UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

Duke Energy Corporation
Cinergy Corp.

Docket No. EC05-103-000

ORDER AUTHORIZING MERGER

(Issued December 20, 2005)

1. On July 12, 2005, as amended on August 4 and 10, 2005, Duke Energy Corporation (Duke) and Cinergy Corp. (Cinergy) (collectively Applicants) filed an application under section 203 of the Federal Power Act (FPA)[1] requesting Commission approval of their proposed merger, which includes: (1) the merger of Duke and Cinergy; and (2) the internal restructuring and consolidation of the merged company. The Commission has reviewed the merger under the Merger Policy Statement[2] and will authorize it as consistent with the public interest, as discussed below.

---

[1] 16 U.S.C. § 824b (2000) (*amended by* Energy Policy Act of 2005 § 1289, Pub. L. No. 109-58, 119 Stat. 594, 982-83 (2005) (EPAct 2005)).

[2] *See Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (1996); FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (*Merger Policy Statement*); *see also Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, 65 Fed. Reg. 70,983 (2000), FERC Stats. & Regs., Regulations Preambles July 1996-Dec. 2000 ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 66 Fed. Reg. 16,121 (2001), 94 FERC ¶ 61,289 (2001) (*Merger Filing Requirements*); *Transactions Subject to FPA Section 203*, Notice of Proposed Rulemaking, 70 Fed. Reg. 58,636 (2005), FERC Stats. & Regs. ¶ 32,589 (2005) (Section 203 NOPR).

I. Background

A. Description of the Applicants

1. Duke

2. Duke's operations are conducted through a number of separate business units, which are described below. Duke Power is a division of Duke that operates Duke's franchised electric utility business unit. It is a vertically-integrated utility that generates, transmits, distributes and sells electricity, and has a franchised service territory in central and western North Carolina and western South Carolina. Duke Power owns over 18,000 megawatts (MW) of electricity and sells wholesale electric power to incorporated municipalities, electric cooperatives, and public and private utilities. It provides transmission service under an open access transmission tariff (OATT).

3. Duke Energy North American (DENA) is a separate business unit of Duke that manages power plants outside of Duke's franchised service territory and markets electric power and natural gas. DENA conducts business through its wholly-owned affiliates Duke Energy Marketing America, LLC and Duke Energy Marketing Canada Corp. and through Duke Energy Trading and Marketing, LLC (Duke Trading), a joint venture 40 percent owned by ExxonMobil Corporation. Through its affiliates and subsidiaries, DENA currently owns or operates approximately 10,000 MW of operating generation and makes wholesale sales pursuant to market-based rate authority.

4. Duke's Natural Gas Transmission business unit provides transportation and storage of natural gas for customers in the eastern United States and in Canada and is conducted primarily through Duke Energy Gas Transmission (Duke Gas Transmission), which owns Texas Eastern Transmission, LP (Texas Eastern), an interstate natural gas pipeline company that operates in the region.

5. Duke's Field Services business unit performs a number of functions related to the gathering and processing of natural gas and natural gas liquids and is conducted primarily through Duke Energy Field Services (Duke Field Services), a joint venture 50 percent owned by ConocoPhillips.

2. Cinergy

6. Cinergy is a registered holding company under the Public Utility Holding Company Act of 1935 (PUHCA 1935).[3] It was created as a result of a merger of The Cincinnati Gas & Electric Company (CG&E) and the parent company of PSI Energy, Inc. (PSI). CG&E and PSI collectively own over 12,000 MW of generation.

7. CG&E is a combination electric and gas public utility and an exempt holding company under PUHCA 1935. It has a franchised service territory in southwestern Ohio and, through its principal subsidiary The Union Light, Heat and Power Company (Union Light), in northern Kentucky. CG&E and Union Light generate, transmit, distribute and sell electricity, distribute and sell natural gas, and provide natural gas transportation service for a limited amount of Cinergy-owned generation. CG&E also owns the KO Transmission Company (KO Gas Transmission), an interstate natural gas pipeline that extends from interconnections in Kentucky with Columbia Gulf Transmission Company and Tennessee Gas Pipeline Company to the city gates of CG&E and Union Light.

8. PSI is a vertically integrated, regulated electric utility that has a franchised service territory across north central, central, and southern Indiana.

9. Cinergy Services, Inc. (Cinergy Services) is a service company that provides Cinergy's subsidiaries with a variety of administrative, management, and support services.

10. Cinergy Investments, Inc. (Cinergy Investments) holds part of Cinergy's non-regulated, energy-related businesses and investments. These include Cinergy's wholesale natural gas marketing and trading operations, which are primarily conducted through Cinergy Market and Trading, LP, and Cinergy's cogeneration business, which is primarily conducted through Cinergy Solutions Holding Company. Cinergy Investments also holds approximately 900 MW of merchant generation in the Tennessee Valley Authority's (TVA) control area in Mississippi and Tennessee.

B. Description of the Merger

11. The proposed merger will create an entity with retail electric and gas customers in Ohio, Kentucky, Indiana, North Carolina, South Carolina, and Canada, and that will own

---

[3] 16 U.S.C. §§ 79a (2000). We note that the EPAct 2005 repeals PUHCA 1935, effective February 8, 2006, and enacts the Public Utility Holding Company Act of 2005 (PUHCA 2005). EPAct 2005, §§ 1261 *et seq.*, Pub. L. No. 109-58, 119 Stat. 594 (2005).

over 45,000 MW of electric generation and 17,500 miles of natural gas transmission pipeline.

12. Duke has formed Duke Energy Holding Corp. (Duke Holding), which in turn formed two wholly-owned subsidiaries, Deer Acquisition Corp. and Cougar Acquisition Corp., which, as part of the proposed merger, will merge with and into Duke and Cinergy, respectively, with Duke and Cinergy as the surviving corporations and becoming wholly-owned subsidiaries of Duke Holding. After the consummation of these two mergers, Duke Holding will be renamed Duke Energy Corporation and will become a registered holding company under PUHCA 1935. The old Duke will be renamed Duke Power Company, LLC.

13. The proposed merger also contemplates a number of restructurings and transfers inside the new holding company. Among these steps, DENA's ownership of generation facilities in the Midwest (the DENA Midwest Assets), which are owned and operated by DENA subsidiaries, will be transferred to CG&E and operated together with CG&E's generation fleet. This transfer of the DENA Midwest Assets may be accomplished either through the transfer to CG&E of a DENA subsidiary's assets or through the transfer of a DENA subsidiary itself, and Applicants request Commission authorization for either means of transfer.

II. Notice and Responsive Pleadings

14. Notice of Applicants' filing on July 22, 2005 was published in the *Federal Register*, 70 Fed. Reg. 42,044 (2005), with interventions and protests due on or before September 26, 2005. On August 25, 2005, Applicants submitted a motion for extension of time to submit comments until September 26, 2005. The Commission granted this motion in a notice issued on August 30, 2005. On December 14, 2005, Applicants filed a definitive agreement they have reached with TVA that provides for the expansion of the interface between the Duke Power control area and the TVA control area.

15. Motions to intervene or notices of intervention were filed by American Electric Power, Blue Ridge Power Agency, Carolina Utility Customers Association, FirstEnergy Service Company, Constellation Energy Commodities Group, Inc., Constellation Generation Group, LLC, Constellation NewEnergy, Inc., Indiana Industrial Consumers Group, Indiana Municipal Power Agency, North Carolina Electric Membership Corporation, North Carolina Municipal Power Agency Number 1 and Piedmont Municipal Power Agency, North Carolina Utilities Commission, Northern Indiana Public Service Company, Proliance Energy, LLC, Public Service Commission of the Commonwealth of Kentucky, South Carolina Electric & Gas Company, South Carolina Energy Users Committee, Steel Dynamics, Inc., Tennessee Valley Authority, Wabash Valley Power Association, Inc., Wisconsin Electric Power Company.

16. Motions to intervene and comments were filed by the Dayton Power and Light Company (Dayton). The Public Staff – North Carolina Utilities Commission and the Attorney General of the State of North Carolina (North Carolina Parties) filed a motion to intervene and comments.

17. Motions to intervene and protests were filed by Albert E. Lane, American Municipal Power-Ohio (AMP-Ohio), American Public Power Association and National Rural Electric Cooperative Association (APPA/NRECA), Office of the Ohio Consumers' Counsel (Ohio Consumers' Counsel), Public Citizen's Energy Program (along with Citizens Action Coalition of Indiana, Ohio Partners for Affordable Energy, and the Southern Alliance for Clean Energy) (collectively, Public Citizen), and South Carolina Public Service Authority (Santee Cooper). Hoosier Energy Rural Electric Cooperative filed a protest and request for hearing, which it subsequently withdrew. The Indiana Utility Regulatory Commission (Indiana Commission) filed a notice of intervention, protest, and suggestion to institute settlement process.

18. On July 28, 2005, Santee Cooper filed a motion to compel Applicants to supplement their filing. On August 4, 2005, Applicants filed a response to Santee Cooper's motion.

19. On October 11, 2005, Applicants filed an answer. On October 26, 2005, Santee Cooper filed an answer to Applicants' answer. On November 4, 2005, Applicants filed an answer to Santee Cooper's answer. On November 21, 2005, Santee Cooper filed an answer to Applicants' answer.

III. Discussion

A. Procedural Matters

20. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), the notices of intervention and timely, unopposed interventions and motions to intervene serve to make the entities that filed them parties to this proceeding.

21. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2005), prohibits an answer to a protest or answer unless otherwise ordered by the decisional authority. We will accept the answers and answers to answers submitted by Applicants and Santee Cooper because they have provided information that assisted us in our decision-making process.

B. Standard of Review under Section 203

22. Section 203(a) provides that the Commission must approve a merger if it finds that the consolidation "will be consistent with the public interest."[4] The Commission's analysis under the Merger Policy Statement of whether a consolidation is consistent with the public interest generally involves consideration of three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.

1. Effect on Competition

A. Horizontal Competitive Issues

i. Applicants' Analysis

23. The Applicants retained Dr. William Hieronymus to analyze the effect of the merger on competition. Dr. Hieronymus identifies three relevant products: non-firm energy, capacity, and ancillary services, across the geographic markets affected by the merger. He concludes that, as mitigated, the merger will not harm competition.

24. As required by the Commission's merger regulations, Applicants present an Appendix A analysis performed by Dr. Hieronymus. Dr. Hieronymus analyzed markets in the footprint of the Midwest Independent Transmission System Operator (MISO), the PJM Interconnection (PJM), and the Duke Power control area. He identified three relevant geographic markets within MISO and PJM: MISO, the "MISO Submarket," and "MISO-PJM Midwest."[5] In his analysis of non-firm energy markets, Dr. Hieronymus uses Economic Capacity and Available Economic Capacity (Available Economic Capacity), as defined in the Merger Policy Statement, as proxies to represent a supplier's

---

[4] 16 U.S.C. § 824(b) (2000) (*amended by* EPAct 2005 § 1289).

[5] The MISO Submarket is all of MISO, excluding the Louisville Gas & Electric control area, the Wisconsin-Upper Michigan System, Iowa, and Minnesota. MISO-PJM Midwest includes the MISO Submarket and the western part of PJM inclusive of the areas in which Duke Energy North America's PJM assets are located, but exclusive of that part of PJM East of Allegheny Energy, Inc., as well as Dominion Resources, Inc.

ability to participate in the market.[6] He uses the Delivered Price Test to evaluate the effect on competition in the relevant markets over 10 separate time periods: Super Peak, Peak and Off-Peak periods for Summer, Winter and Shoulder seasons, along with an extreme Summer Super Peak. He considers actual energy market and fuel prices during 2004, and forecast fuel prices for 2006, the test year for his analysis.[7]

a. MISO and PJM Markets

25. In his analysis of these markets, Dr. Hieronymus uses simultaneous import limits for imports into each geographic market that are based on a transmission study provided by Cinergy. The simultaneous import limits in his analysis are 15,766 MWs for MISO; 11,032 MWs for the MISO Submarket; and 9,705 MWs for the MISO-PJM Midwest market. For imports from PJM to MISO, Dr. Hieronymus used PJM's Open Access Same-time Information System (OASIS) postings of PJM's total transfer capability (TTC) to the former MISO control areas. Dr. Hieronymus allocates scarce transmission availability on a *pro rata* basis.

26. With respect to PUHCA 1935's integration requirements,[8] Dr. Hieronymus assumed 250 MWs of firm transmission from the Duke Power control area. He states that this 250 MWs of firm transmission is in addition to Duke's share of imports calculated in accordance with the Appendix A requirements. Dr. Hieronymus conducted two sensitivity analyses; the first assumes the use of a 100 MW path from Duke Power to Cinergy,[9] and the second assumes that there is no firm transmission integration path. In

---

[6] 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 suppliers' native load obligation from its capacity and adjusts transmission vailability accordingly.

[7] Hieronymus Testimony, Exhibit J-1, at 37.

[8] Section 10 of PUHCA 1935 requires that any registered public-utility holding company comprise a "single integrated ... system" that is "physically interconnected or capable of physical interconnection" and "confined in its operations to a single area or region." 15 U.S.C. § 79j(c)(1) (2000).

[9] A sensitivity analysis is a standard statistical procedure designed to test whether the results of the model change significantly due to small changes in key parameters of the model. Results that are not sensitive to changes in key parameters of the model are

(continued…)

performing his analyses for the MISO and PJM markets, Dr. Hieronymus uses a range of prices from $30 per megawatt hour (MWh) in the Summer Off-Peak to $250 per MWh in the extreme Summer Super Peak. In addition, he conducted sensitivity analyses using slightly lower and higher prices.

27. For Economic Capacity, Dr. Hieronymus' results show that all the post-merger markets are unconcentrated in all time periods in each of the MISO, MISO Submarket, and MISO-PJM Midwest markets. According to Dr. Hieronymous, Herfindahl-Hirschman Index (HHI)[10] changes are under 50 in all time periods in each market: MISO (HHI change not more than 14), MISO Submarket (HHI change not more than 25), and MISO-PJM Midwest Market (HHI change not more than 37). Dr. Hieronymus states that under the Commission's Merger Policy Statement,[11] such a result satisfies the Appendix A screen analysis.

---

considered "robust". For example, the results of the Delivered Price Test can be affected by changes in the assumed market price or input prices such as fuel costs. In Order No. 642 the Commission recognized the importance of sensitively analyses: "[g]iven the importance of prices to the outcome of market definition, we will require applicants to perform sensitivity analysis of alternative prices on the predicted competitive effects. This provides us with an additional measure of confidence and assurance that results are reliable." Order No. 642 at 31,891-92.

[10] The Herfindahl- Hirschman Index 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 1000 points are considered unconcentrated; markets which the HHI is greater than or equal to 1000 but less than 1800 points are considered moderately concentrated; and markets where the HHI is greater than or equal to 1800 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).

[11] Merger Policy Statement, Appendix A at 30,128 (Competitive Analysis Screen).

28. Applicants state that under the Available Economic Capacity measure, all three markets are unconcentrated both before and after the proposed merger. HHI changes are no more than 39 points in MISO, no more than about 50 points in MISO Submarket, and no more than about 60 points in MISO-PJM Midwest. As a result, Applicants state, the proposed merger passes the Available Economic Capacity test in all three relevant geographic markets analyzed.

b. Duke Power Control Area

29. Applicants state that because Duke Power is not a member of a regional transmission organization (RTO), Dr. Hieronymus analyzed the Duke Power control area as a separate destination market. As required by the Commission's merger regulations[12] in those circumstances, Dr. Hieronymus also analyzed all of Duke Power's first-tier control areas.

30. Applicants state that, with respect to import limits, Dr. Hieronymus used OASIS postings of the various entities involved, consistent with the Commission's Merger Policy Statement. He also used simultaneous import limits calculated by Duke Power in its market-based rate compliance filing as well as those in studies submitted by other market participants in their compliance filings.

31. Dr. Hieronymus adjusted his analysis of the 250 MW firm transmission path from the way it was modeled for the MISO and PJM markets in two respects. First, because the proposed path confers firm transmission rights only from Duke Power to Cinergy, Dr. Hieronymus used the "squeeze-down" method[13] for allocating import capacity into the

[12] 18 C.F.R. § 33.3(c)(2) (2005).

[13] Under the "squeeze-down" allocation method, shares of available transmission are allocated at each interface, diluting as they get closer to the destination market. When economic suppliers are competing to get through a constrained transmission interface into a control area, the transmission capability is allocated to the suppliers in proportion to the amount of economic capacity each supplier has outside of the interface. For example, suppose that only two suppliers, A and B, have economic capacity outside of interface X. Supplier A has 60 MW of economic capacity outside of interface X, while Supplier B has 40 MW of economic capacity outside of interface X. By the squeeze down method, Supplier A would be allocated 60 percent of the available transmission at X, and Supplier B 40 percent. So if the transmission capacity at X is 80 MW, Supplier A would be allocated 60 percent, or 48 MW, and Supplier B would be allocated the remaining 32 MW. Under the squeeze-down allocation method, if Supplier A's and Supplier B's

(continued…)

Duke Power control area. Second, he assumed that no capacity is being delivered from Duke Power over the path into Cinergy. He also conducted a sensitivity analysis using a 250 MW firm path from Cinergy to Duke Power.

32. For Economic Capacity, Dr. Hieronymus' results show that the HHIs in the Duke Power control area are above 1,800 both before and after the proposed merger; thus, the market is deemed to be highly concentrated. He finds that since the HHI changes are well below 50, however, the proposed merger does not cause any screen failures.

33. Applicants state that under the Available Economic Capacity measure, the Duke Power control area is either moderately or highly concentrated (with one time period unconcentrated), depending on the load conditions. Dr. Hieronymus states that the relevant HHI changes are below 50 points in all but one instance, when 39 MWs of Cinergy supply results in an HHI change of 65 points in a highly concentrated market.[14]

34. Dr. Hieronymus concludes that there is no systematic pattern of large HHI changes in the relevant market, and thus no concerns are raised. Applicants state that in the first-tier markets to the Duke Power control area, the competitive screen analysis is passed readily, with most markets unconcentrated in most time periods. Dr. Hieronymus' sensitivity analysis shows that mitigation approximately equal to the size of the firm path would be required if the Applicants obtain a firm path from Cinergy to Duke Power.

ii. Protests

35. Public Citizen raises objections to the Commission's approach to merger analysis generally. For instance, it claims that the Commission over-relies on industry analysis. Public Citizen opines that the public interest is not served by having one consulting firm, and one individual in particular, (Dr. Hieronymus of Charles River Associates) conduct every major merger analysis. Public Citizen argues that evidentiary hearings are required

---

generation has to travel through multiple constrained interfaces, their generating capacity squeezing through the constraint will be reduced iteratively, so that their shares of available transmission are diluted as their generation moves closer to the destination market.

[14] Hieronymus Testimony, Exhibit J-1, at 51-52.

to determine whether the analysis provided by Dr. Hieronymus is prejudiced in favor of the companies that pay his salary.[15]

36. Public Citizen also states that the HHI is far too simplistic an index to measure market power in an industry as complex as the electric industry. It instead suggests that the Commission: use simulation modeling that directly measures market power, with a Price-Cost Margin Index; calculate the effects of generators' and power marketers' strategic behaviors to exercise market power; and include additional variables in its analysis.[16]

37. Public Citizen notes that Applicants did not include power marketers in their market power analysis. Public Citizen protests the entire market concentration analysis because it ignores the market concentration (and market power) effects of the Duke-Cinergy power marketing business, and requests that a new market power analysis be performed that includes all power marketing activities.[17]

38. AMP-Ohio states that the proposed merger could adversely affect competitive conditions in the regions in which the merged company will operate. It claims that the approach in the Commission's Merger Policy Statement is too limited to evaluate the broader effects of a merger on industry structure and market functionality.[18] It identifies increased opportunities for strategic bidding and economic withholding as the competitive harms that may result from the proposed merger. Specifically, AMP-Ohio claims that with generating assets both within the heart of MISO and at one of the major entry points to the proposed MISO-PJM joint energy market, Duke will have a host of opportunities to affect regional prices through the manner in which it dispatches the individual units comprising its diverse and far-reaching portfolio.[19] AMP-Ohio proposes that in order to ameliorate the competitive effects of the proposed merger, the proposed merger should be conditioned on a requirement that the merged company offer to sell

---

[15] Public Citizen Protest at 5.

[16] *Id.* at 6.

[17] *Id.* at 7.

[18] AMP-Ohio Protest at 8.

[19] *Id.* at 9.

ownership interests in the Cinergy transmission system to load-serving entities (LSEs), under reasonable terms and conditions.[20]

39. APPA/NRECA state that the repeal of PUHCA 1935 implies that the Commission may need to reexamine its current method, the Appendix A analysis, of analyzing the impact of a merger on horizontal competition. APPA/NRECA argue that with the repeal of PUHCA 1935 the Commission is likely to be faced with several new "long-distance" mergers that may each pass the current Appendix A screen, but may nevertheless cumulatively undermine competition. Each time such a merger is approved, a competitor in the broader markets is eliminated, and the economic and political market power of the remaining competitors is strengthened.[21] North Carolina Parties agree and urge the Commission to be vigilant in assessing the potential of mergers and acquisitions of jurisdictional entities to undermine existing or potential competition.

40. Santee Cooper raises a related point, claiming that the Commission and the courts have been clear that, in determining whether a merger is consistent with the public interest, the Commission has an obligation to consider relevant antitrust law and precedent.[22] The "potential competition" doctrine, which states that a merger may be unlawful if: the target market is substantially concentrated; the acquiring firm has the characteristics, capabilities and economic incentive to render it a perceived potential *de novo* entrant; and the acquiring firm's pre-merger presence on the fringe of the target market (as a potential entrant) in fact tempered oligopolistic behavior on the part of existing participants in the market.[23] Santee Cooper claims that, because of Duke's overwhelmingly dominant position in Southeastern markets, and in view of the ongoing and anticipated trend toward concentration in the electric generation market, Cinergy's elimination as a potential competitor in the markets in which Duke is dominant strongly suggests that the proposed merger runs afoul of the law.[24] Santee Cooper further submits

---

[20] *Id.* at 2.

[21] APPA/NRECA Protest at 5.

[22] Santee Cooper at 7 (*citing Kansas Power & Light Co. v. FPC,* 554 F.2d 178 (D.C. Cir 1977); *Central Maine Power Corp*., 55 FPC ¶ 2,477 (1976)).

[23] Id. at 8 (citing United States v. Marine Bancorporation, Inc. 418 U.S. 602 (1974)).

[24] *Id.* at 8.

that the Commission's principal concern when evaluating the proposed merger must be the substantial probability that the combining companies will emerge as a dominant supplier in an increasingly oligopolistic setting.[25]

41. Santee Cooper argues that Applicants' horizontal competition analysis is based on flawed assumptions and thus understates the potential for market power of the combined entity in the Duke Power control area. Santee Cooper's expert, Dr. John R. Morris, argues that Applicants' Appendix A analysis suffers from several factual errors. Specifically, Dr. Morris claims that Applicants ought to have incorporated the Midwest as a single, first-tier market in their analysis because the Commission has taken steps to ensure that MISO and PJM act as a single market. Santee Cooper cites the high correlation between real-time pricing in MISO and PJM. They also point to Applicants' representation of import capability into the MISO-PJM Midwest market, which shows the Duke Power control area as a first-tier market of MISO-PJM Midwest.[26] Santee Cooper argues that Dr. Hieronymus should have adjusted TTC seasonally, instead of using a single (May 2006) value to represent the entire year. Applicants' witness Dr. Morris notes that TTC data can vary significantly by season and that the monthly TTC data was available to Dr. Hieronymus.[27] Santee Cooper further argues that Applicants skew the results of their competitive analysis by using only the TTC data supplied by Duke. It is standard industry practice to use minimum reported TTC values when calculating import capability, which Applicants failed to do for the Duke-Southern Company interface.[28] Finally, Santee Cooper argues that Applicants understated the Cinergy pro rata share of import capability into the Duke Power control area by assigning portions of the pro rata share to generation that, due to remoteness, constraints and loop flows, it is unreasonable to factor in.[29]

42. Santee Cooper's witness Dr. Morris submits his own analysis. Santee Cooper states that Dr. Morris' corrections reveal violations of the horizontal competitive analysis under various screens: Economic Capacity, Available Economic Capacity, summer,

[25] *Id.* at 12.

[26] *Id.* at 17.

[27] *Id.* at 18.

[28] Id.

[29] *Id.* at 19.

winter, off-peak, Peak, and Super-Peak. Consequently, Santee Cooper claims that the proposed merger will harm competition in the Duke Power control area.[30]

43. Santee Cooper states that a firm transmission path from Cinergy to Duke will greatly exacerbate the screen violations in the Duke Power control area.[31] Santee Cooper's witness Dr. Morris argues that Applicants may have an incentive to pre-empt imports to maintain the market power that the Commission has already determined that Duke has. By acquiring a contract path, Applicants might more effectively integrate the two utility systems and reduce generation costs. Dr. Morris' analysis shows that integration of Applicants' systems could have saved $41,187 per MW in 2003 and 2004 by allowing them to transmit electricity from Cinergy to Duke, translating into $4.1 million in savings for a firm contract path of 100 MWs and $10.3 million for a 250 MW path. Santee Cooper argues that if the Commission approves the proposed merger and Applicants maintain their generation assets in the Carolinas, PJM, and MISO, the Commission would need to rigorously police Applicants' purchases of transmission, given their incentives to do so.[32] Finally, Santee Cooper argues that the Applicants' securing of non-firm transmission from Cinergy to Duke will crowd out other imports into the Carolinas and thus increase Applicants' market power in the Duke Power control area.[33]

iii. <u>Applicants' Answer</u>

44. Applicants challenge Public Citizen's arguments regarding market power, stating that Public Citizen failed to identify any reason for the Commission to conclude that the merger will have an adverse impact on competition.

45. In response to AMP-Ohio's assertion that the merger will create an opportunity for strategic dispatch that could affect prices, and possibly the availability of transmission capacity in the MISO market, Applicants state that AMP-Ohio provides no details in support of its theory. Applicants maintain that AMP-Ohio's claims consist of just the type of unsupported, general claims of harm that Merger Policy Statement says are

---

[30] *Id.* at 19-20.

[31] *Id.* at 20.

[32] *Id.* at 21.

[33] *Id.* at 22.

insufficient grounds to warrant further investigation of an otherwise comprehensive analysis developed by the applicants.[34] Applicants further cite the Commission's statement in *Exelon Corporation and Public Service Enterprise Corporation*[35] that there is no need for applicants to conduct a separate analysis of strategic bidding.

46. Applicants answer APPA/NRECA's and Santee Cooper's assertions regarding competitive harm associated with cross-country mergers by stating that these claims do not require the Commission to deviate from the Merger Policy Statement, absent identification of any potential harm to the public interest as a result of the merger. Applicants contend that these claims lack any indication of exactly how the Applicants could use their increased political power in a fashion that would injure competition. Because they do not own significant amounts of generation in the same market, their merger will not increase their market power in any market. The Commission's traditional Appendix A analysis continues to be an appropriate, conservative screen for determining when a market participant's acquisition of generation capacity will increase its market power in a relevant geographic market.[36] Applicants further maintain that competitive markets can only be assisted when the participants in those markets are economically strong, sustainable entities.

47. In response to Santee Cooper's critique of their horizontal competition analysis, Applicants note that Santee Cooper does not dispute the conclusion of Applicants' witness, Dr. Hieronymus, that there is no adverse competitive impact on Santee Cooper. Applicants assert that the proposed merger has no material impact on competition in Santee Cooper's control area. Further, no other entity, and in particular, no entity located in the Duke Power control area, where Santee Cooper asserts the competitive problems will occur, objects to the proposed merger.

48. Applicants answer Santee Cooper's assertion that the merger will harm competition in general by eliminating a prospective competitor in Duke's markets. They state that Cinergy has made only minimal sales of power in the Duke Power control area in the last two years. Applicants therefore argue that the proposed merger would not

---

[34] Applicants' Answer at 24, 25.

[35] *Id.* at 25 (*citing* 112 FERC 61,011 at P 131 (2005) (*Exelon/PSEG*)).

[36] *Id.* at 5-6.

eliminate Cinergy as a competitor in the Duke Power control area market because Cinergy does not compete to make sales in that market.[37]

49. Applicants respond to Santee Cooper's critique of their horizontal competition analysis by claiming that in order to show horizontal screen failures, Santee Cooper adjusted Dr. Hieronymus' import assumptions in two respects that deviate from the Commission's Appendix A requirements.[38] First, Dr. Morris combined MISO and PJM into a single first-tier market to the Duke Power control area. Applicants argue that this ignores transmission constraints between PJM and MISO. Applicants argue that PJM's simultaneous import limit of 7,500 MWs determines the amount of Cinergy generation that can be imported into the Duke Power control area. By placing PJM and MISO in the same first-tier market, Dr. Morris effectively assumes that all of Cinergy's approximately 12,000 MW of generation located in MISO is available for delivery into the Duke Power control area at the Duke-PJM interface, a physical impossibility in light of PJM's simultaneous import limit.[39] Applicants claim that there is no direct interconnection between MISO and Duke, further undermining Dr. Morris' assumption on deliverability of Cinergy imports to Duke.[40]

50. Applicants also argue that Dr. Morris' assumption deviates from the Commission's Appendix A filing requirements. The Commission has held that markets can be defined as a single control area, or, when the control area is part of an RTO, the market can be as large as the RTO.[41] Applicants state that the Commission has never held that two RTOs should be combined into a single market.

51. Second, Applicants contend that Santee Cooper's witness Dr. Morris violated the Appendix A analysis requirements by cutting significant portions of the PJM and MISO markets out from his first-tier market. The Commission has held that, if an RTO is used as a market instead of a single control area, the entire RTO should be treated as a single market unless there are transmission constraints that would cause the market to be

---

[37] *Id.* at 3.

[38] *Id.* at 10.

[39] *Id.* at 12.

[40] *Id.* at 9.

[41] *Id.* at 11-12 (*citing* Order No. 642 at 31,884).

separated.[42] Applicants state that Dr. Morris did not identify any transmission constraints that would cause him to lop off the portions of the MISO and PJM markets that he did not include in his combined MISO-PJM market. Applicants argue that Dr. Morris' adjustments are not validated by transmission constraints and are therefore invalid.

52. Applicants also challenge three secondary changes that Dr. Morris made in his analysis: seasonal variation of TTC data,;use of Southern Company TTC data for the Duke-Southern Company interface; and exclusion of portions of the MISO market northwest of the states of Missouri and Illinois. They say that Dr. Hieronymus' use of TTC data is a conservative choice not mandated by Commission regulations. Quoting section 33.3(c)(4)(i)(C) of the Commission's regulations, Applicants state that transmission imports are supposed to be allocated based on Available Transmission Capacity (ATC). They add that PJM consistently posts zero ATC between PJM and the Duke Power control area, so Dr. Hieronymus' use of any measure of TTC at all, instead of ATC, is conservative. Moreover, Dr. Hieronymus' choice of TTC data for May is a conservative choice, because it is the highest TTC value posted for the year.[43]

53. Applicants state that Dr. Hieronymus' use of Duke TTC values for the Duke-Southern Company interface was appropriate, even though these values were higher than those used by Southern Company, because Dr. Hieronymus did not calculate imports into the Duke Power control area by adding together the TTC postings at each interface. Rather, Dr, Hieronymus limited imports into the Duke Power control area based on Duke's simultaneous import limit. He then allocated the simultaneous import limit among Duke's interfaces pro rata based on Duke's TTC at each interface. Applicants argue that Dr. Hieronymus had to use the Duke value at this interface, or his result would have been a TTC inconsistent with Duke's study.[44] Applicants say that Dr. Morris' exclusion of MISO from the Appendix A Analysis is inconsistent with reality.

54. Applicants contend that, even if the adjustments made by Dr. Morris were accurate, they are irrelevant. They state that the cumulative impact of the three

---

[42] *Id.* at 13 (*quoting* Order No. 642 at 31,885).

[43] *Id.* at 15-16.

[44] *Id.* at 16-17.

adjustments is to raise the HHI for Economic Capacity by only 13-30 points with similar increases in the HHI for Available Economic Capacity.[45]

55. Applicants argue that even if Santee Cooper's market analysis were accepted, that does not mean that it has demonstrated that the proposed merger would have an adverse impact on competition in the Duke Power control area. Applicants remind the Commission that if horizontal screen violations are shown, then it is necessary to evaluate whether there is in fact any effect of a merger on competition. Applicants contend that the proposed merger will not harm competition because Cinergy's generation is hundreds of miles away from the Duke Power control area. Applicants maintain that Cinergy would not be able to withhold from the Duke Power control area the 100 MWs or so of imports attributed to it by Dr. Morris in light of the capacity competing to sell into the Duke Power control area. Therefore, withholding Cinergy's capacity would not be a threat to competition in the Duke Power control area.[46] Applicants next assert that Dr. Morris' alleged screen failures are "borderline and non-systematic." Because they cannot withhold imports, Applicants state that these screen violations do not raise competitive concerns. Applicants dismiss as dubious any other strategy Cinergy might try to use to increase the price of imports into the Duke Power control area market.

56. Applicants argue that Santee Cooper's assertion regarding a firm/non-firm transmission path is a red herring. There is no reason to assume that a firm path will come into being; Applicants have withdrawn the request for transmission service that they had submitted to PJM. Applicants argue that there is no reason to expect that they could obtain such a path in 2006 – the year their analysis covers – even if they should want to do so, because PJM shows an ATC of zero into the Duke Power control area market.[47] Applicants further state that their screen analysis already addresses the possibility of non-firm transmission between Cinergy and Duke and quantifies the resulting potential impact on the Applicants' market power in the Duke Power control area.[48]

---

[45] *Id.* at 15.

[46] *Id.* at 21-22.

[47] *Id.* at 23.

[48] *Id.* at 24.

iv. **Replies to Applicants' Answer**

57. Santee Cooper claims that Applicants' observations regarding the great distance between Duke and Cinergy ignore the fact that the Commission eliminated seams between PJM and MISO with the express purpose of creating a single marketplace. It again cites Dr. Morris' price analysis, claiming it supports a conclusion that the two RTOs effectively function as a single market.

58. Santee Cooper states that the relevant question for the Appendix A analysis of the Duke Power control area is not whether all of the generation in the MISO control area could be imported into PJM at once, but whether the generation has an equal ability to be sold into the Duke Power control area. Because the transfer limits from MISO to PJM exceed the transfer limits from PJM into Duke, the MISO-PJM constraint is non-binding for purposes of an analysis of the Duke Power control area.[49] Santee Cooper argues that in light of the Commission's efforts to create a single marketplace, there is no reason, from an economic perspective, to assume that MISO generation is not similarly situated to generation in PJM to serve Duke. Santee Cooper argues that the Commission has previously indicated that such similarly-situated generation should be treated alike. Thus, the Midwest should be treated as a single market.[50] Dr. Morris' Midwest market is the same as Dr. Hieronymus' MISO-PJM Midwest Market. This implies that Dr. Hieronymus recognized that there was merit in treating overlapping RTO regions as a single market.[51]

59. Santee Cooper argues that it is appropriate to consider transfer capability data from both exporting and importing utilities in performing an Appendix A analysis because a utility exporting into Duke cannot exceed its own transfer capability at an interface, regardless of whether Duke calculates a higher transfer capability for the same interface. Applicants' analysis of TTC is flawed because Applicants' witness uses a 2003 simultaneous import limit study, while using 2006 TTC data.[52]

---

[49] Santee Cooper Answer at 4.

[50] *Id.* at 5.

[51] *Id.*

[52] *Id.* at 6.

60. Santee Cooper further argues that Applicants' use of TTC, rather than ATC, is not a conservative assumption, as Applicants suggest. In the ATC sensitivity analysis of Applicants' Application, ATC results were generally similar to the TTC results. However, Applicants' Answer contained new ATC data purporting to show little or no ATC from PJM to Duke. Santee Cooper claims that Applicants did not update their ATC sensitivity using these data with a consistent methodology, so there is no factual basis for concluding that their use of TTC data is conservative. Santee Cooper provides as a counterexample the case where ATC is zero on every interface into Duke except for TVA. This case could produce greater screen violations for Cinergy, which has generation in TVA, than would be produced by TTC.[53] Santee Cooper also presents a sampling of two data points to supports its claim that Cinergy capacity should receive greater weight because PJM reports more current ATC from Cinergy to Duke and from PJM to Duke.

61. Santee Cooper argues that Applicants are mistaken in contending that Dr. Morris improperly excluded generation from his analysis. Dr. Morris' exclusion of power produced northwest of the states of Missouri and Illinois was appropriate because such generation is restricted by a binding transmission constraint into the Midwest. However, Applicants fail to mention the location or size of the constraint. Further, Santee Cooper claims that Applicants have misapprehended Dr. Morris' adjustment for eastern PJM generation. Dr. Morris assumed that all generation in PJM was available to serve the Duke Power control area, but his model assumes that generation from eastern PJM would not flow west before flowing south to Duke, but would directly flow south to Duke. Santee Cooper claims that this assumption is more consistent with the physical realities of the system.[54]

62. With respect to the firm transmission path that Santee Cooper alleges the Applicants will pursue, Santee Cooper argues that economic incentive alone is reason enough to assume that the merged company will ultimately secure such a transmission path. They state that the fact that there may be limited ATC between PJM and Duke in 2006 does not support a conclusion that the merged company will never establish such a firm path.[55]

---

[53] *Id.* at 7.

[54] *Id.* at 8.

[55] *Id.* at 8-9.

63. Santee Cooper contends that it has demonstrated that there will be an adverse impact on competition in the Duke Power control area. The Commission should not discount Santee Cooper's position simply because no entity within the Duke Power control area has complained about the proposed merger.[56] Santee Cooper grants that the Appendix A screen is not necessarily the end of the Commission's competitive analysis. It states that Applicants have not offered any mitigation measures with respect to the proposed merger and have presented no substantial evidence that the screen violations identified by Santee Cooper are benign.

64. First, Santee Cooper states that the screen violations are not borderline and non-systematic. Treating the Midwest as a single first-tier market to Duke, Dr. Morris finds screen failures for Available Economic Capacity for the entire winter season, and three screen failures for Economic Capacity. Factoring in his additional adjustments, Dr. Morris finds screen failures in seven out of ten periods for Economic Capacity and four out of ten periods for Available Economic Capacity. Because the Duke Power control area is highly concentrated, Santee Cooper argues, the Commission should not overlook these screen failures.[57]

65. Second, Santee Cooper disagrees with Applicants' argument that the fact of the small amount of Cinergy imports into Duke in Dr. Morris' results suggests that the merger will not, as a practical matter, present competitive problems, and that other suppliers could fill any gap left by an attempt to withhold Cinergy generation. Santee Cooper claims that these arguments are really just a variation on the Applicants' contention that the screen failures are borderline. Antitrust law and good policy dictate that the Commission evaluate the proposed merger in light of the substantial probability that the combining companies will emerge as a dominant supplier in an increasingly oligopolistic setting.

v. Applicants' Answer

66. Applicants state that Santee Cooper has raised only three points that require additional discussion. First, Santee Cooper has presented another novel theory of import allocation. Santee Cooper's assertion that PJM and MISO are a single market effectively assumes away the transmission constraints between PJM and MISO. Santee Cooper justifies this approach by arguing that the amount of generation that can be imported into

[56] *Id.* at 9.

[57] *Id.* at 10.

PJM exceeds the amount of generation that can be exported from PJM into Duke, so from an economic perspective, MISO generation is similarly situated to generation in PJM to serve Duke. Applicants state that this novel theory of allocating imports has not been accepted by the Commission in an Appendix A analysis and that the case Santee Cooper cites in support of its theory is not relevant. Santee Cooper's theory would allow numerous transmission constraints to be ignored, dramatically increasing the size of markets used in the Commission's market power analysis, which could have far-ranging implications and lead to absurd results. Applicants claim further that Santee Cooper did not apply this standard consistently in its analysis. If it had, it would have included all of PJM and MISO in its first-tier market and likely would have had to assume larger first-tier markets at other interconnections to the Duke Power control area. Applicants state that consistent application of Santee Cooper's theory would eliminate the appearance of screen failures in its analysis.[58]

67. Applicants reiterate that Santee Cooper improperly excluded large amounts of PJM and MISO generation from the consolidated market. Applicants contend that Santee Cooper misstated Applicants' argument when it asserted that Applicants believe that the generation was excluded from the analysis altogether. Applicants contend that PJM East capacity and certain MISO capacity was relegated to second-tier markets in Santee Cooper's analysis, thereby significantly reducing the impact of that generation as compared to Cinergy capacity that is included in the first-tier PJM market. Applicants claim that only through its inconsistent treatment of the first-tier market was Santee Cooper able to derive the screen failures. [59]

68. Applicants contend that Santee Cooper's argument is not well founded. Applicants state that they have relied on the analysis of Santee Cooper's expert witness to demonstrate the minimal nature of the assumed Cinergy imports into the Duke Power control area. Applicants assert that, recognizing the weakness of its asserted screen failures, Santee Cooper goes on to make general assertions of future harm due to the substantial probability that the combining companies will emerge as a dominant seller in an increasingly oligopolistic setting. Applicants reply that the evidence in this case shows that they are not likely to emerge as a dominant supplier in any market. Applicants argue that Santee Cooper's argument can only be read as an assertion that,

---

[58] Applicants' Answer at 2-3.

[59] *Id.* at 3-4.

after future unspecified mergers and other market changes, Applicants might possess market power in unspecified markets.[60]

69. Applicants also state that while Santee Cooper has failed to demonstrate any market power problems associated with the merger, Duke has nevertheless entered into a Memorandum of Understanding (MOU) with TVA to upgrade the intertie between their respective systems in order to facilitate additional wholesale transactions and improve reliability. Applicants state that this upgrade will increase the simultaneous import limit into the Duke Power control area by 100 megawatts (MWs) to 600 MWs, depending on the season. The upgrade ensures that the proposed merger will provide a positive net benefit to wholesale and retail customers in the region.

vi. Commission Determination

70. Applicants have shown that the combination of their generation capacity will not harm competition in any relevant market. We address protestors' specific arguments below.

71. In response to Public Citizen's argument that it is not consistent with the public interest that one consulting firm conducts every major analysis, the Commission notes that it does not have the authority to determine the individual or the consulting firm that applicants use to perform their merger analysis. All expert witnesses are paid by one party or another, and we are alert to the possibility of bias in their analyses. However, we do not find anything inherently wrong with a particular firm or individual performing analyses in a number of cases. Therefore, we reject Public Citizen's request to set the matter of any alleged bias on the part of Applicants' economic witness for hearing.

72. With respect to Public Citizen's concern regarding the inadequacy of the HHI, we note that we have already ruled on this issue in Order No. 642. There, we recognized that the HHI statistic is not a perfect measure of a merger's competitive effect, but that it is useful as a conservative screen to identify transactions that clearly do not undermine competition.[61] Accordingly, we find that Public Citizen's argument constitutes a collateral attack on the Commission's regulations and is outside the scope of the current proceeding.

---

[60] *Id.* at 5-6.

[61] Order No. 642 at 31,897.

73. We will deny Public Citizen's request that a new market power analysis be performed that includes all of Applicants' power marketing activities. The Commission's Appendix A analysis focused on capacity *controlled* by all potential sellers in the relevant market. Without control of capacity, whether through ownership of physical assets or through power purchase agreements, sellers cannot harm competition in wholesale energy markets. If Applicants (or any other potential suppliers) gain control of generation capacity through power marketing activities, the Appendix A analysis does consider power marketing activity, but the mere presence of a large power marketing operation, *per se*, does not, in itself, confer any additional market power to on the merged firm, or on any other seller in the relevant market.

74. AMP-Ohio's concern regarding opportunities for strategic dispatch does not withstand careful scrutiny. AMP-Ohio argues that the combination of assets on either side of a major entry point to the proposed MISO-PJM joint energy market will give Duke opportunities to affect regional prices.[62] First, we note the dissimilarity between this case and *Exelon/PSEG*. *Exelon/PSEG* involved a claim of opportunity for strategic bidding between entities within the same market. This claim invokes the opportunity for strategic bidding, or withholding on one side of a transmission constraint to affect prices, and thus profitability of generation, on another side of the same constraint.

75. If the line(s) between the two control areas are uncongested, this strategy would not be successful, unless neither control area had access to imports at the common market price in sufficient quantity to replace the withheld generation. This is possible only if either: (1) all other transmission lines into the two areas are constrained; or (2) the amount withheld is so great as to congest the adjoining lines. The first scenario is exceedingly improbable, unless the line connecting the two areas dwarfs all other adjoining lines. The second implies that the firm would have to withhold a great deal of generation, and this strategy is easily detected and would not be profitable.

76. If the line between the two areas is congested, then the price of energy on the uncongested side of the line would be less than that on the congested side of the line. In this case, withholding on the uncongested side would not affect the price of energy on the congested side, unless the total amount of energy withheld were greater than the amount

---

[62] We disagree with Applicants' assertion that this is just an unsupported, general claim of harm that the Commission found in the Merger Policy Statement to be insufficient grounds for further investigation of an otherwise comprehensive analysis developed by the applicants. AMP-Ohio's is a *specific* claim of harm, and as such, deserves further analysis.

of capacity on the uncongested side available at a price at or below the price on the congested side. Otherwise, production on the uncongested side would just increase to the point of making up for the lost production; prices on the uncongested side would rise, but price on the congested side would remain unchanged.[63] In this case, however, withholding would not be profitable because of the large amount that would have to be withdrawn from the market in order to effectuate the desired price change.

77. If a company on the constrained side were to withhold, this would likely raise price on that same side. However, price on the uncongested side would not rise unless the following conditions were present: (1) the marginal generator is operating at such a high capacity that it could not ramp up to take up the slack; (2) within-control area competition at the margin is slack; and (3) the area is not able to call on imports from other regions to make up the difference. The latter is a high-demand scenario, where the system is operating near capacity, and transmission constraints bind. In this scenario market monitors are exceedingly vigilant against withholding. Thus, even if this strategy were successful, it would likely be discovered and addressed. In summary, the Commission finds that the withholding strategy posited by AMP-Ohio is exceedingly problematic. The Commission does not view this strategy to pose a significant threat to competition.[64]

78. We reject APPA/NRECA's and the North Carolina Parties argument that the Commission should analyze the instant merger not only on its own specific terms but as a harbinger of change. Under section 203 of the FPA, we must approve a transaction if it is consistent with the public interest; we cannot deny or condition a proposed merger based on speculation about general trends that may or may not occur in the future. Moreover, under the Merger Policy Statement, we examine the effect of a merger or disposition of jurisdictional facilities on competition in the relevant geographic and product markets, a well-established framework for analyzing market competition. The geographic markets are those that would be affected by the proposed merger by eliminating a competitor or a

---

[63] Since we are examining the effect of withholding on one side on price on the other side of the constraint, as per AMP-Ohio's claim, this is the correct analysis.

[64] The Commission views the statement AMP-Ohio cites, namely, that "[t]he Merger will give the combined company significant generation assets that straddle the seam between PJM and MISO with pricing optionality in both energy markets," as a recognition by Duke Energy Corp. that it will have the option of selling energy into either market, selling to the highest bidder. Such a strategy, though, is one of producing output in response to a high price, rather than withholding it.

potential competitor in the market. The product markets are capacity, ancillary services, and energy, across a range of season and load conditions. APPA/NRECA refer to the "broader" markets that could be affected by the proposed merger, thus increasing the economic and political market power of the remaining firms, but they do not define those markets. We are aware that, as markets evolve, product market and geographic market definitions can change. For example, the existence of organized markets for ancillary services has made it possible to analyze ancillary services, such as regulation services, as a distinct relevant product market. As another example, as transmission systems are expanded, or rate pancaking is eliminated, the relevant geographic markets can expand. Our standard of review is flexible enough to consider any changes in market structure that ultimately result from the EPAct 2005 and the repeal of PUHCA 1935, but we will not speculate on what general trends might emerge; rather, we will evaluate the effect of the merger on competition based on the record in this case.

79. We reject Santee Cooper's potential competition argument. The Commission agrees with Santee Cooper that the Duke market is concentrated. However, we disagree with the proposition that the acquiring firm's pre-merger presence on the fringe of the target market could possibly have tempered oligopolistic behavior on the part of existing participants in the market, under the circumstances. Santee Cooper has not shown that the Duke Power control area is an oligopolistic market. Moreover, given Cinergy's lack of physical proximity to Duke and the lack of historical sales in the market, Santee Cooper has not presented any evidence to demonstrate that Cinergy was perceived as a potential competitor in the Duke Power control area. The Commission further rejects Santee Cooper's claim that the Commission's principal concern when evaluating the proposed merger must be the substantial probability that post-merger Applicants will emerge as an overwhelmingly dominant supplier in an increasingly oligopolistic setting as being wholly subjective. Because the Commission cannot measure the "probability" of which Santee Cooper speaks, we will not speculate on what general trends might emerge. Rather, we will evaluate the effect of the merger on competition based on the record in this case.

80. Santee Cooper's argument that Applicants ought to have treated the Midwest as a single, first-tier market in their analysis does not comport with the Commission's Merger Filing Requirements.[65] While the Commission has taken steps to ensure that MISO and PJM act as a single market, none of these steps have eliminated transmission constraints

---

[65] In Order No. 642, the Commission explained that applicants must adjust suppliers' capacity consistent with the physical transmission capacity available to reach the destination market. Order No. 642, at 31,887.

between the two control areas. Santee Cooper notes the high correlation between real-time pricing in MISO and PJM; however, this argument applies to whether MISO and PJM ought to be considered as a common *destination market*, not to the ability of suppliers *to reach* a destination market. Further, the Commission agrees that in the absence of identified transmission constraints, Dr. Morris' decision to dispense with portions of the MISO and PJM markets in his combined MISO-PJM market is arbitrary; we also agree with Applicants' argument that once the Commission accepts Applicants' market definition, Santee Cooper's secondary arguments are inconsequential. Moreover, the screen failures shown in Dr. Morris's analysis are the result of less than 100 MWs of Cinergy's generation assets reaching the Duke destination market, not the elimination of a competitor.

81. Finally, Santee Cooper cites Duke's MOU with TVA to upgrade the intertie between their respective systems as evidence that the merger gives Duke and Cinergy an economic incentive to use transfer capability on a firm contract path from Cinergy to Duke. Santee Cooper's witness finds that the increased transfer capability causes an additional screen failure in the Duke market. We find that the merger does not harm competition in the Duke market for the reasons stated above, namely, that: (1) the merger does not eliminate a competitor in the Duke market; and (2) the screen failures shown in Dr. Morris's analysis are the result of a small amount of Cinergy's generation capacity reaching the Duke destination market, which does not alter the competitive dynamics in the market.

82. Santee Cooper notes that the MOU has not been filed, and argues that the Commission should not base its merger approval, even in part, on a document it has not even seen. We agree with Santee Cooper that we could not rely on an MOU that has not been filed. However, we do not rely on the MOU in finding that the merger will not adversely affect competition in the relevant markets. While we encourage transmission expansion, we will only condition merger approval when there would otherwise be harm to competition, and Applicants have shown that the merger will not harm competition in the relevant markets.

83. Therefore we conclude that the horizontal aspects of the merger will not harm competition in any relevant market. There is very little overlap between Duke's and Cinergy's generating capacity. The MISO market, where Cinergy's capacity is located, is not concentrated, and the combination of Cinergy's generation and Duke's generation that could reach the MISO passes the Competitive Analysis Screen for all season/load levels. The Duke market is highly concentrated, with Duke being the dominant firm in that market, but the proposed merger does not eliminate a competitor in that market. Cinergy does not have any significant presence in the Duke market, so the combination of the two cannot reduce competition. Even if we accepted protestors' revisions to Applicants' analysis, which would show screen failures in the Duke market by allowing

more of Cinergy's generation to reach the Duke destination market, the fundamental competitive conditions in the market would not be changed by the proposed merger.[66] We addressed the issue of screen failures caused by factors other than the elimination of a competitor in *NSP*.[67]

B. Vertical Market Power Issues

i. Applicants' Analysis

84. Applicants state that the proposed merger raises no material vertical market power issues. Applicants' witness, Dr. Hieronymus, states that Applicants cannot use either transmission ownership fuel supplier or fuels delivery systems to hinder competing generation.

85. First, Dr. Hieronymus states that the proposed merger does not increase the Applicants' ability or incentive to use control over their transmission facilities to harm competition in wholesale electricity markets, which is the Commission's concern in such

---

[66] We note that as a result of the announced merger, Cinergy does not have market-based rate authority in the Duke market: "Commission policy requires merging utilities to treat one another as affiliates pending the consummation of a merger. In light of the announced merger between Duke Energy Corporation and Cinergy Corporation, Cinergy Companies has committed to treating Duke Power and its affiliates as affiliates for purposes of the code of conduct. Further, Cinergy Companies has committed that it will not make market-based rate sales to Duke Power and its affiliates without first receiving Commission approval under section 205 of the Federal Power Act. We note, however, that the market-based rate tariffs of Duke Power and its affiliates are not applicable to sales in the Duke Power control area. The Commission imposes this same restriction on the Cinergy Companies' sales in the Duke Power control area." *Cincinnati Gas and Electric*, *et al.*, 113 FERC ¶ 61,197 (2005).

[67] *See Northern States Power Company*, 90 FERC ¶ 61,020 (2000) (*NSP*). In *NSP,* the Commission stated: "it is clear from Applicants' analysis that NSP and SPS do not currently compete with each other in any of the 33 relevant markets analyzed by Applicants. Consequently, under this approach, the merger does not eliminate a rival and create or enhance the ability of the merged company to unilaterally exercise market power by withholding output. We are not generally concerned about increases in market concentration exceeding the thresholds in cases where neither NSP or SPS is a supplier in the relevant market or when the market share of one Applicant decreases."

vertical combinations. Dr. Hieronymus states that the vast majority of Duke's generation in MISO and PJM is not in the footprint of Cinergy's transmission system. He states that Cinergy's generation is in MISO where Duke only owns one generation facility. He explains that the Cinergy electric transmission systems are controlled by MISO and that Duke Power's transmission system is subject to an OATT. He adds that Cinergy does not control any generation served by Duke Power's transmission. Thus, Dr. Hieronymus concludes that no transmission-related vertical market power issues are raised by the proposed merger.

86. Applicants also address the effect of combining their natural gas distribution and electric generation assets. Dr. Hieronymus notes that in order for there to be a vertical market power issue, both the upstream and downstream markets need to be highly concentrated.[68] He states that, as demonstrated through his vertical market power analysis, both the upstream and downstream markets are not concentrated.[69]

87. Dr. Hieronymus explains that the proposed merger raises no competitive concerns related to combining Duke's natural gas pipeline assets and Cinergy's generation in MISO because the relevant gas transportation markets are not highly concentrated.[70] He states that the only interstate natural gas pipeline company owned by Duke that runs through MISO is Texas Eastern Transmission, L.P. (Texas Eastern). Dr. Hieronymus adds that there are a significant number of pipelines competing with Texas Eastern for deliveries into MISO. The delivery capacity of Texas Eastern accounts for less than 10 percent of delivery capacity into relevant markets.

88. With respect to the analysis of the downstream market, Dr. Hieronymus states that the Commission's regulations require attributing gas-fired generation to the entity that transports fuel.[71] He presents two examples related to the proposed merger: Duke as an owner of a pipeline serving MISO and Cinergy as a local distribution company. He argues that since the relevant electricity market is unconcentrated, the downstream market would be concentrated only if gas-fired generation were a major part of the generation mix and the newly-affiliated pipeline were the dominant gas transportation

---

[68] *Id.*

[69] Hieronymus Testimony, Exhibit J-1 at 7 and 55.

[70] *Id.* at 7.

[71] *Id.* at 14.

supplier. He states that neither is the case. Nonetheless, Dr. Hieronymus does conduct the analysis required under Part 33.4, where he assigns control of the gas-fired generating units to the owner(s) of the pipeline serving those units. His analysis shows that the markets remain unconcentrated, with post-merger concentration levels ranging from 448 HHI to 916 HHI – well below the Commission's 1,800 HHI threshold. Thus, Dr. Hieronymus concludes that the proposed merger passes the vertical market power screen.

89. Dr. Hieronymus also concludes that there are no vertical market power issues related to Cinergy's ownership of local distribution companies and KO Gas Transmission, an interstate pipeline system delivering to the citygates of its local distribution companies, because the KO Gas Transmission pipeline does not serve any gas-fired generating units and Cinergy's local distribution company operations do not serve any competing gas-fired generating units.[72]

90. Dr. Hieronymus states that he found no other barriers to entry that raise concerns. He states that Applicants do not have dominant control over generating sites, and there has been substantial entry into relevant markets.

91. Applicants state that the transfer of the DENA generation assets to CG&E will not raise "safety net" issues that have been raised in recent cases involving transfers from merchant generation companies to affiliated franchised electric utilities. First, they argue that the transfer of the DENA generation assets to CG&E was negotiated as part of the arm's length negotiations between the Applicants – who were unaffiliated at the time – that led to this proposed merger. Second, they assert that CG&E cannot provide a "safety net" for DENA's generation assets because under Ohio's restructuring statute, CG&E does not charge cost-based generation rates, and no customer, retail or otherwise, can be required to pay costs attributed to the asset transfer.

ii. <u>Protests</u>

92. AMP-Ohio questions Applicants' representation that the combination of Cinergy's generation fleet with Duke's pipeline does not raise vertical market power issues. It states that Dr. Hieronymous' vertical market analysis is based on static conditions that are not realistic in today's dynamic competitive market. The merged entity will own and control extensive pipeline capacity in a region in which it will also compete for sales of generation. Thus, AMP-Ohio argues that the proposed merger could provide

[72] *Id* at 64.

opportunities or incentives for the combined company to engage in anticompetitive behavior.[73]

93. AMP-Ohio recommends that the Commission require joint ownership of Cinergy's transmission system by load serving entities. It contends that increasing diversity of ownership in a regional transmission system provides several procompetitive benefits, such as reducing incentives of vertically integrated utilities to deny access to the transmission system, providing joint owners a direct role in transmission planning, and providing new funding sources for network expansion.[74] This arrangement will ensure that LSEs have transmission access if MISO is disbanded in the future.[75]

94. Public Citizen argues that the merger will result in Duke controlling too much natural gas pipeline capacity. It states that combining Duke's extensive natural gas system with Cinergy's KO Gas Transmission pipeline system raises market concentration concerns that can be alleviated through divestiture of Texas Eastern.[76]

iii. Applicants' Answer

95. Applicants state that AMP-Ohio's arguments about their ability to exercise vertical market power ignores Dr. Hieronymus' vertical market power analysis.[77] Applicants state that there is no evidence to suggest that MISO will cease operations; therefore, there is no reason to grant AMP-Ohio's request to require CG&E to transfer ownership of its transmission facilities to LSEs in Ohio.[78] They argue that AMP-Ohio has not explained: (1) how the termination of MISO would impact the competitive analysis, and (2) how joint ownership would better enable Cinergy to take competitive advantage of a

---

[73] AMP-Ohio Protest at 16-17.

[74] *Id.* at 18-20.

[75] *Id.* at 17-18.

[76] Public Citizen Protest at 9.

[77] Applicants' Response at 25-26.

[78] *Id.* at 4.

dissolution of MISO. Thus, Applicants contend that there are no grounds for granting AMP-Ohio's request.[79]

96. Applicants disagree with Public Citizen's assertion that the combination of Duke's pipeline system with Cinergy's KO Gas Transmission pipeline system presents competitive concerns for Midwest consumers. Applicants note that Public Citizen does not specify what those concerns are and does not challenge the validity of the vertical market power study performed by Dr. Hieronymous. Applicants argue that because the KO Gas Transmission pipeline system does not serve any unaffiliated electric generation facilities, either directly or indirectly, the combination of the two pipeline systems cannot increase the Applicants' ability to exercise market power.[80]

iv. <u>Commission Determination</u>

97. We find that the proposed merger will not create or enhance vertical market power either through the combination of electric generation and transmission assets or the combination of electric generation and fuel sources. We also find that CG&E's acquisition of the DENA Midwest Assets will not harm competition through vertical foreclosure. We discuss the specific issues below.

98. Applicants have shown that the combination of generation and natural gas distribution facilities will not harm competition. In Order No. 642, we stated that in order for a merger to create or enhance vertical market power, both the upstream and downstream markets must be highly concentrated.[81] Applicants' witness has demonstrated that neither the upstream markets nor the downstream markets are highly concentrated, nor will they be after the merger.[82] Thus, there would not be the possibility of market foreclosure or raising rivals' costs in order to harm competition.

99. Applicants have also shown that the combination of their generation and transmission facilities will not harm competition. Applicants' transmission systems are generally remote from each other's generation, so there is no incentive or ability to exercise vertical market power. Cinergy has turned over operational control of its

---

[79] *Id.* at 8.

[80] *Id.* at 26.

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

[82] Hieronymous Testimony, Exhibit J-1 at 6-7.

transmission facilities to the MISO, so it cannot use its transmission assets to harm competition in downstream electricity markets. In addition, because Duke Power's transmission system is far removed from Cinergy's generation assets, which are in MISO, it would not be able to use control of its transmission assets to harm competition in the relevant downstream electricity markets.

100. We agree with Applicants that requiring CG&E to transfer ownership of its transmission system to LSEs in Ohio is unnecessary. AMP-Ohio has presented no evidence indicating that MISO may cease operations in the future. Moreover, in reviewing an application under section 203 of the FPA, the Commission looks for changes that could enhance the ability or incentive of a company to engage in anticompetitive behavior. The likelihood of continued operation of MISO is not relevant to that determination.

101. We disagree with Public Citizen's assertion that the merger will result in Duke controlling too much natural gas pipeline capacity. Applicants analyzed the effect of combining Duke's natural gas transportation interests with Cinergy's electric generation assets and demonstrated that the merger does not present vertical market power concerns. Using the Commission's attribution method, which assumes that the owner of the pipeline capacity serving a gas-fired generator controls the electric generation capacity, Applicants have shown that the relevant downstream electricity markets are not highly concentrated, as required by Order No. 642. Public Citizen has not provided a basis for the Commission to determine otherwise. Therefore, we find that divestiture of Texas Eastern is not warranted.

C. Safety Net Issue

i. Protests

102. Ohio Consumers' Counsel, AMP-Ohio, and Public Citizen argue that there is a safety net issue relating to the transfer of the DENA merchant plants to CG&E. It asserts that the sale will allow Applicants to combine unprofitable merchant plants with the assets of a regulated electric utility and to charge Ohio customers for capital and operating costs associated with those plants.[83] It further contends that that the purchase of the DENA plants by CG&E shows a preference for the output of high cost plants that

[83] Ohio Consumers' Counsel Protest at 4.

are currently owned by DENA and that this violates the Public Utilities Commission of Ohio's (PUC-Ohio) corporate separation plan.[84]

103. Ohio Consumers' Counsel states that the cost of the DENA plants exceeds current market prices for similar generation facilities. It argues that the sale was overvalued because the proposed merger was not made at arm's length, as claimed by Applicants[85] and offers examples of sales of other generating facilities in the Midwest market that were sold at a lower dollar per megawatt basis than the DENA plants.

104. Ohio Consumers' Counsel disputes Applicants' claim that CG&E does not charge cost-based generation rates.[86] It argues that CG&E currently operates under a rate stabilization plan approved by the PUC-Ohio that is based on CG&E's generation costs and is effective through 2008. Under the rate stabilization plan, CG&E charges customers various non-bypassable fees related to generation, fuel, and purchased power. The plan also provides for an annual adjustment fee related to other generation charges. Thus, Ohio Consumers' Counsel contends that CG&E charges regulated, cost-based generation rates, and that consumers can be harmed by the sale of the DENA plants because the costs related to the sale could be passed through to them. In a separate PUC-Ohio docket, CG&E applied for approval of: certain parameters within which CG&E can purchase or build generation facilities; to recover certain costs and a reasonable rate of return on the capital investment in such generating facilities; and to recover such costs and return through its system reliability tracker through 2008 and through a non-bypassable market-based standard service offer charge after 2008. It concludes that CG&E plans to charge Ohio's retail customers for the costs of newly acquired generating plants by means of a system reliability tracker charge through 2008 and a non-bypassable distribution charge that would extend beyond 2008.[87]

105. AMP-Ohio also challenges Dr. Hieronymous' statement that there is no safety net because CG&E is not subject to rate-base regulation. It states that Ohio's experience with retail access has been mixed, leading some observers to question how long retail choice will continue in Ohio. The possibility that the DENA merchant plants could be

---

[84] *Id.* at 5.

[85] *Id.* at 7.

[86] *Id.* at 8.

[87] *Id.* at 9.

part of the rate base in the future gives rise to the safety net issue.[88] It concludes that, because the perception of a safety net discourages entry by other potential suppliers of generation sources, wholesale and retail competition would be harmed.[89]

106. Similarly, Public Citizen states that this transfer of "unregulated" generation violates the Commission's policy on transfers of assets between affiliates.[90] This asset transfer will take place only after DENA and CG&E become affiliates. It states that the Duke-Cinergy merger agreement is written so as to assure that this asset transfer does not occur unless the merger is consummated. In addition, it argues that CG&E has a virtual monopoly over the residential customers in its service territory because no alternative electricity supplier offers service.[91] Public Citizen is concerned that the "unregulated" generation will be included in CG&E's revenue requirement, thus leading to rate increases for consumers.

ii. <u>Applicants' Answer</u>

107. Applicants state that the protestors have not raised any legitimate issues that should prevent the transfer of the DENA assets to CG&E. They state that none of the protestors allege that the transfer of the DENA assets will affect competition or prevent unaffiliated generation companies to compete with the Applicants.[92]

108. Applicants assert that Ohio Consumers' Counsel is wrong about CG&E's ability to pass through the costs of the DENA assets in its retail rates and that it misstates the terms of the Ohio Restructuring Act and the current settlement and PUC-Ohio order related to CG&E's default service rates. They add that many of Ohio Consumers' Counsel's arguments relate to implementation of the Ohio statue, which is not relevant to this proceeding.[93]

---

[88] AMP-Ohio Protest at 13.

[89] *Id.* at 14.

[90] Public Citizen Protest at 9

[91] *Id.* at 9.

[92] Applicants' Response at 27.

[93] *Id.* at 27.

109. Applicants state that CG&E operates as a provider of last resort and charges market-based rates under a Rate Stabilization Plan that was approved by the PUC-Ohio in 2004 and is effective through 2008. The plan allows CG&E to charge customers various fees that include a rate stabilization charge for provider of last resort service and an annual adjustment charge to maintain capacity margins and to recover costs associated with homeland security, taxes, environmental compliance, and emission allowances. Applicants note that CG&E must apply to the PUC-Ohio each year for all increases to the rate stabilization charge and annual adjustment charge for a determination of whether the increases are reasonable.

110. Applicants state that CG&E is limited to providing a default service at market-based rates for those customers who have not switched service providers. CG&E has no assurance of the recovery of any costs associated with the DENA assets, even if it could include those costs in its default service rates, because its default customers can switch to an alternative supplier. Applicants further maintain that CG&E cannot recover the costs of the DENA assets in its default service rates because those rates are limited to the recovery of certain costs associated with its existing generation.[94]

111. Applicants disagree with Ohio Consumers' Counsel that Cinergy is overpaying for the DENA assets. It performed simplistic calculations to determine the value of the plants using the cost per megawatt of capacity purchased in several recent acquisitions. Such calculations do not take into consideration other factors that could influence the price, such as the type of capacity being purchased. Applicants state that the DENA assets are combined cycle units that are expected to cost more than the simple cycle units used as examples by Ohio Consumers' Counsel. Regardless of the price paid for the DENA assets, under existing Ohio law and CG&E's default rate settlement, CG&E cannot recover the costs of the assets in rates.[95]

112. Finally, Applicants disagree with Ohio Consumers' Counsel's argument that the transfer of the DENA assets to CG&E violates the corporate separation requirements of Ohio law. However, they state that they will not address that issue here because that issue is under state, not Commission, jurisdiction.[96]

---

[94] *Id.* at 28 (*citing In re CG&E's MBSSO,* PUC-Ohio Case No. 03-93-EL-ATA, Entry On Rehearing at 9-12 (November 2004)).

[95] *Id.* at 29.

[96] *Id.* at 29.

iii. Commission Determination

113. In *Ameren*,[97] the Commission established guidelines, which are based on its decision in *Boston Edison Company Re: Edgar Electric Co.*,[98] for reviewing under section 203 mergers that involve the acquisition of an affiliate's assets and their effect on competition.[99] Acquisitions involving affiliates have an inherent potential for discriminatory treatment in favor of the affiliate. Affiliate preference when acquiring assets can have serious adverse effects on competition and may therefore not be consistent with the public interest.

114. Applicants state that they intend to transfer the DENA Midwest Assets to CG&E as part of the proposed merger in order to achieve operating efficiencies and to diversify fuel risk. They state that the opportunity to consolidate these assets was an important factor in their decision to enter into the proposed merger.[100] However, Applicants have not provided evidence that the transfer agreement was in fact negotiated before the merger announcement. Indeed, given the contemporaneous nature of the mergers, it is reasonable to assume that the initial negotiations regarding the merger took place simultaneously with negotiations regarding the assets. Therefore, we find that the self-

---

[97] Ameren Energy Generating Company, 108 FERC ¶ 61,081 (2004) (Ameren)

[98] *Boston Edison Company Re: Edgar Electric Co.*, 55 FERC ¶ 61,382 (1991) (*Edgar*). In *Edgar*, the Commission gave three examples of how to demonstrate lack of affiliate abuse: (1) evidence of direct head-to-head competition between affiliated and unaffiliated suppliers; (2) evidence of the prices that non-affiliated buyers were willing to pay for similar services from the affiliate; and (3) "benchmark" evidence of the prices, terms and conditions of sales made by non-affiliated sellers. These examples were not an all-inclusive list; the individual facts of a case could bring forth other examples not expressed in *Edgar* to show that a merger is without affiliate abuse.

[99] In *Ameren*, the Commission discussed a concern with "safety net" transactions, involving transfers of merchant generation to an affiliated franchised electric utility when the market declines, thus giving the affiliated merchant a "safety net" that merchant generators not affiliated with a franchised utility lack. The Commission was concerned that the existence of a safety net could affect the incentive of new merchant generators to invest in new facilities, erecting a barrier to entry that could harm the competitive process.

[100] Application at 30.

interest of the merging partners converged sufficiently, even before the consummation of the merger, to compromise the market discipline inherent in arm's-length bargaining.[101] Moreover, as argued by Public Citizen, when the asset transfer does occur, the two corporations will in fact be one merged entity, so the exchange will be an affiliate transaction. Therefore, we will treat the two entities as affiliates, and analyze the transfer's effect on competition accordingly.

115. In *Ameren*, we were concerned that affiliate preferences, or the possibility thereof, in asset acquisitions may harm competition. However, as we recognized in *Ameren/Illinois Power*, in order for a profit-maximizing firm to have an incentive to pay an inflated price for an asset (in that case, a power purchase agreement), it must be able to pass on those inflated costs to captive, cost-based ratepayers:

> Finally, for 2007 and beyond, Illinois Power's retail load obligations will be served through a competitive bidding process that will ensure that competitors are not foreclosed. Moreover, we note that Illinois is under a retail rate freeze through 2006. The PPAs are for 2005 and 2006, so there will be no time when they are in effect and Illinois is not under a retail rate freeze. Therefore, Illinois Power would be unable to pass any inflated power purchase costs onto customers. This eliminates Applicants' incentive to engage in regulatory evasion though the PPAs. The Commission finds that Applicants have shown that the PPAs do not serve as a vehicle for vertical foreclosure in this case. [102]

Here, as in *Ameren/Illinois Power*, CG&E would not be able to pass on inflated costs to captive ratepayers because the Ohio restructuring limits CG&E to the recovery of certain costs associated with its *existing* generation, not newly-acquired generation. Therefore, we reject protestors' arguments that the DENA transfer could harm competition by vertical foreclosure.

116. We also clarify that the "safety net" concern discussed in *Ameren* is restricted to vertical foreclosure through regulatory evasion, which is relevant only if a utility can pass inflated costs onto captive cost-based customers. We also note that in such circumstances, there are a number of ways to show that no such affiliate preference

---

[101] *See Cenergy*, Inc. 74 FERC ¶ 61,281 (1996) (*Cenergy*).

[102] *Ameren Corporation*,108 FERC ¶ 61,094 at P 61 (2004) (*Ameren/Illinois Power*).

occurred, including review of competitive solicitation processes by the relevant state commissions.

2. Effect on Rates

A. Applicants' Analysis

117. Applicants contend that the proposed merger will have no adverse effect on rates charged to wholesale power and transmission customers. They commit to hold these customers harmless from any wholesale or transmission 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. In order to meet this commitment, Applicants request authorization to defer merger-related savings to the extent that they are not otherwise deferred under generally accepted accounting principles.

B. Protests

118. Dayton states that the merger may affect CG&E's operation of units that Dayton jointly owns with CG&E (Jointly-Owned Units). It requests that the Commission establish an evidentiary hearing, settlement judge procedures, or a technical conference to assess the effect of the merged entity's operation of the Jointly-Owned Units on Dayton as well as on competition, rates, and regulation. It also asks that we condition approval of the merger to ensure that Dayton and its ratepayers will be held harmless from any adverse impacts, such as increased costs or additional risks and liabilities.[103]

119. Public Citizen states that the proposed merger will increase rates because the costs of the merger will be passed on to consumers. It states that Applicants have requested the Ohio Public Utilities Commission to authorize collection of costs, net of savings, associated with the merger, which Public Citizen claims violates the FPA.[104] It notes that Applicants acknowledge that there are no guarantees of merger-related savings.

C. Applicants' Response

120. Applicants state that Dayton and Cinergy have negotiated agreements regarding the operation of the Jointly-Owned Units, and argue that Dayton can protect itself by enforcing its rights under those agreements.

---

[103] Dayton Comments at 9-10.

[104] Public Citizen Protest at 10.

D. Commission Determination

121. In the Merger Policy Statement, we explained the need for ratepayer protection. The Merger Policy statement also describes various commitments that may be acceptable means of protecting ratepayers in particular cases, such as the hold harmless commitment offered by the Applicants. Thus, we find that Applicants have shown that the proposed merger will not adversely affect wholesale or transmission rates, and we rely on their hold harmless commitment in making this finding.

122. As discussed above, Ohio Consumers' Counsel, AMP-Ohio, and Public Citizen raise the question of ratepayer protection as related to the "safety net" issue. They claim that CG&E operates under regulated, cost-based rates, which could result in the costs of the DENA plants being passed through to ratepayers. However, we find that the hold harmless commitment will shield ratepayers from adverse rate impacts. Applicants also state that no ratepayer will pay for the costs of the DENA plants because, under the PUC-Ohio order regarding CG&E's market-based default rates, only costs associated with existing generation – not newly-acquired generation – can be recovered.[105] Given these protections, we agree with Applicants that issues related to CG&E's cost recovery and rate structure are not relevant to our decision here.

123. We will deny Dayton's request for an evidentiary hearing on the effect of the merger on the operation of the Jointly-Owned Units and will not impose conditions. Applicants' hold-harmless commitment, along with the agreements regarding the operation of the Jointly-Owned Units, provide adequate ratepayer protection. Dayton has not shown that the proposed merger will not alter Dayton's rights or Cinergy's responsibilities under their agreements.

3. Effect on Regulation

A. Applicants' Analysis

124. Applicants state that the proposed merger will not adversely affect federal regulation. They state that the proposed merger will create a new registered holding company, subject to the regulation by the Securities and Exchange Commission (SEC) under PUHCA 1935. Applicants commit that, for wholesale ratemaking purposes, they will follow the Commission's policy regarding the pricing of affiliate transactions for non-power goods and services. Applicants state that this commitment ensures that Duke,

---

[105] Applicant Response at 28.

Cinergy, and their affiliates will remain subject to the Commission's regulation regarding wholesale ratemaking effects of affiliate non-power transactions and eliminates any potential concern of the Commission regarding wholesale ratemaking impacts of affiliate non-power transactions and eliminates any potential concern of the Commission regarding the preemptive effect of SEC jurisdiction under the holding in *Ohio Power Co. v. FERC*.[106]

125. Applicants state the proposed merger will not adversely affect state regulation. They are filing applications for approval of the proposed merger with four of the five affected state commissions and argue that those state commissions will have the ability to protect their own jurisdiction.

126. Applicants state that, while the Indiana Commission does not have jurisdiction over the merger, it will have the opportunity to consider PSI's request for approval of various affiliate relationships related to the proposed merger and for accounting referral for certain merger-related costs. They state that DENA's proposed transfer of its 75 percent interest in the Vermillion Energy Facility (Vermillion) to CG&E may require approval and/or an order disclaiming jurisdiction over the transaction from the Indiana Commission. Because Vermillion is a merchant generating plant that does not provide retail service within Indiana, the Indiana Commission has declined to exercise its jurisdiction over Duke Vermillion with respect to the construction, ownership, and operation of the facility. Finally, Applicants argue that because the proposed merger will not change PSI, its business, its assets, or its regulatory status, it will not adversely affect Indiana Commission's ability to regulate PSI.

B. Protests

127. The Indiana Commission states that it lacks full authority to act with respect to the proposed merger, and therefore may not be fully able to fulfill its regulatory duties without the assistance of the Commission. It states that commitments made to the Indiana Commission by CG&E and PSI Energy at the time of the merger forming Cinergy may not be operative. A key concern addressed in the settlements involving that merger was the preservation of the Indiana Commission's ability to maintain proper regulatory oversight regarding the components of the charges to be passed through to Indiana ratepayers, who are under a cost-of-service regulatory system. The Indiana Commission states that approval of the proposed merger should be conditioned on state regulators such as the Indiana Commission retaining the full authority traditionally

---

[106] 954 F.2d 779 (D.C. Cir. 1992).

exercised to assess and make orders with respect to mergers between PSI and its affiliates insofar as those mergers affect retail rates. It requests that the Commission send this matter to settlement discussions. The Indiana Commission also argues that the merger will create a multi-state holding company covering some states where rates are set by competitive forces and other states where they are set by cost-based regulation, which,, combined with the repeal of PUHCA 1935, may result in unintended consequences.

128. Santee Cooper, AMP-Ohio, Public Citizen, and Dayton argue that Applicants should explain the steps they will take to ensure that improper cross-subsidization or cross-collateralization will not occur as a result of the merger. Santee Cooper argues that, although the merger application was filed before the enactment of EPAct, August 8, 2005, it was not complete until August 18, 2005, when Applicants supplemented their application. It concludes that the EPAct 2005 standards should apply. AMP-Ohio raises the possibility that the merged firm could, for example, build a generating facility in North Carolina, then use that capacity to serve load in Ohio, while receiving cost recovery through North Carolina customers' cost-based rates.

C. <u>Applicants' Response</u>

129. In response to the Indiana Commission's concerns, Applicants reiterate that while the Indiana Commission will not approve the overall merger, it has the authority to address the issue it raises in its protest – affiliate agreements related to the proposed merger. Applicants further argue that the repeal of PUHCA 1935 and the enactment of PUHCA 2005 are issues that the Commission is considering in its rulemaking on that subject.[107] Any concerns that a state commission has in this regard should be raised in that proceeding. Applicants also note that PUHCA 2005 states that nothing therein "precludes the Commission or a State commission from exercising its jurisdiction under otherwise applicable law to protect utility customers."[108]

130. In response to protestors' arguments that Applicants should present an analysis of whether the merger will create opportunities for cross-subsidization between regulated and unregulated affiliates within the holding company, Applicants argue that the merger

---

[107] Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005, Order No. 667, FERC Stats. & Regs. ¶ 31,197 (2005).

[108] Applicants' Answer at 31 (*citing* EPAct 2005 § 1269).

should be reviewed under the Commission's existing standard, rather than the standard that will be in effect after February 8, 2006, when EPAct 2005 becomes effective.[109]

D. Commission Determination

131. Applicants have shown that the proposed merger will not adversely affect federal regulation. We note that the transfer is expected to occur after February 8, 2006 – the date on which PUHCA 2005 will replace PUHCA 1935. However, Applicants filed their application for the proposed merger before the date on which PUHCA 2005 was enacted, August 8, 2005, and thus the current section 203 standards apply to the proposed merger.[110] We find that the transfer will not adversely affect federal regulation, because Applicants have committed that, for wholesale ratemaking, they will follow the Commission's policy regarding the pricing of affiliate transactions for non-power goods and services. We reject protesters' arguments that Applicants should present a specific analysis of whether the proposed merger will create opportunities for cross-subsidization. Furthermore, we have found no evidence that the proposed merger will create opportunities for cross-subsidization, and no protestor has raised a credible scenario whereby the merger increases the likelihood of cross-subsidization. In particular, our discussion of the safety net issue above focuses on the merged firm's ability and incentive to engage in cross-subsidization, and concludes that the proposed merger will not create such opportunities because of the regulatory safeguards in place.

132. We deny the Indiana Commission's requests that we place the proceeding on a settlement track and condition our approval of the merger on state regulators retaining their authority regarding mergers that affect rates paid by retail ratepayers. The Indiana Commission raises the concerns that the merger will create a multi-state holding company covering some states where rates are set by competitive forces and other states where they are set by cost-based regulation. As noted by Applicants, PUHCA 2005 is not intended to prevent any state commission from exercising its jurisdiction under otherwise applicable law to protect utility customers. Moreover, Indiana Commission retains jurisdiction over the affiliate transactions with which it is concerned.

---

[109] *Id.* at 34. Applicants argue that the merger application was filed before the enactment of EPAct 2005, despite Santee Cooper's claim that the Application was not complete until after that date.

[110] Section 1289 of EPAct 2005 states that "[t]he amendments made by this section shall not apply to any application under section 203 of the [FPA] that was filed on or before the date of enactment of [PUHCA 2005]." EPAct § 1289(c).

C. Other Issues

1. Protests

133. Public Citizen states that representatives of the Applicants held multiple private meetings with some or all of the Commissioners before the companies' July 12 filing at the Commission and after the companies filed details of the merger with the Securities and Exchange Commission. Public Citizen requests that all participants in any and all of these meetings with the Commissioners—including the Commissioners themselves—testify under oath what was discussed at the meetings, and that this testimony shall be provided as part of the public record of this proceeding.

134. Public Citizen states that it is making this request because Commissioners are required by the Administrative Procedure Act (APA),[111] to record meetings if they have knowledge that the matter will be "noticed for hearing." According to Public Citizen, the Commission should have known that the Duke-Cinergy merger would be "noticed for hearing" because on May 27, 2005, the companies filed a "Stock Purchase Agreement" with the SEC, which provided the public and the Commission notice that the merger was going forward and would have to be filed for approval at the Commission.

135. Public Citizen further contends that Commission rules prohibiting off-the-record communications with "decisional" employees during any "contested on-the-record proceeding," as applied in this case, conflicts with federal law. According to Public Citizen, the Administrative Procedure Act limits the ability of federal agencies to conduct "off-the-record" private meetings: "the prohibitions of this subsection shall apply beginning at such time as the agency may designate, but in no case shall they begin to apply later than the time at which a proceeding is noticed for hearing unless the person responsible for the communication has knowledge that it will be noticed, in which case the prohibitions shall apply beginning at the time of his acquisition of such knowledge."[112]

2. Commission Determination

136. We reject Public Citizen's argument that the Commissioners' pre-filing meetings were in violation of either the Commission's regulations or the APA. First, the

---

[111] 5 U.S.C. § 551 *et seq.* (2000).

[112] 5 U.S.C. § 557(d)(1)(E) (2000).

regulations prohibit off-the-record communications in any "contested on-the-record proceedings."[113] The regulations define a "contested on-the-record proceeding" as "any proceeding before the Commission to which there is a right to intervene and in which an intervenor disputes any material issue …"[114] The regulations prohibit such off-the-record communications in a contested on-the-record proceeding "from the time of filing of an intervention disputing any material fact that is the subject of a proceeding."[115]

137. At the time that employees of the Applicants met with the Commissioners, the Commission's prohibition against off-the-record communications did not apply because there was no proceeding whatsoever, much less a contested on-the-record proceeding, nor were there any parties. As the prohibition against off-the-record communications did not apply at this point, we find that the Commissioners acted according to the rules set forth in the Commission's regulations.

138. Second, we reject Public Citizen's argument that any pre-filing meetings between the Commissioners and Applicants violated the APA because, when the pre-filing meetings occurred, there was no "proceeding", so the pre-filing meeting was not an *ex parte* communication. The APA defines an "*ex parte* communication" as "an oral or written communication not on the public record with respect to which reasonable prior notice to all *parties* is not given."[116] A "party" is "a person or agency named or admitted as a party, or properly seeking and entitled as of right to be admitted as a party, in an agency *proceeding*."[117] Prior to filing, as there was no Commission proceeding, the

---

[113] 18 C.F.R. § 385.2201(a) (2005).

[114] 18 C.F.R. § 385.2201 (c)(1) (2005). In Order No. 607, the final rule implementing the Commission's *ex parte* rules, we noted that "[t]he explicit requirement that the proceeding be "contested" before *ex parte* rules attach reflects the notion that procedural requirements and constraints originally developed to preserve the rights of parties in an adjudication have no place in an administrative proceeding in which there is no "contest" comparable to the controversy in a judicial case." *Regulations Governing Off-the-Record Communications*, Order No. 607, FERC Stats. & Regs. ¶ 31,079 at 30,881, 64 Fed. Reg. 51,222 at 51,230 (1999).

[115] 18 C.F.R. § 385.2201(d)(1)(iv) (2005).

[116] 5 U.S.C. § 551(14) (2000) (emphasis added).

[117] 5 U.S.C. § 551(3) (2000) (Emphasis added).

APA's prohibition on *ex parte* communication could not apply. Public Citizen's protest would effectively read out of the statute the requirement that there be an agency proceeding to which parties are named, admitted, or are entitled as of right to seek admission, and we must therefore reject it as inconsistent with the APA's definition of *ex parte* communication. Furthermore, we note that Public Citizen makes no effort to explain when, in its view of the APA, a "proceeding" begins. Under Public Citizen's view, there is no limit to how early a "proceeding begins.

139. In Order No. 607, we similarly concluded that pre-filing meetings are not *ex parte* communications, as defined by the APA. In the Notice of Proposed Rulemaking underlying that order, the Commission proposed to explicitly provide an exemption for pre-filing meetings.[118] However, we determined in Order No. 607 that no pre-filing exemption was necessary and thus that pre-filing communications were not covered by the APA prohibition on *ex parte* communications "because they take place prior to the filing of an application, and therefore prior to any 'proceeding' at the Commission."[119]

140. Public Citizen cites *Electric Power Supply Association v. FERC*[120] to support its argument that the Commissioners' pre-filing meetings violated the APA. However, *EPSA* dealt with *ex parte* communications related to a specific "pending on-the-record proceeding" and post-filing meetings. The Court indicated in *EPSA* that the overriding concern of section 557 is to ensure that an adequate record exists for purposes of judicial review and that the fairness of the proceedings is above reproach.[121] In the situation at hand, there was no "pending on-the-record proceeding" because no application had yet been filed. Therefore, the APA was not violated.

---

[118] *Regulations Governing Off-the-Record Communications*, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,534 at 33,506-07 (1998) ("pre-filing communications are often useful in educating applicants as to the appropriate format, content, and form that an application or other filing should take. Such consultations can therefore improve the chances that filings, once made, will be ready for evaluation on the merits.").

[119] Order No. 607 at 30,879.

[120] Electric Power Supply Association v. FERC, 391 F.3d 1255 (2004) (EPSA).

[121] *EPSA*, 391 F.3d at 1266 (2004).

141. Finally, we note that the current proceeding is not the proper venue for Public Citizen to challenge the validity of the Commission's regulations; its arguments are, in fact, a collateral attack on those regulations. We will not ignore our regulations because a party to a specific case argues that the regulations are invalid. If Public Citizen believes that the Commission should amend its regulations, Public Citizen should submit a petition for rulemaking setting forth the changes it believes are necessary.[122]

The Commission orders:

(A) Applicants' proposed merger is authorized, as 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 now pending or which may come before the Commission.

(C) 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.

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

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

(F) If the Proposed Acquisition result in changes in the status or the upstream ownership of Applicants' affiliated qualifying facilities, if any, an appropriate filing for recertification pursuant to 18 C.F.R. § 292.207 shall be made.

(G) The Applicants shall submit their proposed final accounting on the merger within six months of the consummation of the merger as more fully discussed in the body of this order. The Applicants shall account for the transfer of the generation assets in

[122] 18 C.F.R. § 385.207(a)(4) (2005).

accordance with Electric Plant Instruction No. 5 and Account 102, Electric Plant Purchased or Sold, of the Uniform System of Accounts as more fully discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.