6-7.

[54] Protest of the Massachusetts Attorney General, page 7, footnote 22.

[55] *Id.* at 6.

[56] Multiple Intervenors' Protest at 11-12.

[57] Applicants' Answer at 26.

consummation of the transaction. Applicants state that the Commission has approved this approach before and that the Mass AG has offered no reason why the Commission should depart from its practice in this proceeding.[58]

53. Applicants assert that there is no basis for concern that the Commission's approval will encroach on the jurisdiction of state commissions. According to Applicants, the Commission's approval will not impair the ability of state commissions to regulate the retail rates of the Applicants' utility subsidiaries and no condition on the Commission's approval of the transaction is necessary to ensure this result. Applicants have not asked the Commission to address the rate recovery of an acquisition premium or to rule on any other issue affecting their utility subsidiaries' rates for retail services or, for that matter, their rates for transmission services or wholesale sales. Moreover, the Commission's approval of the merger will not establish rates for wholesale sales or transmission service that must be flowed through in retail rates.[59] Applicants argue that their commitment to hold transmission customers and customers taking wholesale power service under cost-based rates harmless from any transaction-related costs in excess of transaction savings for a period of five years is sufficient to protect customers against any potential adverse effects of the merger on jurisdictional rates.[60]

d. Commission Determination

54. Applicants have shown that the merger would not adversely affect wholesale rates. Applicants have committed to hold ratepayers harmless from transaction-related costs in excess of transaction savings for a period of five years.[61] With respect to effect on retail rates, the merger does not raise concerns that are relevant to our analysis. It would not remove regulated utilities from state jurisdiction, and our approval of the merger does not preempt state oversight of the regulated utilities' retail rates.[62] The states will address all issues concerning retail rates, including the proper apportionment of resulting savings.

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[58] *Id.* at 27, citing *Ameren Corp.*, 108 FERC ¶ 61,094 at P 72 (2004).

[59] Applicants' Answer at 20-21.

[60] *Id.* at 20, citing *Duke Energy Corp.* 113 FERC ¶ 61,297 (2005) at P 117, 121.

[61] *See* Merger Policy Statement P 30,124.

[62] *See Ameren Corp.*, 111 FERC ¶ 61,055 (2005).

4. Effect on Regulation

a. Applicants' Analysis

55. Applicants state that the merger will not adversely affect federal or state regulation. They assert that there is nothing in the transaction that will affect any aspect of the Commission's jurisdiction. Applicants further state that the transaction will have no effect on the regulatory jurisdiction of any state over the Applicants.[63]

b. Comments and Protests

56. The Mass AG argues that regulatory burden on Massachusetts will increase due to the complexity of the transaction and the scope of the merged company. It claims that the complexity of cost allocation will increase with the vastly expanded size of the new enterprise and its presence in more jurisdictions, each with a separate timetable for conducting rate reviews of newly affiliated utilities. Additionally, calculating the cost of capital will become more complex because National Grid and KeySpan sell into different markets and thus face different risks. Finally, meaningful access to books and records will become more difficult after the merger, because the existence of a greater number of affiliates means more books and records for regulators to review at the state level. The Mass AG claims that this added complexity will impose a special burden on the Massachusetts Department because the latter does not perform annual regulatory accounting audits of its jurisdictional utilities. The Mass AG concludes that Applicants have failed to demonstrate that the merger will not change the burden on state regulators.[64]

c. Applicants' Answer

57. Applicants cite *Exelon Corp.*[65] for the proposition that a merger does not adversely affect state regulation if the merger does not affect a state commission's authority over the rates and operations of a merging company's utility subsidiaries. The Mass AG has acknowledged that the Massachusetts Department will retain jurisdiction over the rates and operations of the Applicants' utility subsidiaries serving customers in the state.

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[63] Application at 37-38.

[64] Protest of the Massachusetts Attorney General at 7-8.

[65] 112 FERC ¶ 61,011 at 213, 217.

Applicants also assert that a finding of "no adverse effect" is appropriate where, as here, the relevant state commission has not sought investigation of the effect on state regulation.[66]

58. Applicants assert that the Mass AG has not shown that the transaction will adversely affect state regulatory authority. First, the Massachusetts subsidiaries of National Grid and KeySpan are already parts of holding companies, so the Massachusetts Department already considers cost allocation issues in its retail rate proceedings. Applicants argue that the Mass AG points to nothing to support its claim that the combination of the two holding companies into a single system will make those cost allocation issues so complex that the Massachusetts Department will be unable to address them effectively. Second, Applicants argue that the transaction will have no effect on the Massachusetts Department's determination of the cost of capital for the Massachusetts utility subsidiaries of the Applicants. Like the Commission, the Massachusetts Department determines return on equity based on the risks of the regulated utility, not the risks of the parent holding company. Applicants argue that under this approach, a change in the holding company that owns a Massachusetts utility does not change the method through which the Massachusetts Department establishes the return on equity.[67] Finally, Applicants argue that the Massachusetts Department will be able to get the information it needs to regulate the utilities' rates and operations effectively after the merger.[68]

d. Commission Determination

59. The merger will not adversely affect Commission or state regulation as contemplated in our Merger Policy Statement. With respect to the merger's effect on state regulation, we note that the merger will not change any state commission's jurisdiction over any utility and, further, that no state commission has alleged that the merger will adversely affect state regulation. We conclude in these circumstances that the states will continue to protect retail ratepayers.[69] While we acknowledge the Mass AG's concern that the merger will increase regulatory burdens on state commissions, that concern does not, in itself, suggest that the merger would render state regulation ineffective.

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[66] Applicants' Answer at 21-22, citing *Exelon Corp. supra* at P 217 and *Ohio Edison Co.* 94 FERC ¶ 61,291 at 62,043-44 (2001).

[67] Applicants' Answer at 22-23.

[68] *Id.* at 23.

[69] *See* Merger Policy Statement at 30,125.

60. Indeed, Congress has given state commissions new powers to meet the regulatory challenges that are presented by complex holding company structures; under PUHCA 2005, state commissions may obtain and gain access to books and records of holding companies and associate companies as necessary to meet their regulatory responsibilities.[70] This increase in the state commission's powers reinforces our determination that this merger will not adversely affect state regulation.

5. Cross-subsidization

a. Applicants' Analysis

61. Applicants assert that the transaction will not result in cross-subsidization of a non-utility company or in the pledge or encumbrance of utility assets for the benefit of an associate company. First, as required under 18 C.F.R. § 33.2(j), Applicants verify that the transaction does not require or provide for: (1) any transfer of facilities by a public utility company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities to an associate company; any new issuance of securities by any public utility company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities for the benefit of an associate company; any new pledge or encumbrance of assets of a public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities for the benefit of an associate company; or (4) any new affiliate contract between a non-utility associate company and a public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, other than non-power goods and services agreements that are subject to review under sections 205 and 206 of the FPA.[71] Second, as required under 18 C.F.R. § 33.2(j), Applicants have provided statements of existing pledges and/or encumbrances of utility assets.[72]

62. According to Applicants, the Commission's inquiry under section 203 is limited to whether a merger "requires or provides for" cross-subsidization or encumbrance of utility assets. Applicants assert that, if the Commission looks beyond what is required or provided for as part of the merger transaction, sufficient protection is provided here because: (1)) each of the regulated utilities in the merged company will continue to be subject to the same state and Commission regulatory oversight for retail and wholesale services; (2) a Code of Conduct will be implemented for all subsidiaries of the merged company that is similar to National Grid's existing Code of Conduct; (3) the transaction's

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[70] EPAct 2005 § 1265.

[71] *See* 18 C.F.R. § 33.2(j) (2006), as revised by Order No. 669-B at P 49.

[72] *Id.*

hold harmless commitment will protect customers from merger-related rate increases for a period of five years following the transaction; and (4) the Commission will oversee any modification to the National Grid money pool that provides for KeySpan subsidiaries to participate.[73]

63. Applicants note that, after they filed their application, the Commission modified its regulations to require an applicant to address whether a transaction will result in a cross-subsidization or encumbrance in the future, as well as at the time of the transaction, based on facts and circumstances known or reasonably foreseeable.[74] Applicants assert that they have addressed reasonably foreseeable developments that might occur in the future and showed that those developments would not be a prohibited cross-subsidization or encumbrance.[75]

b. Commission Determination

64. We disagree with Applicants' argument that the Commission's inquiry is limited to effects that are directly required or provided for as part of a merger transaction. The statute addresses whether a transaction will result in cross-subsidization of a non-utility company, not whether cross-subsidization is provided for in the transaction.[76] In effect, while there must be a nexus between the merger and the cross-subsidization, the statute does not require that the transaction actually "provides for" the cross-subsidization.

65. In this case, Applicants have provided sufficient assurance that their merger will not result in cross-subsidization of a non-utility company or in the pledge or encumbrance of utility assets for the benefit of an associate company. Applicants have provided the verifications and information as provided for in our regulations. Moreover, Applicants have committed that (1) the merger will not change state or Commission regulatory oversight of the affected utilities for retail and wholesale services; (2) a Code of Conduct will be implemented for all subsidiaries of the merged company that is similar to National Grid's existing Code of Conduct; (3) the transaction's hold harmless commitment will protect customers from merger-related rate increases for a period of five years following the transaction; and (4) any modification to the National Grid money pool that provides for KeySpan subsidiaries' participation will be subject to Commission approval and represent that the merger will not change regulatory oversight of the affected utilities.

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[73] Application at 42-43.

[74] 18 C.F.R. § 33.2(j)(1) (2006), as revised by Order No. 669-B at P 49.

[75] Applicants' Answer at 24.

[76] EPAct 2005 § 1289(a)(4).

66. Implementation of the Code of Conduct for all utility subsidiaries of the merged company, as required by our decision here, will address both power and non-power goods and services transactions between the utility subsidiaries and their affiliates. The Code of Conduct to be implemented by the merged company shall (1) require our approval of all power sales by a utility to an affiliate, (2) require a utility with captive customers to provide non-power goods or services to a non-utility or "non-regulated utility"[77] affiliate at a price that is the higher of cost or market price, (3) prohibit a non-utility or non-regulated utility affiliate from providing non-power goods or services to a utility affiliate with captive customers at a price above market price, and (4) prohibit a centralized service company from providing non-power services to a utility affiliate with captive customers at a price above cost. These requirements protect a utility's captive customers against inappropriate cross-subsidization of non-utility or non-regulated utility affiliates by ensuring that the utility with captive customers neither recovers too little for goods and services that the utility provides to an affiliate nor pays too much for goods and services that the utility receives from an affiliate. Implementation of these requirements provides a prophylactic mechanism to ensure that the merger will not result in cross-subsidization of non-utility or non-regulated utility companies in the same holding company system and therefore meets the requirement of section 203(a)(4) that a merger not result in inappropriate cross-subsidization of a non-utility associate company.[78]

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[77] The term "non-regulated utility," as used here, refers to affiliates or associate companies that are utilities but that are not regulated on a cost basis. Although section 203 refers to cross-subsidization of "non-utility" associate companies, the same concerns arise with respect to entities that are in the utility business but that are either unregulated or not regulated on a cost basis and whose profits go to shareholders.

[78] In prior cases under section 203, we required our ongoing oversight of non-power transactions between a merged company's utility and non-utility or non-regulated subsidiaries as a condition of finding that the merger would not adversely affect federal regulation. *See, e.g.*, *Niagara Mohawk Holdings, Inc.*, 95 FERC ¶ 61,381 (2001). That requirement grew out of judicial determinations that, when a merger would create or involve a registered holding company, the Securities Exchange Commission rather than the Commission would have jurisdiction over the non-power transactions between subsidiaries of that holding company. *See Ohio Power Co. v. FERC*, 954 F.2d 779, 792-86 (D.C. Cir.), *cert. denied sub nom., Arcadia v. Ohio Power Co.*, 506 U.S. 981 (1992). The provisions of PUHCA 1935 that formed the basis for *Ohio Power* are no longer in effect, *see* EPAct 2005 § 1263, thus removing the *Ohio Power* limitation on our oversight of non-power transactions. As suggested above, however, we believe that it is in the public interest to continue to require such conditions in approving a proposed merger.

67. Finally, we note that no protest argues that the transaction presents concerns regarding cross-subsidization or encumbrance of utility assets.

6. Other

a. Comments and Protests

68. UWUA claims that since purchasing the New England Electric System in 2000, National Grid has reduced its utility workforce at its distribution companies. UWUA asserts that these staff reductions have resulted in poor service quality with respect to the System Average Interruption Duration Index (Interruption Duration) and System Average Interruption Frequency Index (Interruption Frequency). Examining data filed by National Grid with the Massachusetts Department, UWUA found that Massachusetts Electric exceeded its Interruption Frequency benchmark in three of the last four years, and significantly exceeded the penalty benchmark in two of these years. UWUA also finds that Massachusetts Electric exceeded the Interruption Duration penalty benchmark in three of the last four years.[79] UWUA argues that National Grid's business model appears to be to reduce experienced staff despite problems with quality of service and that whether this reduction occurs through attrition or through layoffs, the result is the same.[80] By contrast, UWUA claims, KeySpan's Massachusetts affiliates have good reliability records and generally meet or exceed their service quality benchmarks on an important service quality indicator for a gas company, response to odor calls.

69. UWUA submits that the Commission should not approve the merger as proposed in light of the lack of information provided by Applicants about anticipated job reductions, the allegedly poor service provided by certain of National Grid's affiliates, and Applicants' stated intention of reducing staffing through attrition and early retirement.[81] UWUA asserts that there is no obvious reason why combining the two companies should result in job reduction efficiencies, given Applicants' claim that National Grid and KeySpan are not significant participants in the same market and do not own or control generating capacity or inputs to electricity production in the same relevant geographic markets.[82] UWUA argues that elimination of positions through attrition will put further pressure on a workforce that is, in the case of National Grid's operating utilities, already stretched thin.[83] UWUA argues that the most direct way to ensure that

[79] UWUA Protest at 15.

[80] *Id*. at 16.

[81] UWUA Protest at 17-18.

[82] UWUA Protest at 18, citing Application at 27.

[83] UWUA Protest at 19.

any approval of the acquisition is consistent with the public interest is to prohibit acquisition-related job reductions, whether through attrition, early retirements, or layoffs.[84]

70. UWUA asks the Commission to require Applicants to identify the collective bargaining agreements that would be honored by Applicants, as part of Applicants' submission of the complete merger agreement under 18 C.F.R. section 33.2(f).[85] UWUA claims that identification of the collective bargaining agreements is necessary for UWUA to assess the potential impacts of the proposed acquisition on its members and on service quality.

71. Saint Regis expresses concern that the merger could distract Niagara Mohawk from timely constructing required system upgrades necessary to accommodate commercial customers at Saint Regis' reservation.[86] Nassau County expresses concern that National Grid, upon acquiring KeySpan, will reduce the local workforce, resulting in an economic impact on the County as well as having a negative impact on customer service. Nassau County is also concerned about whether National Grid's acquisition of KeySpan should be conditioned upon the upgrading, rebuilding, and/or re-powering of certain facilities owned and/or controlled by KeySpan and/or its subsidiaries and affiliated corporations.[87]

72. The Mass AG and UWUA argue that Applicants' request that the Commission approve the merger within 150 days is a request for expedited review. They argue that the Commission should deny Applicants' request because the FPA clearly states that the Commission shall not review merger applications on a fast track. They petition the Commission to toll the 180-day period in order to provide intervenors and the Commission a meaningful opportunity to determine the effect of the merger on rates, competition, and regulation.[88]

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[84] UWUA Protest at 20. UWUA alternatively suggests that the Commission could impose a condition such that any acquisition-related job reductions would be prohibited unless Applicants show that the reductions will not result in any additional diminution in service quality.

[85] UWUA states that section 33.2(f) requires Applicants to provide "All contracts related to the transaction together with copies of all other written instruments entered into or proposed to be entered into by the parties to the transaction." UWUA Protest at 21-22.

[86] Motion to Intervene of Saint Regis at 2.

[87] Motion to Intervene of Nassau County at 2.

[88] UWUA Protest at 23, Protest of the Massachusetts Attorney General at 12-13.

b. Applicants' Answer

73. Applicants claim that the UWUA's protest regarding reliability issues is unfounded. They claim that the UWUA is wrong to blame the recent outage experience on insufficient manpower and that National Grid has maintained through its own employees and contractors adequate personnel levels to maintain its transmission and distribution facilities and to restore service after storms, which are the most significant causes of extended outages. Applicants contend that increased outages in recent years are principally the result of unusually severe weather, including record numbers of lightning strikes, as well as the need for additional investment in infrastructure. Applicants submit that National Grid is meeting that investment challenge, planning to invest approximately $3.4 billion over the next five years in upgrades to its transmission and distribution grid in New York and New England and in other projects to enhance delivery reliability.[89]

74. Applicants challenge UWUA's assumption that Applicants will cut the staffing available to maintain delivery facilities and respond to outages to meet merger savings goals. While payroll reductions are planned through attrition and early retirement incentives, they are expected to come primarily in administrative areas, where the transaction will allow for the combination of duplicate systems. In addition, Applicants pledge that, if there are reductions in transmission and distribution field staffing, there will be adequate coverage by employees and contractor personnel to deliver the reliability improvements that the planned increase in investment is intended to deliver.[90] Further, Applicants urge the Commission to recognize that state commissions have jurisdiction over the reliability of service provided by National Grid's distribution subsidiaries to their retail customers. Expanding the Commission's review of merger applications to consider labor staffing issues based on claims related to distribution-level reliability would needlessly duplicate existing state authority over service quality programs.[91]

75. Applicants claim that they omitted collective bargaining agreements from their application because the agreements do not bear on the Commission's analysis.

[89] Applicants' Answer at 28-29.

[90] Applicants' Answer at 29.

[91] Applicants' Answer at 29-30.

Applicants argue that the Commission has accepted such omissions in prior proceedings and that it should do the same in this case.[92] They state that the omission does not affect their obligations to the union under the agreements.[93]

76. Applicants answer that Saint Regis' concerns are beyond the scope of this proceeding and, moreover, that the transaction has no effect on the construction program.[94] Finally, Applicants argue that Nassau County's concerns regarding facilities upgrades are beyond the scope of this proceeding.[95]

d. Commission Determination

77. We find that the merger presents no other concerns that are relevant to our analysis. Matters such as National Grid's staffing policies involve speculation and go beyond the scope of our analysis as set forth in the Merger Policy Statement. Similarly, review of National Grid's collective bargaining agreements is not part of our analysis. Insofar as intervenors are concerned that the merged company's future activities will adversely affect reliability, we note that we may address those concerns in the future as part of our authority to oversee reliability. Finally, we disagree with Mass AG and UWUA that further time is necessary to provide the Commission a meaningful opportunity to weigh the merits of this merger.

D. Alleged *Ex Parte* Communication

78. Public Citizen alleges that Applicants, the Commission and Commission Staff violated restrictions on off-the-record or "*ex parte*" communication by meeting on April 26, 2006, before Applicants filed their application in this proceeding. As we have

[92] Applicants' Answer at 30, citing Joint Application for Approval of the Disposition of Jurisdictional Facilities Under section 203 of the FPA submitted by PNM Resources, Inc., at 31 n.60, Docket No. EC05-29-000 (Dec. 23, 2004).

[93] Applicants' Answer at 30-31.

[94] Applicants' Answer at 33.

[95] Applicants' Answer at 34.

previously held, pre-filing meetings are permissible.[96] Our *ex parte* regulations are triggered only when a filing is made and contested.[97] At the time of the April 26 meeting, that was not the case.

E. Petition for Declaratory Order

79. Upon National Grid's acquisition of KeySpan, the common equity of each of KeySpan's subsidiaries would be restated to reflect a portion of the purchase price. As part of the restatement, any retained earnings that KeySpan's subsidiaries held before the transaction would become common equity. Section 305(a) of the FPA bars the directors of public utilities from paying dividends out of a capital account, including common equity.[98] Applicants therefore seek a declaratory order that, after the merger, KeySpan's subsidiaries may pay dividends out of common equity funds that, before the merger, had been retained earnings.

80. We will grant Applicants' petition. Section 305(a) provides:

> It shall be unlawful for any officer or director of any public utility to receive for his own benefit, directly or indirectly, any money or thing of value in respect of the negotiation, hypothecation, or sale by such public utility of any security issued or to be issued by such public utility, or to share in any of the proceeds thereof, or to participate in the making or paying of any dividends of such public utility from any funds properly included in capital accounts.[99]

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[96] *See Commonwealth Edison Co.*, 115 FERC ¶ 61,133 at P 23-26 (2006); *Exelon Corp.*, 113 FERC ¶ 61,299 at P 92-97 (2005); *Duke Energy Corp.*, 113 FERC ¶ 61,297 at P 14-23 (2005); *MidAmerican Energy Holdings Co.*, 113 FERC ¶ 61,298 at P 13-21 (2005).

[97] *See* 18 C.F.R. §§ 385.2201(a), (b), (c)(1)(i) (2006); *Regulations Governing Off-the-Record Communications*, Order No. 607**,** FERC Stats. & Regs. P 31,079 at 30,879 and 30,890-92, 64 Fed. Reg. 51,222 at 51,230 (1999), *order on reh'g and clarification*, Order No. 607-A, FERC Stats. & Regs. P 31,112, 65 Fed. Reg. 71,247 (2000).

[98] 16 U.S.C. § 825d(a) (2000).

[99] *Id.*

81. The concerns that underlie section 305(a) are that dividends would be paid from sources that were not clearly identified, that holding companies would pay excessive dividends on utility stock, and that corporate officials would raid corporate coffers for their personal financial benefit.[100]

82. Those concerns are not present here. First, Applicants have clearly identified the source from which the dividends would be paid. Second, there is nothing to indicate that the dividends would be excessive; Applicants have represented that the dividends will not exceed the amounts recorded as retained earnings prior to the merger, and they commit to pay dividends out of common equity only up to these amounts.[101]

83. Under the circumstances of this case, we will grant the petition and find that section 305(a) does not bar the payment of dividends out of common equity as described above. In addition to the commitments that Applicants identified, and consistent with prior precedent, Applicants may not pay dividends out of capital if the equity of KeySpan's public utilities subsidiaries, as a percentage of total capital, would fall below thirty percent.[102]

The Commission orders:

(A) The proposed merger and disposition of jurisdictional facilities is hereby authorized as discussed in the body of this order, including, but not limited to, the Commission's acceptance of the Applicants' commitments to: (i) hold wholesale power and transmission customers harmless for a period of five years from costs related to the merger that exceed merger-related savings; and (ii) seek prior Commission authorization for sales from upstate generating resources into New York City or Long Island submarkets. The Commission also will hold Applicants to their other commitments discussed in the body of this order.

(B) The foregoing authorization is without prejudice to the authority of the Commission or any other regulatory body with respect to rates, service, accounts, valuation, estimates or determinations of costs, or any other matter whatsoever new pending or which may come before this Commission.

(C) The Commission retains the authority under sections 203(b) and 309 of the FPA to issue supplemental orders as appropriate.

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[100] *See Entergy Louisiana Inc.*, 114 FERC ¶ 61,060 at P 12 (2006); *Exelon Corp.*, 109 FERC ¶ 61,172 at P 8 (2004); *ALLETE, Inc.*, 107 FERC ¶ 61,041 at P 10 (2004).

[101] Applicants acknowledge that to pay out any more would require separate, additional Commission authorization.

[102] *See Entergy Louisiana*, 114 FERC at P 13.

(D) Nothing in this order shall be construed to imply acquiescence in any estimate or determination of cost or any valuation of property claimed or asserted.

(E) Applicants shall make appropriate filings under section 205 of the FPA, as necessary, to implement the merger.

(F) Applicants shall notify the Commission within 10 days of the date that the merger and disposition of jurisdictional facilities have been consummated.

(G) Applicants' petition for declaratory order is hereby granted as discussed in the body of this order.

(H) Applicants must inform the Commission of any change in circumstances that would reflect a departure from the facts the Commission relied upon in granting the petition.

(I) Applicants shall submit its merger accounting to the Commission within six months after the merger is consummated. The accounting submission shall provide: (1) all accounting entries necessary to effect the merger, along with narrative explanations describing the basis for the entries; and (2) an explanation of the accounting for the acquisition premium.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.