

137 FERC ¶ 61,210
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
and Cheryl A. LaFleur.

Duke Energy Corporation
Progress Energy, Inc.

Docket No. EC11-60-001

ORDER REJECTING COMPLIANCE FILING

(Issued December 14, 2011)

1. On October 17, 2011, Duke Energy Corporation (Duke Energy) and Progress Energy, Inc. (Progress Energy) (together, with their public utility subsidiaries, Applicants) filed a compliance filing¹ in accordance with the Commission's September 30, 2011 order conditionally accepting Applicants' proposed merger transaction.² This order rejects the October 17 Compliance Filing.

I. Background

2. On April 4, 2011, pursuant to sections 203(a)(1) and 203(a)(2) of the Federal Power Act (FPA)³ and Part 33 of the Commission's regulations,⁴ Applicants filed an application (Merger Application) for the approval of a transaction pursuant to which Progress Energy would become a wholly-owned subsidiary of Duke Energy and the

¹ *Compliance Filing of Duke Energy Corporation and Progress Energy, Inc.*, Docket No. EC11-60-001 (October 17, 2011) (October 17 Compliance Filing).

² *Duke Energy Corp.*, 136 FERC ¶ 61,245 (2011) (Merger Order), *rehearing pending*.

³ 16 U.S.C. § 824b(a)(1) and (a)(2) (2006).

⁴ 18 C.F.R. § 33, *et seq.* (2011).

former shareholders of Progress Energy would become shareholders of Duke Energy (Proposed Transaction).⁵

3. Subsequent to the filing of the Merger Application, the Director of the Division of Electric Power Regulation-West issued a request for additional information from Applicants.⁶ In the Request for Additional Information, Applicants were directed to provide additional analyses and information which was not provided in the Merger Application.⁷ Among other things, the Request for Additional Information directed Applicants to provide price sensitivity analyses for the Duke Energy Carolinas, Progress Energy Carolinas-East, and Progress Energy Carolinas-West Balancing Authority Areas (BAA)⁸ under two different scenarios – a 10 percent price increase and a 10 percent price decrease. Applicants were also instructed to produce a set of prices based on EQR data, and, using those prices, conduct a DPT of the base case and two price sensitivities (a 10 percent price increase and a 10 percent decrease) for the three BAAs. In response to the Request for Additional Information, Applicants submitted a DPT based on EQR data (August 29 DPT) as directed.⁹ Although the August 29 DPT differs from the Merger Application DPT with respect to the source of the forecasted 2012 prices, Applicants adjusted both the system lambda and EQR prices used in the Merger Application and August 29 DPTs, respectively, by a common natural gas price forecast.

⁵ *Application for Authorization of Disposition of Jurisdictional Assets and Merger under Sections 203(a)(1) and 203(a)(2) of the Federal Power Act*, Docket No. EC11-60-000 (Apr. 4, 2011) (Merger Application).

⁶ Request for Additional Information, Docket No. EC11-60-000 (Aug. 22, 2011) (Request for Additional Information).

⁷ As noted in the Merger Order, Applicants did not provide a Delivered Price Test (DPT) based on prices derived from Electric Quarterly Reports (EQR) data with the Merger Application. The DPT submitted with the Merger Application was based on system lambda price proxies (Merger Application DPT). Merger Order, 136 FERC ¶ 61,245 at P 47. DPTs are used to determine the pre- and post-transaction market shares from which the market concentration or Herfindahl-Hirschman Index (HHI) change can be calculated.

⁸ As explained in the Merger Order, Applicants focused their analysis on these BAAs. *See* Merger Order, 136 FERC ¶ 61,245 at P 37.

⁹ Answer of Duke Energy Corporation and Progress Energy, Inc. to Request for Additional Information, Docket No. EC11-60-000 (Aug. 29, 2011, corrected Aug. 30, 2011) (Applicants August 29 Answer).

4. The Commission reviewed the Merger Application pursuant to the Commission's Merger Policy Statement¹⁰ and found that, in the absence of appropriate mitigation, the Proposed Transaction could be expected to result in adverse effects on competition in both the Duke Energy Carolinas and the Progress Energy Carolinas-East BAAs.¹¹ The Commission thus conditionally authorized the Proposed Transaction subject to Commission approval of market power mitigation measures. The Commission explained that these mitigation measures could include, but were not limited to: "joining or forming a [Regional Transmission Organization (RTO)], implementation of an independent coordinator of transmission (ICT) arrangement, generation divestiture, virtual divestiture, and proposals to build new transmission to provide greater access to third party suppliers."¹² The Commission stated that if Applicants wished to proceed with the Proposed Transaction, they were directed to make a compliance filing within 60 days of the Merger Order proposing mitigation that would be sufficient to remedy the screen failures discussed in the Merger Order.¹³ The Commission explained that after providing an opportunity for comments from interested parties, it would issue a subsequent order indicating whether the proposed mitigation is sufficient.¹⁴

¹⁰ See *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) (Merger Policy Statement). See also *FPA Section 203 Supplemental Policy Statement*, 72 Fed. Reg. 42,277 (Aug. 2, 2007), FERC Stats. & Regs. ¶ 31,253 (2007) (Supplemental Policy Statement). See also *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 94 FERC ¶ 61,289 (2001). See also *Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006).

¹¹ Merger Order, 136 FERC ¶ 61,245 at P 1.

¹² *Id.* at P 146.

¹³ *Id.* at P 145.

¹⁴ *Id.*

5. As discussed in further detail below, the October 17 Compliance Filing contains Applicants' proposal for mitigating the screen failures identified by the Commission in the Merger Order.¹⁵

II. Notice of Filing and Responsive Pleadings

6. Notice of the October 17 Compliance Filing was published in the *Federal Register*, 76 Fed. Reg. 66,284 (2011), with comments due on or before November 16, 2011.

7. Amsterdam Generating Company, LLC (Amsterdam Generating) filed a motion to intervene in Docket No. EC11-60-001.

8. The Electric Power Supply Association (EPSA) filed comments on the Mitigation Proposal, as did the City of Orangeburg, South Carolina (City of Orangeburg), the North Carolina Electric Membership Corporation (NCEMC), the Carolinas EMCs,¹⁶ and Public Staff-North Carolina Utilities Commission (NCUC Public Staff). The North Carolina Eastern Municipal Power Agency (NCEMPA) filed a motion for leave to submit comments out-of-time and comments. The Cities of New Bern and Rocky Mount, North Carolina (City of New Bern), and the Florida Municipal Power Agency (FMPA) filed protests.

9. On November 22, 2011, Applicants filed an answer to the protests of the Mitigation Proposal.

10. On December 2, 2011, FMPA filed an answer to Applicants' answer to the protests of the compliance filing. On December 7, 2011, City of New Bern also filed an answer to Applicants' answer.

III. Discussion

A. Procedural Matters

11. Pursuant to Rule 214(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214(d) (2011), we will grant Amsterdam Generating's motion to

¹⁵ Applicants' proposed mitigation is referred to in this order as the Mitigation Proposal.

¹⁶ The Carolina EMCs consist of Blue Ridge Electric Membership Corporation, Rutherford Electric Membership Corporation, Piedmont Electric Membership Corporation, and Haywood Electric Membership Corporation.

intervene in the compliance proceeding in Docket No. EC11-60-001 given its interest in the proceeding, the early stage of the proceeding, and the absence of undue prejudice or delay. However, that intervention is limited to the compliance subdocket and all future subdockets and does not provide party status with respect to the root docket.¹⁷

12. Although NCEMPA's comments were submitted late, in light of the lack of prejudice to other parties we accept the late-filed comments.

13. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 395.213(a)(2), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Applicants' answer and the other answers because they have provided information that assisted us in our decision-making process.

B. The October 17 Compliance Filing

1. Overview of the Mitigation Proposal

14. Applicants state that the Mitigation Proposal adopts the virtual divestiture option suggested by the Commission in the Merger Order. According to Applicants, the proposed mitigation "consists of a 'must offer' obligation for Applicants to sell specific quantities of energy at cost-based rates to entities that serve load, directly or indirectly," in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs.¹⁸ Applicants contend that the product offered to be sold, referred to as AEC Energy, replicates the Available Economic Capacity (AEC) product analyzed by the Commission in the August 29 DPT and will be offered to be sold pursuant to Applicants' existing cost-based tariffs and under standard and reasonable terms for sales of this type of product.¹⁹ Applicants explain that they are proposing virtual divestiture rather than physical generation divestiture because they do not have AEC in all time periods, and divesting a unit that is needed to serve native load in some time periods would result in an

¹⁷ See, e.g., *PJM Interconnection, L.L.C.*, 134 FERC ¶ 61,048, at P 6 (2011).

¹⁸ October 17 Compliance Filing at 3.

¹⁹ *Id.*. Applicants appear to define AEC Energy as "available generation not used to serve retail and wholesale native load or existing (as of the date the merger closes) firm obligations, including operating reserves." October 17 Compliance Filing, Exhibit A, Term Sheet for Virtual Divestiture at 11.

unwarranted increase in the cost of serving retail and wholesale native load customers in those periods.²⁰

15. Applicants propose that the must offer obligation apply in the Duke Energy Carolinas BAA in the summer and winter seasons, and in the Progress Energy Carolinas-East BAA in the summer season.²¹ In the Duke Energy Carolinas BAA, Applicants will offer 300 MWh of AEC Energy in each hour in the summer, and 225 MWh of AEC Energy in each hour in the winter. In the Progress Energy Carolinas-East BAA, Applicants will make 500 MWh of AEC Energy available for sale in each hour in the summer.²² Applicants state that the only limit on the obligation to offer AEC Energy is that Applicants must “have generation resources available and not needed to serve retail and wholesale native load or existing (as of the date the merger closes) firm sales (including operating reserves).”²³ Applicants explain that when no such generation resources are available, they will not have any AEC and thus will have no ability or incentive to exercise market power in the [AEC] market.²⁴

16. Applicants propose that the obligation to offer AEC Energy last for a term of eight years. According to Applicants, the Commission has held that long-term capacity markets are competitive, and an eight-year term provides more than adequate time for new entry, the time it would take for a number of different types of competing generation capacity to be planned, sited, receive regulatory approval and installed.²⁵ Applicants’

²⁰ October 17 Compliance Filing at 2.

²¹ Applicants note that the obligation to offer AEC Energy will apply for the entirety of these seasons, even though the Commission found screen failures in only certain load conditions within those seasons. October 17 Compliance Filing at 3. No offers would be required in either the Duke Energy Carolinas or Progress Energy Carolinas-East BAAs in the shoulder (fall and spring) seasons or in the Progress Energy Carolinas-East BAA in the winter season since the Commission found no screen failures in those seasons. Similarly, the Mitigation Proposal would not extend to the Progress Energy Carolinas-West BAA because the Commission found no screen violations in that BAA.

²² October 17 Compliance Filing at 4.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.* at 7.

witness asserts that: “[e]ight years is a more than ample period for siting and building any of the types of power plants likely to be built by or for Applicants’ wholesale customers under current market power conditions (i.e. gas-fired power plants or renewable resources).”²⁶

17. Applicants explain that AEC Energy will be offered on a day-ahead basis, and they will be obligated to commit generation units if necessary to satisfy requests for AEC Energy, with the associated start-up and related costs included in the incremental costs to be recovered. If more offers to purchase AEC Energy are made than there is energy available under the must offer commitment, the AEC Energy will be allocated among all purchasers on a *pro rata* basis.²⁷ Applicants will deliver the amount of energy purchased during the offer process subject to interruption only if necessary for Applicants to comply with their reliability obligations.²⁸

18. Eligible purchasers of AEC Energy will be limited to entities ultimately serving load located in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs, and the energy purchased must sink in the Duke Energy Carolinas and/or Progress Energy Carolinas-East BAAs.²⁹ Applicants contend that the entities eligible to purchase AEC Energy are the entities that would be affected by any exercise of market power in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs, and constitute the class of customers that the mitigation is designed to protect. Finally, Applicants state that the energy purchased may not be used to replace less costly resources that are sold outside of the applicable BAA.³⁰

²⁶ October 17 Compliance Filing, Exhibit B, Affidavit of William H. Hieronymus (Hieronymus Aff.) at P 26.

²⁷ October 17 Compliance filing at 5.

²⁸ *Id.*

²⁹ *Id.*

³⁰ October 17 Compliance Filing at 6. We note that Exhibit A of the October 17 Compliance Filing, Term Sheet for Virtual Divestiture, states that the energy purchased “may not be used to replace resources that are sold outside of the applicable BAA.” October 17 Compliance Filing, Exhibit A, Term Sheet for Virtual Divestiture at 11. Applicants explain that “Exhibit A is a term sheet for the sale of Available Economic Capacity that constitutes Applicants’ virtual divestiture proposal.” October 17 Compliance Filing at 2.

19. With respect to the nature of the proposed must offer obligation, Applicants explain that while they have an obligation to offer the product, there is no corresponding obligation for any entity to purchase any specific amount of energy. Further, if the full amount of AEC Energy offered at the cost-based prices is not purchased in a particular hour, Applicants can offer to sell the unsold amount to other parties either inside or outside of Applicants' BAAs, consistent with their applicable tariffs.³¹

20. Applicants state that the price at which AEC Energy must be offered is the "forecasted average incremental cost (after serving retail and wholesale native load and existing (as of the date the merger closes) firm obligations) of [Applicants] plus [ten percent]."³² The price will be established on a day-ahead basis based on the amount and hours of energy actually purchased during the offer process. Applicants state that this price appropriately reflects the cost of the AEC Energy product that is analyzed under the Commission's merger regulations and is the appropriate price for virtually divesting AEC as required by the Commission.³³

21. Applicants propose to engage an independent monitoring entity to ensure that they are in compliance with the Mitigation Proposal. According to Applicants, each day they will provide the independent monitoring entity "with the information regarding the AEC Energy offered and sold the previous day, including all requests to purchase AEC Energy, the calculations of available generation capacity, and the calculations of the price at which the AEC Energy was sold."³⁴ Applicants state that, to the extent the independent monitoring entity believes that Applicants are not in compliance with their commitment, it would inform Applicants and make a filing with the Commission explaining its reasons for arriving at this conclusion. Applicants explain that while they have not yet selected the independent monitoring entity, they anticipate selecting an entity that already performs similar functions in the electric utility industry. Applicants commit to making an informational filing with the Commission prior to the first offer under the Mitigation Proposal that would identify the independent monitoring entity and

³¹ October 17 Compliance Filing at 4.

³² *Id.* at 5.

³³ Applicants also note that this offer price is consistent with their respective cost-based tariffs. *Id.*

³⁴ *Id.* at 6.

confirm that it is in place and able to perform its functions as of the date the Mitigation Proposal takes effect.³⁵

22. Finally, Applicants state that they may file at the Commission in the future to reduce the must offer obligation by the amount of any increase in import capability resulting from new transmission constructed into the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs beyond what has currently been planned. Applicants state that the Commission would be able to evaluate the proposal at that time, and, to the extent that it agrees with Applicants' analysis, authorize a reduction in Applicants' must offer obligation equal to the amount of new imports that will become available in the BAA.³⁶ Applicants note that, in the Merger Order, the Commission found that transmission expansion would constitute acceptable mitigation, and this component of the Mitigation Proposal would substitute one form of acceptable mitigation for another.

2. Applicants' Analysis of the Mitigation Proposal

23. Applicants claim that the Mitigation Proposal fully mitigates the screen failures identified in the Merger Order.³⁷ Applicants explain that "by obligating themselves to sell AEC Energy in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs [they] are tailoring their proposal to the exact market power concern identified by the Commission."³⁸ According to Applicants, the must offer obligation will ensure that AEC Energy will be made available in the relevant BAAs, and that Applicants cannot economically or physically withhold such capacity from the market in order to raise prices. Applicants also contend that the amount of AEC Energy they propose to offer for sale pursuant to the Mitigation Proposal will be adequate to mitigate the screen failures

³⁵ *Id.* at 6.

³⁶ October 17 Compliance Filing at 7. We note that the October 17 Compliance Filing, Exhibit A, Term Sheet for Virtual Divestiture, states: "FERC will review any such filing and approve the reduction in [Applicants'] must offer obligation equal to the increase in import capability resulting from the transmission expansion." *Id.*, Exhibit A, Term Sheet for Virtual Divestiture at 12.

³⁷ October 17 Compliance Filing at 7.

³⁸ *Id.* at 7-8.

identified in the Merger Order.³⁹ Applicants present new HHI values that they claim demonstrate that the Mitigation Proposal completely mitigates the screen failures identified in the Merger Order, under the base case and the 10 percent price increase and decrease sensitivity analyses.⁴⁰ As discussed in further detail below, these HHI values are predicated on the assumption that all of the AEC Energy offered by Applicants is sold in equal amounts to two new buyers.

24. According to Applicants' witness, the AEC Energy product offered by Applicants represents an appropriate form of mitigation because: (1) Applicants have ensured that there will be AEC Energy deliverable into the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs in an amount that fully mitigates the concerns identified in the Merger Order; (2) potential purchasers of AEC Energy have access to power under conditions that are more favorable than either if the Proposed Transaction had not occurred or if actual, rather than virtual, divestiture were used for mitigation; and (3) the pricing of the AEC Energy is favorable to purchasers and represents the lowest cost of Applicants' available capacity that matches the product definition of AEC established by the Commission.⁴¹ Applicants conclude that the analysis performed by their witness demonstrates that the Mitigation Proposal fully satisfies the requirements of the Merger Order.⁴²

C. Comments and Protests

25. In its comments, NCEMC expresses support for the Mitigation Proposal on the basis that the proposal satisfies the Merger Order's requirements.⁴³ According to NCEMC, it is appropriate to limit the purchasers of the energy to be sold by Applicants to those entities that ultimately serve load located in the Carolinas.⁴⁴ NCEMC states that

³⁹ Applicants state that they "recalculated" the Competitive Analysis Screen results for the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs, "taking into account the Mitigation Proposal." *Id.* at 8.

⁴⁰ October 17 Compliance Filing at 8-9 (including Tables 1 and 2).

⁴¹ *Id.* at 9. *See also* October 17 Compliance Filing, Exhibit B, Hieronymus Aff.

⁴² October 17 Compliance Filing at 10.

⁴³ *Comments in Support of Compliance filing of North Carolina Electric Membership Corporation* at 2, Docket No. EC11-60-000, EC11-60-001, EC11-60-002 (Nov. 16, 2011) (NCEMC Comments).

⁴⁴ NCEMC Comments at 1-2.

in addition to complying with the Merger Order, the Mitigation Proposal is preferable to other mitigation measures suggested by the Commission in the Merger Order. In particular, NCEMC explains that requiring unilaterally-determined transmission upgrades could have a disruptive effect on Duke Energy and Progress Energy's Order No. 890-compliant local and regional transmission process, the North Carolina Transmission Collaborative. NCEMC states that while it supports investment in new, cost-effective transmission infrastructure, any new transmission that might stem from the Proposed Transaction should proceed through the North Carolina Transmission Collaborative.⁴⁵

26. The Carolina EMCs also support the Mitigation Proposal, based on the customer benefits of the Proposed Transaction and Applicants' hold harmless commitment.⁴⁶ According to the Carolina EMCs, the Mitigation Proposal satisfies the requirements of the Merger Order and is also designed in a way that maintains the benefits noted in the Merger Application.⁴⁷

27. NCUC Public Staff also requests that the Commission accept the Mitigation Proposal. According to NCUC Public Staff, the Mitigation Proposal cures the screen failures identified in the Merger Order, and the must offer nature of the proposal removes Applicants' ability to withhold capacity, either physically or economically, in order to raise prices.⁴⁸ NCUC Public Staff also notes that the Mitigation Proposal preserves the benefits of the Proposed Transaction. NCUC Public Staff contends that more stringent mitigation would increase costs without sufficient offsetting benefits, and, as a result, would not be in the public interest.

28. NCUC Public Staff explains that North Carolina has retained a traditional electric industry structure and thus Applicants are vertically integrated (they own generation,

⁴⁵ NCEMC Comments at 3.

⁴⁶ *Comments of Blue Ridge Electric Membership Corporation, Rutherford Electric Membership Corporation, Piedmont Electric Membership Corporation and Haywood Electric Membership Corporation to the October 17, 2011 Duke Energy Corporation and Progress Energy, Inc. Compliance Filing* at 3, Docket No. EC11-60-001 (Nov. 16, 2011) (Carolina EMCs Comments).

⁴⁷ Carolina EMCs Comments at 4.

⁴⁸ *Comments of the Public Staff of the North Carolina Utilities Commission* at 5, Docket Nos. EC11-60-000, EC11-60-001 (Nov. 16, 2011) (NCUC Public Staff Comments).

transmission and distribution resources), and have exclusive retail franchises and an obligation to serve retail load under North Carolina law.⁴⁹ With respect to wholesale customers, NCUC Public Staff states that “virtually all of the wholesale customers located within [Progress Energy Carolinas’] BAA are served by [Progress Energy Carolinas] under long-term, native load priority contracts at average system rates, and the bulk of that load is served pursuant to contracts that extend out [10] to 20 years.”⁵⁰ According to NCUC Public Staff, the service provided by Duke Energy Carolinas to the wholesale customers located in its BAA is similar to the service provided by Progress Energy Carolinas.

29. NCUC Public Staff contends that the other types of mitigation the Commission suggested in the Merger Order are not feasible. With respect to physical, or actual, divestiture, NCUC Public Staff states that neither Duke Energy Carolinas nor Progress Energy Carolinas have AEC in all time periods, and both companies have a well-documented need to add capacity in the future.⁵¹ Physical divestiture would harm both wholesale and retail native load customers by reducing reliability of service and increasing those customers’ costs. NCUC Public Staff also represents that an ICT arrangement would increase costs without providing corresponding benefits.⁵² Regarding participation in an RTO, NCUC Public Staff argues that the decision to participate in an RTO is voluntary and, pursuant to state law, North Carolina would have to approve such participation. NCUC Public Staff urges the Commission not to require participation in an RTO as a condition to the Proposed Transaction because neither Duke Energy Carolinas’ nor Progress Energy Carolinas’ retail customers would benefit from those companies’ participation in an RTO. According to NCUC Public Staff, the Mitigation Proposal will not permit Applicants to take advantage of any increase in market power for the vast majority of their wholesale sales, but requiring virtual

⁴⁹ NCUC Public Staff Comments at 5-6.

⁵⁰ NCUC Public Staff Comments at 6. NCUC Public Staff notes that to the extent Progress Energy Carolinas’ customers own generation, it serves those customers mainly through partial requirements contracts; other wholesale customers are served primarily through full requirements contracts. *Id.* at n.5. NCUC Public Staff also notes that NCEMPA, which is contractually bound to make power supply decisions for its members (which include the Cities of New Bern and Rocky Mount, North Carolina), recently signed a power supply agreement with Progress Energy Carolinas that will, after expiration of their current contractual arrangement, continue until December 31, 2031.

⁵¹ *Id.* at 7.

⁵² *Id.*

divestiture on more onerous terms or mandating any of the other mitigation measures mentioned in the Merger Order will harm the wholesale customers the Commission is charged with protecting.⁵³

30. NCUC Public Staff also makes two recommendations with respect to the proposed independent monitoring entity. First, so that the Commission and the public are informed about Applicants' post-merger compliance, NCUC Public Staff recommends that the Commission require the independent monitoring entity to file status reports with the Commission on an ongoing, periodic basis for as long as the Mitigation Proposal remains in place. Second, NCUC Public Staff recommends that the independent monitoring entity be required to conduct its activities at arm's length from Applicants, so that the monitor's independence will be assured.⁵⁴

31. NCEMPA reiterates its support for the Merger Application, as modified by the Mitigation Proposal.⁵⁵ NCEMPA asserts that the Mitigation Proposal satisfies the directives in the Merger Order, and is preferable to other forms of mitigation suggested in that order. NCEMPA claims that other potential mitigation would likely increase the cost of the services NCEMPA purchases from Progress Energy Carolinas, which would in turn increase the cost of the services that NCEMPA provides to the members it serves.⁵⁶ NCEMPA also argues that other proposed mitigation measures would likely impair the merger-related benefits that are anticipated to accrue to Applicants' customers.

32. EPSA argues that the Commission should reject the Mitigation Proposal because it is vague, insufficient, likely ineffective, and fails to address adequately the market power concerns expressed in the Merger Order. According to EPSA, the Mitigation Proposal is an ineffective remedy because there are opportunities for the AEC Energy that Applicants

⁵³ *Id.* at 7-8.

⁵⁴ NCUC Public Staff Comments at 9.

⁵⁵ *Motion for Leave to Submit Comments Out of Time, and Comments on Applicants' Market Power Mitigation Proposal by North Carolina Eastern Municipal Power Agency* at 2, Docket No. EC11-60-001 (Nov. 21, 2011) (NCEMPA Comments).

⁵⁶ NCEMPA notes that it recently entered into a supplemental power services agreement with Progress Energy Carolinas. NCEMPA Comments at 2. NCEMPA explains that this agreement will begin when its current supplemental power services agreement with Progress Energy Carolinas ends on December 31, 2017, and will continue until December 31, 2031. NCEMPA note that this agreement has been filed with the Commission and is pending in Docket No. ER12-355-000. NCEMPA Comments at n.2.

propose to offer for sale to remain in Applicants' control. EPSA explains that the Mitigation Proposal provides no assurance that Applicants will, in fact, sell the energy, and that if they do not, Applicants will be free to sell that energy at market-based rates to any buyer. EPSA argues that, "[g]iven the very limited pool of buyers to whom [Applicants] would make AEC Energy available," it is implausible that Applicants will sell enough AEC Energy to ensure that the Mitigation Proposal succeeds.⁵⁷ EPSA contends that Applicants' failure to relinquish dispatch control of the AEC Energy is the Mitigation Proposal's greatest flaw. EPSA also challenges the Mitigation Proposal on the basis that the must offer obligation is interruptible only if necessary for Applicants to comply with their reliability obligations, but that the Mitigation Proposal provides no specific details about what constitutes a reliability obligation.⁵⁸

33. EPSA also argues that the independent monitoring plan proposed by Applicants is vague. EPSA faults Applicants for not specifying any date by which the merged entity will provide the Commission with further details regarding the independent monitoring entity, and for failing to provide specific details regarding the monitoring arrangement.⁵⁹ EPSA contends that the Commission cannot and should not approve the Mitigation Proposal without obtaining details of the monitoring arrangement so that the arrangement can be assessed and approved. EPSA states that market participants and other stakeholders should have a full opportunity to review and comment on the plan. According to EPSA, the monitoring arrangement is as important as the details of the must offer obligation under the Mitigation Proposal.

34. EPSA concludes that, rather than accepting the Mitigation Proposal, the Commission should reject it or set the Mitigation Proposal for hearing to explore what modifications could mitigate the problems posed by the Proposed Transaction. Further, EPSA suggests that if Applicants truly desire an expeditious resolution, they could join an RTO, which, according to EPSA, is the most efficient and timely solution, and the most concrete way to satisfy the Commission's concerns.⁶⁰

⁵⁷ *Comments of the Electric Power Supply Association* at 4, Docket No. EC11-60-000 (Nov. 16, 2011) (EPSA Comments).

⁵⁸ EPSA Comments at 5.

⁵⁹ *Id.* at 6.

⁶⁰ *Id.* at 10.

35. City of Orangeburg protests the Mitigation Proposal because it does not address the issues and concerns that the city has raised in this proceeding.⁶¹ First, City of Orangeburg argues that the Mitigation Proposal consists of a “must offer obligation with respect to short-term, interruptible power,” but City of Orangeburg’s concerns relate to the availability of “long-term power requirements service.”⁶² Second, City of Orangeburg contends that, because the Mitigation Proposal would have a term of eight years, the Mitigation Proposal will not affect, in the longer-term, the supply options of entities like City of Orangeburg. Third, City of Orangeburg notes that the must offer obligation will only apply in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs and will not improve the situation of entities that are, like it, located outside of these areas. Finally, City of Orangeburg states that the Mitigation Proposal does not remove the discrimination caused by the favored and disfavored categories of customers created by the native/non-native customer distinction. City of Orangeburg concludes by reiterating that the Proposed Transaction will not be consistent with the public interest absent proper conditioning by the Commission.

36. City of New Bern protests the Mitigation Proposal on the basis that it fails entirely to comply with the mitigation requirements established in the Merger Order.⁶³ City of New Bern argues that, because Applicants will retain operational control over all of their generating assets at all times under the Mitigation Proposal, Applicants will be fully able to use their post-merger control of assets to foreclose competition and control prices in the markets where concentration levels will reach unacceptably high levels after consummation of the Proposed Transaction.⁶⁴ According to City of New Bern, by Applicants retaining operational control of their assets, the Mitigation Proposal fails to provide any prospect of genuine mitigation. City of New Bern claims that instead of virtually divesting limited high cost energy through very short term day-ahead sales only

⁶¹ *Comments of the City of Orangeburg, South Carolina* at 3, Docket No. EC11-60-001 (Nov. 16, 2011) (City of Orangeburg Comments). City of Orangeburg claims that it has demonstrated, in pleadings filed previously in this proceeding, that the Proposed Transaction will interfere with the Commission’s jurisdiction, result in undue discrimination in wholesale power sales, and impede competition in wholesale power markets in the Carolinas. *Id.* at 1.

⁶² City of Orangeburg Comments at 2-3.

⁶³ *Protest of the Cities of New Bern and Rocky Mount, North Carolina Concerning Applicants’ Mitigation Compliance Filing* at 1, Docket No. EC11-60-001 (Nov. 16, 2011) (City of New Bern Protest).

⁶⁴ City of New Bern Protest at 2.

in a few months and on very restrictive terms, certain “crown jewel” assets that would support viable and effective competition in the markets affected by the proposed merger would have to be divested in order to resolve the market power problems created by the Proposal Transaction.⁶⁵

37. City of New Bern also argues that because Applicants retain operational control of their assets, the proposal to engage an independent monitoring entity accomplishes nothing of value.⁶⁶ City of New Bern notes that the Commission has previously rejected post-merger updates or filing requirements which are designed to ensure the adequacy of applicants’ commitments, implying that the future informational filing Applicants commit to make is not an acceptable substitute for establishing the terms of monitoring prior to the consummation of the Proposed Transaction. According to City of New Bern, the Commission must ensure with as much certainty as possible that proposed transactions, once consummated, will continue to be consistent with the public interest.⁶⁷ City of New Bern concludes that, if Applicants must retain the ability to use capacity to serve wholesale and retail native load customers but still wish to consummate the Proposed Transaction, they should select a different mitigation strategy rather than “advocate one that is wholly ineffective and inconsistent with the most basic criteria for effective remediation of merger-related increases in market concentration.”⁶⁸

38. City of New Bern challenges Applicants’ analysis of the Mitigation Proposal, arguing that it depends on unstated and unexplained assumptions that two new competitors will emerge in each mitigated market and that each of these two new market entrants will purchase and resell half of the AEC Energy in competition with the merged entity.⁶⁹ City of New Bern contends that this assumption is flatly implausible.⁷⁰ City of New Bern explains that the AEC Energy could, for example, be sold to an already existing market participant. City of New Bern states that it tested this alternative assumption and found that if the AEC Energy Applicants propose to offer for sale is sold

⁶⁵ City of New Bern Protest, Second Affidavit of John W. Wilson (Second Wilson Aff.) at P 7-8.

⁶⁶ City of New Bern Protest at 8.

⁶⁷ *Id.* at 8.

⁶⁸ *Id.* at 8.

⁶⁹ *Id.* at 7.

⁷⁰ *Id.*

to the next largest assumed seller in the market, the HHI levels would remain above the thresholds identified in the Merger Order.⁷¹

39. City of New Bern argues that the Mitigation Proposal itself effectively acts as a form of economic withholding. According to City of New Bern, to the extent that Applicants do not sell the AEC Energy at the proposed system incremental cost plus 10 percent price, Applicants may sell any unsold AEC Energy into any market outside of the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs. City of New Bern notes that Applicants are not subject to cost-based price caps in markets outside of these two BAAs, and that the ability to sell any unsold AEC Energy at market-based rates essentially turns the ceiling on their cost-based tariffs into a floor price for AEC Energy.⁷² City of New Bern contends that, in effect, the AEC Energy would be withheld from the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs at any price below hourly system incremental cost (as determined by Applicants) plus 10 percent.

40. City of New Bern also challenges Applicants' proposed eight-year sunset date for the Mitigation Proposal. According to City of New Bern, Applicants' rationale for the eight-year term, namely, that the Commission has found on a number of occasions that long-term markets are competitive in the absence of barriers to entry, is based on a misunderstanding of the Commission's current policy on this issue. City of New Bern explains that under contemporary Commission policy, mitigated sellers may demonstrate, on a case-by-case basis, that market power did not play a role in the formation of price in a long-term contract, but that the Commission has disclaimed reliance on an "academic hypothesis of entry without regard to the justness and reasonableness of rates."⁷³ City of New Bern believes that the latter point could become important if Applicants present another mitigation proposal, given Applicants' pre- and post-merger market dominance, the absence of retail competition, and the operating characteristics of the eastern North Carolina transmission system, all of which do, or could, present barriers to entry. City of New Bern also protests the eight-year term for the Mitigation Proposal on the basis that Applicants provide no empirical support for the period chosen.⁷⁴

⁷¹ *Id.* See also, City of New Bern Protest, Second Wilson Aff. at P 17.

⁷² City of New Bern Protest at 9.

⁷³ *Id.* at 11 (quoting *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services*, Order No. 697-A, FERC Stats. & Regs. ¶ 31,268, at P 283 (2008)).

⁷⁴ *Id.*

41. FMPA also protests the Mitigation Proposal, arguing that it restricts sales in interstate markets contrary to established constitutional and antitrust principles.⁷⁵ FMPA explains that the prohibition on reselling AEC Energy outside of the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs must be removed because the divested power must be available for sale to Florida. FMPA states that, by restricting AEC Energy sales, the Mitigation Proposal would unlawfully divide wholesale markets and “create a system in which [Applicants’] North Carolina power would be reserved for Carolina markets, barring sales to Florida or any other state unless the power is excess to Carolina markets.”⁷⁶ FMPA suggests that if this “balkanization” of power markets is permitted, other states will follow North Carolina’s lead and prohibit or limit wholesale power sales.⁷⁷ According to FMPA, in addition to violating the Commerce Clause,⁷⁸ the Mitigation Proposal violates the Federal Power Act, which gives the Commission jurisdiction over wholesale sales, and violates antitrust principles regarding sales restrictions, territorial restrictions, and resale limitations.⁷⁹ FMPA argues that, if the Commission does not reject the Proposed Transaction, it must adopt conditions that will correct market concentration and protect the public from the harms that would result from the Proposed Transaction.⁸⁰ FMPA states that, at the very least, the Mitigation Proposal should be revised to permit unrestricted sales into Florida.

42. Finally, FMPA contends that the Mitigation Proposal demonstrates why the Proposed Transaction cannot be authorized without corrective conditions, including an investigation of Florida market conditions. FMPA explains that because Applicants propose to sell power from the Carolinas BAAs on a daily basis, but only in the specific

⁷⁵ *FMPA Protest of the Duke-Progress October 17, 2011 Compliance Filing* at 3, Docket No. EC11-60-001 (Nov. 16, 2011) (FMPA Protest). FMPA notes that it included arguments relating to the Mitigation Proposal in its request for rehearing, but repeats its analysis in the FMPA Protest for “the convenience of the Commission and parties.” *Id.* at 1. *See also FMPA Request for Rehearing of the Commission’s Order on Disposition of Jurisdictional Facilities and Merger Conditionally Approving a Duke Energy - Progress Energy Merger* at 42-44, Docket No. EC11-60-000 (Oct. 31, 2011).

⁷⁶ FMPA Protest at 5.

⁷⁷ *Id.*

⁷⁸ *Id.* at 6 (*citing* U.S. Const. art. I, § 8, cl. 3).

⁷⁹ *Id.* at 5-6.

⁸⁰ *Id.* at 3.

seasons and areas of market screen failures, and the power Applicants propose to sell would be of inferior quality and price than power that serves Duke Energy's current local North Carolina retail and wholesale loads, the Mitigation Proposal will not cure Carolina market power concerns. FMPA objects because the proffered sales cannot be used to meet firm power needs.⁸¹

D. Applicants' Answer to the Protests of the Mitigation Proposal and Responsive Pleadings

43. In their answer to the protests of the Mitigation Proposal, Applicants claim that none of the protests provide any basis for the Commission to find that the Mitigation Proposal will not fully mitigate the market power issues identified by the Commission in the Merger Order.⁸² According to Applicants, it is important for the Commission to note that all of the comments submitted by parties who purchase wholesale power directly from them in the Duke Energy Carolinas and Progress Energy Carolinas BAAs support the Mitigation Proposal. Applicants state that these purchasers are the parties that the Commission intended to protect when it found that Applicants should be required to mitigate their potential market power in these BAAs. Applicants state that none of the parties that submitted comments in opposition to the Mitigation Proposal purchase power directly from Applicants in the Duke Energy Carolinas or Progress Energy Carolinas-East BAAs, and "thus, none of these parties are among the entities to be protected" by the Mitigation Proposal.⁸³

44. Applicants assert that the Commission should reject certain arguments raised by FMPA, City of Orangeburg, and EPSA because the arguments are unrelated to the effectiveness of the Mitigation Proposal.

45. With respect to FMPA's arguments, Applicants note that FMPA has previously argued that Duke Energy's true motive in pursuing the merger was to allow Duke Energy Carolinas to make sales of power into Florida at elevated prices based on the exercise of market power. Applicants state that FMPA now complains that the Mitigation Proposal will restrict Duke Energy's ability to sell at wholesale into Florida.⁸⁴ FMPA disputes

⁸¹ *Id.* at 4.

⁸² *Answer of Duke Energy Corporation and Progress Energy, Inc.* at 1, Docket No. EC11-60-001 (Nov. 22, 2011) (Applicants Answer).

⁸³ Applicants Answer at 2.

⁸⁴ *Id.* at 7.

Applicants' claim that it has taken contradictory positions in this proceeding, in its protests of the Proposed Transaction and rehearing request, and in its protest of the Mitigation Proposal. According to FMPA, there is no contradiction in its concerns that: (1) post-merger, the merged firm will be able to over-price or withhold power sales to third-parties like FMPA; and (2) FMPA will be prevented from purchasing "mitigation power" when such power is available and economic.⁸⁵ FMPA states that both of these concerns are valid and must be corrected.⁸⁶

46. Applicants also object to City of Orangeburg's complaint that the Mitigation Proposal fails to address the issues the city has raised in this proceeding related to jurisdiction, rates, and competition. According to Applicants, the Mitigation Proposal was intended to address the Commission's concerns in the Merger Order, not the arguments raised by City of Orangeburg (which, Applicants assert, the Commission rejected in the Merger Order).⁸⁷ Finally, Applicants reject EPSA's renewed request that the Commission require Applicants to join an RTO, stating that EPSA's arguments are not related to the appropriateness of the Mitigation Proposal.⁸⁸

47. Applicants also contend that none of the protestors have shown that the Mitigation Proposal is inappropriate or inadequate to address the potential market power concerns addressed in the Merger Order. According to Applicants, *Allegheny Energy, Inc.*, 84 FERC ¶ 61,223 (1998) (*Allegheny Energy*), a Commission order cited by City of New Bern to demonstrate that the Mitigation Proposal is not effective because Applicants have not proposed to transfer operational control over a specific generation unit, applies only to proposed mitigation sales from a specific generating unit.⁸⁹ Applicants contend that, in that case, the Commission found that if the applicants could use their operational control to avoid making mitigation sales from the particular unit, then nothing would prevent the applicants from withholding that unit's capacity from the market.

⁸⁵ *FMPA Reply to Applicants' Answer to Compliance Filing Protests* at 2, Docket No. EC11-60-000 (Dec. 2, 2011) (FMPA Dec. 2 Answer). FMPA also reiterates its argument that the resale restrictions Applicants propose as part of the Mitigation Proposal are anticompetitive and violate long-standing Commission policy. *Id.*

⁸⁶ FMPA Dec. 2 Answer at 2.

⁸⁷ Applicants Answer at 8.

⁸⁸ *Id.* at 9.

⁸⁹ *Id.* at 10.

48. According to Applicants, the requirement in *Allegheny Energy* that operational control be transferred does not apply to virtual divestiture proposals that are not tied to specific units but rather obligate the applicants to make energy available regardless of the availability of a specific unit.⁹⁰ Applicants claim that this distinction was made clear in *Exelon Corp.*, 112 FERC ¶ 61,011 (2005) (*Exelon*). Applicants explain that, in that case, applicants proposed to make non-unit specific firm sales and that the Commission approved the proposal recognizing that it prevented the applicants from withholding baseload energy from the market even though there was no transfer of operational control over any specific units.⁹¹ According to Applicants, the Mitigation Proposal has the same effect as the mitigation proposed in *Exelon* because Applicants propose to offer all of their AEC into the market, up to the amount required to limit the screen failures, and thus, Applicants cannot withhold the energy from the market.⁹²

49. Applicants also reject protestors' argument that, because Applicants retain the right to sell unsold AEC Energy, the Mitigation Proposal will enable Applicants to withhold AEC Energy from the market. Applicants explain that, pursuant to the Mitigation Proposal, the AEC Energy would revert back to Applicants only after it is offered to eligible buyers. Applicants state that, by definition, the energy cannot be withheld from the market because it would come under the Applicants' control only because no other market participants wished to purchase the energy.⁹³ Since eligible purchasers will determine whether they wish to purchase AEC Energy or have it revert back to Applicants, eligible purchasers can defeat any attempt by Applicants to exercise market power through the use of AEC Energy simply by purchasing the AEC Energy themselves at the cost-based price.⁹⁴

50. Applicants also dispute City of New Bern's characterization of Applicants' offer to sell AEC Energy as economic withholding. Applicants state that economic withholding consists of offering energy for sale at a price that is above the cost of

⁹⁰ *Id.*

⁹¹ Applicants Answer at 10-11.

⁹² *Id.* at 11-12. Applicants also urge the Commission to reject City of New Bern's claim that the Mitigation Proposal should be rejected because it does not transfer adequate control to permit the entrance of a new competitor into the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs. *Id.*

⁹³ *Id.* at 12-13.

⁹⁴ *Id.* at 13.

producing that energy – in contrast, the incremental cost plus 10 percent price at which the AEC Energy will be offered is equivalent to the cost-based offer caps that are imposed in organized markets.⁹⁵ According to Applicants, the AEC Energy will be sold at an equivalent price, and there is nothing improper regarding offering this capacity at its cost of production.

51. Applicants also respond to City of New Bern’s argument that mitigation could best be accomplished by requiring Applicants to actually divest certain “crown jewel” assets.⁹⁶ According to Applicants, since they have engaged in active generation construction programs in order to be able to meet their growing native load requirements, if they were now required to divest “crown jewel” assets, Applicants would then be required to construct even more new generation capacity in the future. Applicants state that the only effect of such a divestiture would be to require Applicants to trade existing, low cost and depreciated generation assets for newly constructed generation assets with higher, undepreciated capital costs.⁹⁷ Applicants conclude that the type of divestiture advocated by City of New Bern would increase the costs of the generation that Applicants use to serve their wholesale and retail native load customers.

52. Applicants also defend the eight-year term proposed for the Mitigation Proposal. Applicants explain that their witness stated that the eight-year term is more than enough time for a party concerned with market power to plan, site, permit, and construct a new gas-fired generation unit that would protect them from the exercise of market power at the end of the Mitigation Proposal’s term. Applicants state that City of New Bern provides no reasons why their witnesses’ conclusion is incorrect.⁹⁸

53. Applicants argue that the Mitigation Proposal appropriately requires that the AEC Energy be sold to load located in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs. According to Applicants, the cases cited by FMPA to support its arguments that this requirement violates the commerce clause and antitrust principles are irrelevant to the Mitigation Proposal. Applicants argue that the sales restrictions of the Mitigation Proposal do not resemble the practices prohibited in the cases cited by FMPA.

⁹⁵ Applicants cite the New York Independent System Operator, Inc. (NYISO) and PJM Interconnection, L.L.C. (PJM) markets as examples. *Id.* at 13-14, n.9.

⁹⁶ Applicants Answer at 14 (*quoting* City of New Bern Protest, Second Wilson Aff. at P 7).

⁹⁷ *Id.* at 14-15.

⁹⁸ *Id.* at 16.

Applicants emphasize that the reason for the restrictions in the Mitigation Proposal is to ensure that it effectively mitigates the potential exercise of market power identified in the Merger Order.⁹⁹ Applicants explain that the purpose of the Mitigation Proposal is to make AEC Energy available in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs so that neither Applicants nor any other party could exercise market power to increase energy prices in those markets. Applicants contend that if the AEC Energy is “resold outside of the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs, then that energy effectively has been removed from those markets and the protection provided by the [Mitigation Proposal] is undermined if not completely eliminated.”¹⁰⁰

54. According to Applicants, to the extent that the AEC Energy is resold outside of the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs, “the only effect is to transfer to the purchasers of the AEC Energy the revenues for out-of-market sales that otherwise would have been earned by [Applicants].”¹⁰¹ Applicants state that such an outcome would harm retail customers without providing market power mitigation in the relevant BAAs because off-system sales revenues are shared with retail customers that have shouldered the cost of the generation resources used to make the sales. Applicants claim that the purpose of the restriction on sales of AEC Energy is related to providing effective market power mitigation in compliance with the Merger Order.

55. Applicants also respond to City of New Bern’s argument that Applicants’ witness, in performing the new HHI calculations, assumes, inappropriately, that the AEC Energy will be sold to two new market entrants. Applicants argue that, unlike the divestiture of ownership or control over a generation unit which would allow the new owner to attempt to exercise market power by withholding generation capacity from the market, it is not possible for a purchaser of AEC Energy under the Mitigation Proposal to withhold that energy from the market. Applicants explain that buyers of AEC Energy in the day-ahead offer process must “take the AEC Energy and sell it the same day, directly or indirectly, to load located in the [Duke Energy Carolinas and Progress Energy Carolinas-East] BAAs.”¹⁰² According to Applicants, without the ability to withhold its AEC Energy from the market or to divert it to other markets, the purchaser cannot use its purchases to

⁹⁹ *Id.* at 17.

¹⁰⁰ Applicants Answer at 17.

¹⁰¹ *Id.*

¹⁰² *Id.* at 18-19.

exercise market power. Consequently, it would be impossible for the purchaser of the AEC Energy to exercise market power and raise prices in the market.¹⁰³

56. Applicants argue that attributing AEC Energy purchases to existing suppliers, as City of New Bern suggests, would lead to the incorrect presumption that the purchaser could somehow withhold the AEC Energy to exercise market power.¹⁰⁴ According to Applicants, because it is impossible for the purchaser of the AEC Energy to use that energy to exercise market power, it makes no sense to assume for purposes of calculating HHIs that the purchaser has any existing market presence.¹⁰⁵ Applicants conclude that their witness's assumption best reflects the reality of the effect of the purchase on the purchaser's market power, while simultaneously allowing the calculation to focus on whether the amount of AEC Energy sold adequately reduces Applicants' market power.

57. Applicants also respond to EPSA's claims that Applicants provided insufficient details regarding the scope of Applicants' ability to interrupt delivery of AEC Energy for reliability reasons, and the scope of the duties performed by the independent monitoring entity. With respect to the first issue, Applicants claim that they do not have the ability to interrupt deliveries for economic reasons.¹⁰⁶ Applicants state that so long as they have generation capacity available, they must use that capacity to produce the AEC Energy that was sold, regardless of the cost – they may not interrupt deliveries simply because they will have to run more expensive generation resources than were assumed in developing the price for AEC Energy the previous day. Applicants explain that their right to interrupt will result only from reliability reasons, that is, “some kind of unexpected outage or load excursion that would prevent [Applicants] from using their generation assets to deliver the full amount of AEC Energy sold after first satisfying [their] wholesale and native load and existing firm obligations.”¹⁰⁷ Applicants state that this interruption could result from either a generation or transmission outage, but only to the extent that the outage makes it physically impossible to deliver the full amount of AEC Energy sold in the day-ahead offer process. Applicants conclude that the proposed restriction allows the delivery obligation to be interrupted only if, due to unexpected outages or higher load (e.g., due to unexpected weather conditions), no AEC is available

¹⁰³ *Id.* at 19.

¹⁰⁴ *Id.*

¹⁰⁵ Applicants Answer at 19.

¹⁰⁶ *Id.* at 20.

¹⁰⁷ *Id.* Applicants note that these are the same obligations that are used to define the amount of AEC Energy that is available in the first place. *Id.*

to make delivery.¹⁰⁸ Applicants contend that in that event, they would not have the ability to exercise market power in AEC, and the interruption would be appropriate.

58. With respect to EPSA's claim that Applicants must provide more detail regarding the independent monitoring entity, Applicants contend that the Mitigation Proposal provided details regarding the independent monitoring entity. Applicants note that the Mitigation Proposal stated that each day Applicants would provide the independent monitoring entity with the information regarding the AEC Energy offered and sold the previous day. According to Applicants, that information would include all requests to purchase AEC Energy; the calculations of available generation capacity; and the calculations of the price at which the AEC Energy was offered for sale. Applicants also explained that to the extent the independent monitoring entity believes that they are not in compliance with their commitment, the independent monitoring entity would inform Applicants and make a filing with the Commission explaining the independent monitoring entity's reasons for reaching that conclusion.¹⁰⁹

59. Applicants state that since they filed the Mitigation Proposal, they have had discussions with Potomac Economics, which has expressed an interest in performing the independent monitoring entity function under the Mitigation Proposal.¹¹⁰ Applicants state that they have reached an agreement in principle with Potomac Economics, subject to reaching agreement on the business terms and conditions.¹¹¹ In the course of these discussions, Applicants and Potomac Economics reached agreement regarding the general scope of the services to be provided. Applicants explain that they have been authorized by Potomac Economics to state that it has reviewed and commented on the scope and is in agreement that this scope is appropriate for purposes of monitoring compliance with the Mitigation Proposal.¹¹²

60. Applicants state that under the scope of the proposal, the independent monitoring entity will, on a daily basis, provide independent and impartial verification, monitoring, analysis and reporting as to four aspects of the Mitigation Proposal: (1) the daily,

¹⁰⁸ *Id.* at 21.

¹⁰⁹ Applicants Answer at 21-22.

¹¹⁰ Applicants state that Potomac Economics serves as the independent transmission monitor for Duke Energy Carolinas. *Id.* at 22.

¹¹¹ *Id.*

¹¹² *Id.*

day-ahead offer of AEC Energy; (2) the delivery of AEC Energy to subscribing eligible purchasers sinking the AEC Energy in the applicable BAA; (3) the pricing of the AEC Energy; and (4) any reliability interruptions which Applicants may impose on the delivery of the AEC Energy sold through the day-ahead process.¹¹³ Applicants state that, to the extent the independent monitoring entity believes that Applicants are not in compliance with their commitments, the independent monitoring entity will immediately inform the Applicants and, after discussing the circumstances with the Applicants, promptly make a filing with the Commission explaining its reasons for reaching this conclusion.¹¹⁴ In addition, all eligible purchasers will be provided with the independent monitoring entity's contact information so that they can directly contact it.

61. Applicants add that, within 30 business days following the conclusion of each winter and summer period, the independent monitoring entity will provide to Applicants and file with the Commission a report certifying Applicants' compliance with their obligations under the Mitigation Proposal and, to the extent there are any incidents of non-compliance, describing and analyzing such incidents. Applicants have also reached an agreement with Potomac Economics regarding the information that they will provide to it to enable it to perform its monitoring functions. According to Applicants, each day during the applicable winter and summer periods, Applicants will provide the independent monitoring entity with "the energy sales, energy procurement requests, generation outage and other capacity availability information, forecasted and actual load, transmission availability and congestion management actions, pricing calculations and other relevant information regarding the AEC Energy offered and sold the previous day."¹¹⁵ Finally, in the event that there is any reliability interruption of the sale of AEC Energy, Applicants will, within the same day as the interruption, notify the independent monitoring entity of the reliability interruption and provide it with any further information regarding the circumstances of and need for the interruption.

¹¹³ *Id.*

¹¹⁴ Applicants Answer at 22.

¹¹⁵ *Id.* at 23. Applicants state that they will not have the unilateral right to decide what information is provided to the independent monitoring entity – they will agree to provide it with any other information it reasonably requests to fulfill its duties. All confidential or proprietary information of the Applicants will be treated as confidential by the independent monitoring entity, which will take steps to protect the confidentiality of that information. *Id.*

62. In its response to Applicants' answer, City of New Bern argues that the Commission should reject Applicants' answer and the Mitigation Proposal.¹¹⁶ City of New Bern also responds to a number of arguments raised by Applicants in their answer.

63. City of New Bern first responds to Applicants' statements regarding parties that support the Proposed Transaction and parties that do not. According to City of New Bern, Applicants' observations are irrelevant because the adequacy of the Mitigation Proposal is not determined by "litigant head-counting," and the absence of objection to a merger is not conclusive of the merger's legality.¹¹⁷ City of New Bern also defends its claim that Applicants should consider divesting "crown jewel" assets to ensure effective mitigation. City of New Bern clarifies that it used this expression as shorthand for the quality of assets that Applicants should divest in order to ensure effective divestiture.

64. Next, City of New Bern reiterates its argument that, pursuant to the Mitigation Proposal, Applicants will not relinquish control of anything of value, and also responds to Applicants' reliance on *Exelon*.¹¹⁸ With respect to *Exelon*, City of New Bern explains that the decision has no precedential effect given that it was vacated by the United States Court of Appeals for the District of Columbia Circuit. City of New Bern argues that, in any case, *Exelon* would not support Applicants' position because the mitigation proposed in that case was considerably more stringent than the Mitigation Proposal.¹¹⁹ City of New Bern also claims that Applicants' attempt to analogize the pricing in the Mitigation Proposal to the bid caps used as market power mitigation measures in the PJM and NYISO markets is unavailing. City of New Bern contends that the use of margins above generator-specific reference prices in some RTOs as mitigation thresholds establishes

¹¹⁶ *Answer of the Cities of New Bern and Rocky Mount, North Carolina in Opposition to Applicants' Motion for Leave to Answer Protests Concerning Mitigation Compliance Filing* at 1, Docket No. EC11-60-001 (Dec. 7, 2011) (City of New Bern Dec. 12 Answer).

¹¹⁷ City of New Bern also notes that the entities that have registered support for the Mitigation Proposal are parties to settlement agreements with Applicants. City of New Bern Dec. 12 Answer at 3.

¹¹⁸ *Id.* at 6.

¹¹⁹ *Id.*

tolerance levels for prices above competitive levels, but does not establish that system incremental cost plus 10 percent is pricing at cost.¹²⁰

65. City of New Bern also rejects Applicants' justification for relying on the assumption that "two new market entrants will somehow emerge each day to purchase and resell [Applicants'] proposed daily offerings" of AEC Energy.¹²¹ According to City of New Bern, Applicants' response, that given the restrictions on the AEC Energy it will be impossible for a purchaser of AEC Energy to exercise market power and raise prices in the market, is a *non sequitor*.¹²² City of New Bern contends that there is no basis in fact for Applicants' unstated and unexplained assumption, and that the more likely outcome is that the AEC Energy will go unsold in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs, and then Applicants will sell that energy in other BAAs where they are not subject to cost-based caps. City of New Bern also reiterates its argument that Applicants have failed to support the eight-year term for the Mitigation Proposal, and that Applicants did not provide any additional support for the term in their answer. Finally, with respect to Applicants noting that they have reached an agreement in principle with Potomac Economics, City of New Bern states that if Applicants had availed themselves of the full 60-day period afforded by the Merger Order, they would not have had to announce details of the Mitigation Proposal on a piecemeal basis.¹²³

E. Analysis of Mitigation Proposal

66. As discussed in further detail below, the Commission rejects the October 17 Compliance Filing. Specifically, the Mitigation Proposal does not remedy the Proposed Transaction's adverse effects on competition, including screen failures, identified in the Merger Order. Thus, the Commission continues to find, pursuant to the Merger Policy Statement and related regulations and precedent, that the Proposed Transaction, as initially submitted by Applicants and supplemented by the Mitigation Proposal, will have an adverse effect on competition. The Proposed Transaction remains conditionally authorized, subject to Commission approval of market power mitigation measures that remedy the screen failures identified in the Merger Order. Until Applicants correct the adverse effects of the Proposed Transaction, the Commission cannot unconditionally authorize it.

¹²⁰ *Id.* at 8.

¹²¹ *Id.* at 9.

¹²² City of New Bern Dec. 12 Answer at 9-10.

¹²³ *Id.* at n. 2.

67. Below, the Commission discusses several of the Mitigation Proposal's flaws. Although the Commission rejects the Mitigation Proposal, that rejection is without prejudice to Applicants proposing mitigation measures that remedy the screen failures identified in the Merger Order.

1. Applicants' supporting analysis for the Mitigation Proposal is flawed.

68. Applicants' supporting analysis for the Mitigation Proposal is flawed and does not demonstrate that the proposal will mitigate the market power screen failures identified in the Merger Order. In order to evaluate whether the Mitigation Proposal would reduce the market HHIs below the thresholds identified in the Merger Order, Applicants reexamine the August 29 DPT results for the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs, taking the proposed sales of AEC Energy into account.¹²⁴ As part of their analysis, Applicants assume that all of the AEC Energy is to be sold in equal amounts to two entities that do not currently control any capacity¹²⁵ in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs. According to Applicants, no plausible alternative assumption would materially change the analysis.¹²⁶

69. As an initial matter, Applicants do not explain in detail how they arrived at the new HHI values resulting from their analysis, but the reductions in the Post Mitigation market HHIs appear to stem from arithmetic adjustments to supplier shares in the August 29 DPT.¹²⁷ The new HHI values result from recomputing the HHI values based on the adjusted supplier shares, including the shares of the two new buyers and Applicants' reduced share. Specifically, the "HHI change" column in the mitigated season/load periods appears to be the result of: (1) reducing Applicants capacity by the amounts in the "Divested MW" column; (2) while simultaneously moving one half of the

¹²⁴ See generally October 17 Compliance Filing, Exhibit B, Hieronymus Aff. at P 12-19.

¹²⁵ October 17 Compliance Filing, Exhibit B, Hieronymus Aff. at n. 6. For example, for the summer season in the Duke Energy Carolinas BAA, Applicants assume that two buyers will each buy 150 MWh of the AEC Energy offered for sale in the Duke Energy Carolinas BAA (300 MWh total). October 17 Compliance Filing, Exhibit B, Hieronymus Aff., Exhibit WHH-1.

¹²⁶ October 17 Compliance Filing, Exhibit B, Hieronymus Aff. at n. 6.

¹²⁷ See, e.g., October 17 Compliance Filing, Exhibit B, Hieronymus Aff., Exhibits WHH-1, Exhibit WHH-2, and accompanying workpapers.

divested MW amounts to each of two new market participants; and then (3) recalculating the market HHIs.¹²⁸ Mathematically, such a computation will always reduce the market HHI, which is the sum of every market seller's market share raised to the second power.¹²⁹

70. Other than the statement that no plausible alternative assumption would materially change their analysis, Applicants do not provide any support or explanation for assuming that two new buyers will appear in every season. This assumption, however, is key to the outcome of Applicants' analysis. By assuming that the AEC Energy will be purchased by entities that do not currently control any capacity in the two BAAs, Applicants posit that two *new* buyers will purchase the AEC Energy. Applicants do not explain how or why two new buyers would begin participation in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs, each purchase one-half of the amount of the AEC Energy offered, and sink that power into the two BAAs. However, Applicants state that these two buyers will exist, and rely on this assumption in their analysis of the Mitigation Proposal on these new buyers. As discussed below, Applicants' reliance on two new buyers raises serious questions as to the effectiveness of the Mitigation Proposal as a means to address the screen failures identified in the Merger Order.

71. First, Applicants' assumption of two new buyers forecloses consideration of purchases by eligible buyers that do currently own or control capacity in the Duke Energy Carolinas or Progress Energy Carolinas-East BAAs, i.e. existing buyers, and limits the number of possible purchasers of AEC Energy. Second, Applicants do not consider alternative scenarios, such as the effect of one eligible purchaser currently in the market purchasing the entire amount of AEC Energy offered, or one or two buyers with existing market shares making purchases.¹³⁰ Although the identity and existing market share of the eligible purchasers of the AEC Energy have a direct effect on market concentration

¹²⁸ *Id.*

¹²⁹ For example, if a market has five equal size sellers, each with 20 percent of the market, the market HHI would be 2,000 ($20^2 + 20^2 + 20^2 + 20^2 + 20^2$, or $400 + 400 + 400 + 400 + 400$, is 2,000). If the first seller divested to two new hypothetical sellers enough generation capacity so as to reduce its market share by half, the market HHI would be reduced to 1,750 – the first seller would now have 10 percent of the market and two new sellers would each have five percent ($5^2 + 5^2 + 10^2 + 20^2 + 20^2 + 20^2 + 20^2$, or $25 + 25 + 100 + 400 + 400 + 400 + 400$, is 1,750).

¹³⁰ As noted above, mathematically speaking if one of the eligible purchasers buys the entire amount of AEC Energy offered, the resulting decrease in market concentration will be smaller than if the purchaser had no previous market presence.

and HHI values, Applicants do not test, for example, whether varying the number of purchasers of AEC Energy negates the efficacy of the Mitigation Proposal. By failing to consider alternatives to the two new buyer scenario, Applicants' supporting analysis demonstrates only that the Mitigation Proposal remedies the screen failures identified in the Merger Order in only some, but not all, circumstances – thus, screen failures would persist even if the Mitigation Proposal was implemented. Outside of the limited circumstances Applicants focus on, the Mitigation Proposal does not remedy the screen failures in some circumstances and therefore we reject it.

72. Moreover, the Mitigation Proposal does not specify that there must be two new purchasers of AEC Energy, or restrict the amount of AEC Energy that can be purchased to one-half of the amount available. Thus, on the one hand, Applicants' analysis is based on an assumption that two new buyers with no existing market share will each purchase one-half of the available AEC Energy, but on the other hand, the Mitigation Proposal does not place such restrictions on the number of eligible buyers or establish an amount of AEC Energy that must be purchased. Accordingly, Applicants' analysis does not reflect the terms of the Mitigation Proposal itself. Other than the broad eligibility requirements described above, Applicants do not identify any other constraints on who may purchase AEC Energy. Nevertheless, Applicants rely on an analysis that focuses on two new buyers without existing shares that each purchase one-half of the AEC Energy offered, even though the Mitigation Proposal does not limit eligible buyers in such a way.

73. In their answer, Applicants' response to this flaw does not directly address the central question regarding the October 17 Compliance Filing: would the Mitigation Proposal adequately reduce market concentration if it is implemented, such that there would no longer be screen failures? Rather than responding to this issue and demonstrating that the Mitigation Proposal and its two buyer assumption support a reduction of market HHIs, Applicants' response to City of New Bern, which challenges Applicants' reliance on the two buyer assumption, focuses on whether purchasers of the AEC Energy with existing market share will withhold that energy from the market.¹³¹ Applicants' argument focuses on whether a buyer of AEC Energy has existing market share and if that buyer could exercise market power by withholding the purchased AEC Energy from the market. Applicants argue that it is impossible for buyers of AEC Energy with existing market shares to use that energy to exercise market power, and therefore conclude that it makes no sense to assume, for purposes of calculating HHIs, that any purchaser of AEC Energy has an existing market presence.

74. Applicants' response does not address the flaw discussed above – in some circumstances, the Mitigation Proposal will fail to reduce the HHI increases caused by

¹³¹ Applicants Answer at 18-19.

the Proposed Transaction to levels below those established in the Merger Policy Statement and identified in the Merger Order¹³² if purchasers with existing market shares buy the AEC Energy. Given the extremely high levels of market concentration demonstrated in the August 29 DPT, our analysis remains focused on Applicants, the entities in those concentrated markets with very large market shares. Furthermore, Applicants' withholding argument assumes that a purchaser of AEC Energy would buy that energy only to subsequently not use it or withhold it from the market. Not only would such a withholding scheme fail given the small market shares of purchasers in the Duke Energy Carolinas and Progress Energy Carolinas-East BAA, but those purchasers would also take a loss on the AEC Energy purchased. In failing to consider whether the Mitigation Proposal will reduce market HHI levels if the purchasers of AEC Energy possess existing market shares, Applicants fail to provide a complete analysis and demonstrate that the Mitigation Proposal will have the intended remedial effect in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs.

2. The Mitigation Proposal will not remedy the screen failures identified in the Merger Order.

75. Based on the evidence provided by Applicants and the Mitigation Proposal itself, we find that the Mitigation Proposal would fail to adequately mitigate the market power screen failures identified in the Merger Order. While Applicants describe the Mitigation Proposal as a virtual divestiture, Applicants would not, due to the specific details of the Mitigation Proposal, relinquish control over the AEC Energy they propose to offer to sell. The Commission has recognized that operational control of generation resources is a key element of market power analysis and mitigation.¹³³ Here, however, the proposed virtual divestiture does not transfer control of Applicants' generation from the merged firm.

¹³² See, e.g., Merger Order, 136 FERC ¶ 61,245 at n.316 (“The Commission notes again that mergers in moderately concentrated markets (with an HHI greater than or equal to 1,000 but less than 1,800) that produce an HHI increase over 100 points potentially raise significant competitive concerns. Mergers in highly concentrated markets (with an HHI of more than 1,800) that produce an HHI increase over 50 points potentially raise significant competitive concerns; if the change in HHI exceeds 100 points it is presumed likely to create or enhance market power”). See also, Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,134.

¹³³ See, e.g., Order No. 642, FERC Stats. & Regs. ¶ 31,111 at 31,887-88 (explaining that operational control over generation resources requires attribution of that capacity to the seller).

76. Among the shortcomings of Applicants' proposal are the restrictions on eligible buyers established in the Mitigation Proposal circumscribing and limiting the pool of eligible buyers for the AEC Energy. First, the Mitigation Proposal requires that the AEC Energy sold must sink in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs. Second, AEC Energy may not be used to replace resources that are sold outside of the applicable BAA.¹³⁴ By limiting how potential buyers can use the AEC Energy purchased, the Mitigation Proposal narrows the pool of eligible buyers, which, based on the comments received in this proceeding, is already small given that the product Applicants propose to sell pursuant to the Mitigation Proposal is not the type of product potential buyers appear to be interested in purchasing. Applicants also do not address how these limitations can be reconciled with their assumption, described above, of two new buyers, unless they expect the two new entities to buy the power and profitably resell it to load-serving entities in the relevant market, even though the latter would have an opportunity to buy directly from Applicants at the same price offered to the new entities.

77. In addition, the type of product offered may not interest buyers in the relevant market. City of Orangeburg, for example, states that the proposed mitigation consists of a must-offer obligation with respect to short-term, interruptible power, but City of Orangeburg's concerns "relate to the availability of long-term power requirements service."¹³⁵ In this regard, City of New Bern explains that, since "the proposed sale is extremely short term (day-ahead) and only in limited time periods," there is "likely to be very limited demand, if any, for the resources offered...."¹³⁶ Similarly, EPSA explains that "[given] the very limited pool of buyers to whom [Applicants] would make AEC Energy available, it is implausible that they will in fact sell enough AEC Energy to ensure that the plan succeeds, even by [Applicants'] own terms."¹³⁷

78. In *Allegheny Energy, Inc.*, the Commission considered a mitigation proposal submitted by two applicants seeking approval to merge. Specifically, those applicants proposed to relinquish control of generating capacity by selling the output of a generating

¹³⁴ October 17 Compliance Filing, Exhibit A, Term Sheet for Virtual Divestiture at 11. As noted above, elsewhere Applicants state that the AEC Energy "may not be used to replace less costly resources that are sold outside of the applicable BAA." *Id.* at 6. In either case, as explained in detail below, such a restriction may also be unenforceable.

¹³⁵ City of Orangeburg Comments at 2-3 (citations omitted).

¹³⁶ City of New Bern, Second Wilson Aff. at P 12.

¹³⁷ EPSA Comments at 4.

station in a public auction (referred to as the RFP).¹³⁸ Although the Commission agreed that relinquishing control of the generating station's output would adequately address the competitive concerns raised by the proposed merger, the Commission concluded that applicants' proposal for relinquishing control, through short-term sales, was inadequate.¹³⁹ The Commission found that applicants' proposal failed to eliminate the opportunity for the merged company to act anticompetitively.¹⁴⁰ The Commission explained that applicants' proposal did not remove the output of the generating station from the merged company's control, and that given the merged company's dominance in the relevant markets post-merger, the merged company could withhold such output (or output from similar capacity) in order to drive up electricity prices.¹⁴¹ The Commission also had concerns regarding whether applicants would be able to sell the output of the generating station. The Commission stated that its primary concern was that there was no guarantee that the entire output of the generating station would be sold by applicants.¹⁴² Citing concerns raised by intervenors, the Commission observed that there could be limited demand for the output under the specific terms and conditions of the RFP, and thus it might not be sold. The Commission also noted that the output could be difficult to market due to the lack of transmission arrangements, and that the lack of assured transmission service would also decrease the certainty that all of the output of the generating station would be sold under the RFP.¹⁴³

79. The concerns expressed by the Commission in *Allegheny Energy* apply with equal force in this case with respect to the Mitigation Proposal. Applicants are proposing to offer energy only to certain buyers and in the form of products that few, if any, buyers are interested in purchasing. Due to the terms of the Mitigation Proposal, the Commission has no guarantee that the Mitigation Proposal will attract sufficient buyers for the AEC Energy so as to remedy the market power screen failures identified in the Merger Order.

¹³⁸ *Allegheny Energy*, 84 FERC at 62,067.

¹³⁹ *Id.* at 62,070.

¹⁴⁰ *Id.*

¹⁴¹ *Allegheny Energy*, 84 FERC at 62,070.

¹⁴² *Id.*

¹⁴³ *Id.*

80. In addition to the restrictions established by the Mitigation Proposal, the lack of certainty regarding availability of the AEC Energy limits its usefulness for potential buyers and contributes to our doubts regarding the AEC Energy product Applicants propose to offer. Although Applicants have stated that specific amounts of AEC Energy will be offered under the Mitigation Proposal, they also state that “Applicants must have generation resources available and not needed to serve retail and wholesale native load or existing (as of the date the merger closes) firm sales (including operating reserves).”¹⁴⁴ Potential buyers require some amount of certainty regarding the availability of a product, but the Mitigation Proposal provides none. Similarly, Applicants provide limited information regarding how the amount of AEC Energy offered will be calculated. Exhibit A, Term Sheet for Virtual Divestiture describes the product available pursuant to the Mitigation Proposal as “AEC Energy (as defined by this term sheet),” but the term sheet does not provide a definition of AEC Energy nor sufficient explanation regarding how the amount of AEC Energy available for sale will be calculated. Accordingly, based on these concerns and the restrictions imposed by the Mitigation Proposal, we agree with protestors that the terms of the proposed sales would make the AEC Energy difficult to market and would not provide an attractive product for the already limited pool of potential buyers. For these reasons, we conclude that the Mitigation Proposal, as submitted by Applicants, does not remedy the screen failures identified in the Merger Order.

81. Applicants attempt to rebut these arguments by claiming that *Allegheny Energy* applies only to proposed mitigation sales from a specific generating unit.¹⁴⁵ Applicants contend that the requirement in *Allegheny Energy* to transfer operational control does not apply to virtual divestiture proposals that are not tied to specific units but rather obligate the applicants to make energy available regardless of the availability of a specific unit.¹⁴⁶ We disagree with Applicants’ narrow interpretation of *Allegheny Energy*. Here, as in *Allegheny Energy*, Applicants propose an offer to sell a short-term product in lieu of actual divestiture. In *Allegheny Energy*, the applicants proposed an offer of short-term sales from the output of a specific generating station; in this case Applicants propose an offer to sell, on a short-term basis, specific amounts of AEC energy, without regard to specific generating facilities. The end result, however, should have been the same: the amount of capacity under the applicants’ control is reduced so as to eliminate market concentration. In both cases, however, merger applicants failed to propose mitigation reasonably designed to achieve these results. The Commission concluded that the RFP

¹⁴⁴ October 17 Compliance Filing at 4.

¹⁴⁵ Applicants Answer at 10.

¹⁴⁶ *Id.*

proposed as mitigation in *Allegheny Energy* was flawed. The Mitigation Proposal suffers from the same flaws: in markets where Applicants are and will remain dominant, Applicants propose to offer AEC Energy under restrictive terms that will reduce the pool of eligible buyers, and provide a product that buyers may not even want.¹⁴⁷

82. Applicants also imply that the term of the Mitigation Proposal could be shorter than eight years because: “[by] its nature, AEC is ephemeral. Unlike Economic Capacity that lasts as long as the underlying generating plants, AEC disappears as a result of load growth.”¹⁴⁸ However, Applicants do not clearly state how much AEC Energy will be available under the Mitigation Proposal, undermining the marketability of AEC Energy as described above, nor do they clearly state for how long AEC Energy will be offered. If Applicants expect load growth over time to use up enough of the AEC that now causes them to fail the market power screens, they can, at a later date, make a filing to request that the Commission remove or reduce the amount of mitigation.

83. We also note that Applicants’ explanation of the price at which AEC Energy will be offered also lacks sufficient detail. For example, Applicants do not explain whether incremental cost will be calculated in the same manner as described in their existing cost-based tariffs; whether the proposed price will include a demand charge; and whether AEC Energy will be offered at the same price in the Duke Energy Carolinas and Progress

¹⁴⁷ We note that Applicants rely on *Exelon* to support their position. Even if that order had not been vacated by the U.S. Court of Appeals for the District of Columbia Circuit and remained valid precedent, the Commission would reject Applicants’ reliance on that case. There, the Commission concluded that the proposed virtual divestiture effectively transferred control of the output of applicants’ capacity from the merged firm to the purchasers. Among other things, the Commission noted that applicants had “committed to sell all of the energy that is offered, regardless of the price of the bids...” which ensured that control over that capacity would be removed. *Exelon Corporation*, 112 FERC ¶ 61,011 (2005), *order on reh’g*, 113 FERC ¶ 61,299 (2005), *vacated*, *PPL Elec. Utils. Corp. v. FERC*, 2006 U.S. App. LEXIS 31478 (D.C. Cir. Dec. 21, 2006) (“Upon consideration of the motion to dismiss the case as moot and vacate the underlying orders...it is ordered that the motion to dismiss the case as moot and vacate the underlying orders be granted. ... The Federal Energy Regulatory Commission’s orders in *Exelon Corporation and Public Service Enterprise Group, Inc.*, 112 FERC ¶ 61,011 (July 1, 2005) (Commission Docket No. EC05-43-000) and *Exelon Corporation and Public Service Enterprise Group, Inc.*, 113 FERC ¶ 61,299 (Dec. 21, 2005) (Commission Docket Nos. EC05-43-000 and EC05-43-001) are *hereby vacated*” (emphasis added)).

¹⁴⁸ October 17 Compliance Filing, Exhibit B, Hieronymus Aff. at P 25.

Energy Carolinas-East BAAs.¹⁴⁹ The Mitigation Proposal also fails to clearly state whether the day-ahead price of AEC Energy is locked in. For example, if a buyer places an offer for AEC Energy at the day-ahead price calculated by Applicants, it is unclear whether, if Applicants must dispatch additional generation the next day to satisfy unanticipated native load needs, that buyer's price will increase, or whether it would remain locked in at the day-ahead price. In other words, Applicants do not specify whether they would adjust the price *ex post facto* if they must use more expensive generation than expected to meet the sales of AEC Energy.

84. Further, as noted above, Applicants are obligated to deliver the AEC Energy subject to interruption only if necessary for Applicants to comply with their reliability obligations.¹⁵⁰ As EPSA notes, Applicants' failure to include specific details as to what constitutes a reliability obligation is problematic.¹⁵¹ Applicants state, in their answer, that by reliability reasons, they mean "some kind of unexpected outage or load excursion that would prevent the Applicants from using their generation assets to deliver the full amount of AEC Energy sold after first satisfying all of the Applicants' wholesale and retail native load and existing firm obligations – the same obligations that are used to define the amount of AEC Energy that is available in the first place."¹⁵² We however, remain unconvinced that Applicants' explanation removes their discretion regarding when they can interrupt delivery. The lack of detail regarding Applicants' reliability obligations provides Applicants with too much discretion regarding when delivery may be interrupted, and reduces the marketability of the AEC Energy and provides the opportunity for Applicants to retain control of the AEC Energy.

85. Applicants argue that the energy cannot be withheld from the market because it would be under their control only because no other market participants wished to purchase energy. However, as the Commission explained in the Merger Policy Statement:

¹⁴⁹ Applicants have explained that they intend to maintain these two BAAs separately after the merger. *See* Merger Application at n.24.

¹⁵⁰ October 17 Compliance Filing, Exhibit A, Term Sheet for Virtual Divestiture at 11.

¹⁵¹ EPSA Comments at 5.

¹⁵² Applicants Answer at 20. Applicants explain that the interruption would result from either a generation and/or transmission outage, but only to the extent that the outage makes it physically impossible to deliver the full amount of AEC Energy sold in the day-ahead offer process.

...we believe that competition is now the best tool to discipline wholesale electric markets and thereby protect the public interest. But the competition needed to protect the public interest will not be efficient and deliver lower prices in poorly structured markets. For example, a concentration of generation assets that allows a company to dominate a market will dampen or preclude the benefits of competition. In sum, as customer protection is increasingly dependent upon vibrant competition, it is critically important that mergers be evaluated on the basis of their effect on market structure and performance. Merger Policy Statement, FERC Stats. & Regs. ¶ 31,044 at 30,117.

Even if an offer to sell may, in certain circumstances, be sufficient mitigation, the restrictions and uncertainties in Applicants' mitigation proposal provide an inadequate basis for us to find their proposal sufficient.

86. Finally, Applicants propose that the Mitigation Proposal remain in effect for a term of eight years, which they characterize as an adequate amount of time for new entry.¹⁵³ It is not clear what would occur after the eight year deadline expired. Applicants provide no evidence in support of their choice of an eight-year term for the Mitigation Proposal other than their witness' conclusory statement that eight years is "more than [an] ample period for siting and building any of the types of power plants likely to be built by or for Applicants' wholesale customers under current power market conditions (i.e. gas-fired power plants or renewable resources)."¹⁵⁴ City of Orangeburg also disputes the proposed eight-year term for the Mitigation Proposal, noting that due to the length of the proposed term, it will not, in the longer-term, affect the power supply options of entities in City of Orangeburg's position.¹⁵⁵ Although Applicants attempt, in their answer, to rebut criticism of the eight-year term, their answer simply reiterates their witness's conclusory statements without providing any additional support. Applicants have provided no evidence that that the adverse competitive effects of the Proposed Transaction would be remedied within eight years and thus, the period of time Applicants propose seems arbitrary.

¹⁵³ October 17 Compliance Filing at 7.

¹⁵⁴ October 17 Compliance Filing, Exhibit B, Hieronymus Aff. at P 26.

¹⁵⁵ City of Orangeburg Protest at 3.

3. The independent monitoring entity will not provide sufficient oversight of the Mitigation Proposal.

87. As part of the Mitigation Proposal, Applicants propose to engage an independent monitoring entity to ensure that they are in compliance with the Mitigation Proposal.¹⁵⁶ Applicants' explanation of this component of the proposal in the October 17 Compliance Filing is vague. In that filing, Applicants stated that: "[e]ach day, [] Applicants will provide the independent monitoring entity with the information regarding the AEC Energy offered and sold the previous day, including all requests to purchase AEC Energy, the calculations of available generation capacity, and the calculations of the price at which the AEC Energy was sold."¹⁵⁷ Applicants state that, if the independent monitoring entity believes that Applicants are not in compliance with their commitment, the independent monitoring entity would inform Applicants and make a filing with the Commission explaining its reasons for reaching this conclusion.¹⁵⁸

88. As noted above, in their answer, Applicants provide some additional information regarding the independent monitoring entity. First, Applicants note that they have had discussions with Potomac Economics to serve as the independent monitoring entity, and have reached an agreement in principle with the firm. Second, the independent monitoring entity will provide independent and impartial verification, monitoring, analysis and reporting as to four aspects of the Mitigation Proposal: (1) the daily, day-ahead offer of AEC Energy; (2) the delivery of AEC Energy to subscribing eligible purchasers sinking the AEC Energy in the applicable BAA; (3) the pricing of the AEC Energy; and (4) any reliability interruptions which Applicants may impose on the delivery of the AEC Energy sold through the day-ahead process.¹⁵⁹ Third, if the independent monitoring entity believes at any time that Applicants are not in compliance with their commitments, the independent monitoring entity will immediately inform Applicants and, after discussing the circumstances with Applicants, promptly make a filing with the Commission explaining its reasons for reaching this conclusion.¹⁶⁰

¹⁵⁶ October 17 Compliance Filing at 6.

¹⁵⁷ *Id.*

¹⁵⁸ October 17 Compliance filing at 6.

¹⁵⁹ Applicants Answer at 22.

¹⁶⁰ Applicants also propose that, within 30 business days following the conclusion of each winter and summer period, the independent monitoring entity will provide to Applicants and file with the Commission a report certifying Applicants' compliance with

(continued...)

Finally, Applicants explain that they will not have the unilateral right to decide what information is provided to the independent monitoring entity – they will provide the independent monitoring entity with any other information reasonably requested by it to fulfill its duties.

89. Despite their clarifications to the independent monitoring entity portion of the Mitigation Proposal, we find that it would not provide sufficient oversight of the proposed mitigation. For example, Applicants fail to provide necessary details regarding how the independent monitoring entity’s oversight function will operate, such as whether the independent monitoring entity will administer a public, transparent electronic platform, such as an Open Access Same-time Information System (OASIS) web-site, on which offers would be posted; how Applicants propose to ensure the independence of the monitor; and whether the Commission will have the authority to approve the independent monitoring entity that Applicants propose to engage. As noted by EPSA, Applicants also do not commit to provide specific details regarding the proposed monitoring arrangement. Rather, Applicants propose to file an informational filing that will be made sometime prior to the first offer under the Mitigation Proposal.¹⁶¹ According to Applicants, that filing “will identify the independent monitoring entity and confirm that the independent monitoring entity is in place and able to perform its functions as of the date that [Applicants’] mitigation proposal takes effect.”¹⁶²

90. The Commission must be persuaded that the Proposed Transaction, once consummated, will be consistent with the public interest.¹⁶³ Thus, the terms of an independent monitoring arrangement should be established prior to consummation of the Proposed Transaction – not after. As the Commission has explained, it is not pre-disposed towards accepting post-merger updates or imposing filing requirements

their obligations under the Mitigation Proposal and describing and analyzing any incidents of non-compliance. *Id.* at 23.

¹⁶¹ October 17 Compliance Filing at 6. We note that Applicants do not indicate whether they still intend to make this informational filing with the Commission given the clarifications to the independent monitoring arrangement they provide in their answer. Applicants state their belief that, based on the information provided in their answer, “the Commission can approve [the Mitigation Proposal], including the independent monitoring provisions of [the Mitigation Proposal].” Applicants Answer at 26.

¹⁶² October 17 Compliance Filing at 6.

¹⁶³ City of New Bern Protest at 8 (*citing Allegheny Energy, Inc.*, 84 FERC at 62,072).

designed to ensure the adequacy and completeness of Applicants' commitments.¹⁶⁴ Section 203(a)(4) provides that the Commission must approve a transaction "if it finds that the proposed transaction will be consistent with the public interest," and such a finding would necessarily include evaluating whether the independent monitoring arrangement will ensure adequate oversight of the Mitigation Proposal.

4. Conclusion.

91. For the reasons discussed above, the Commission rejects the October 17 Compliance Filing. As discussed above, an acceptable mitigation proposal must remedy the screen failures identified in the Merger Order, and provide a Delivered Price Test analysis supporting the new HHI values. The Commission has addressed virtual divestiture mitigation proposals in the past.¹⁶⁵

¹⁶⁴ See *Allegheny Energy*, 84 FERC at 62,072 (finding that divestiture of a generating station could be an effective means of mitigating post-merger market power in advance of the proposed merger, but that Commission required assurance that the proposed merger was consistent with the public interest before approval).

¹⁶⁵ See, e.g., *Ameren Corp.*, 108 FERC ¶ 61,094 (2004) (accepting as effective interim mitigation a proposal to sell capacity and energy from a specific facility to non-affiliates through a competitive bidding process until such time as applicants made a showing that competitive harm from the proposed merger was otherwise mitigated); *Ameren Services Co.*, 101 FERC ¶ 61,202 (2002) (accepting as effective interim mitigation, among other mitigation measures, a commitment to sell to non-affiliated entities a specified amount of power and energy at a market value index until such time as transmission upgrades were completed); *American Electric Power Co.*, 90 FERC ¶ 61,242 (2000) (rejecting, among other mitigation measures, a proposal to divest partial ownership interests in certain generating units because applicants would retain control over the divested output, but accepting, until divestiture was completed, interim system sale of energy for specific amounts of power on a financially firm basis through auction); *CP&L Holdings, Inc.*, 92 FERC ¶ 61,023 (2000) (accepting as effective market power mitigation a commitment to sell a firm amount of non-recallable energy under long-term contract at a pre-determined price where purchaser would determine dispatch of the capacity); *Consolidated Edison Co. of New York, Inc.*, 86 FERC ¶ 61,064 (1999) (accepting as effective interim mitigation, until such time as applicants completed certain generation divestitures, a proposal to bid energy into the NYISO market at variable costs, to bid capacity into the capacity market at the avoided cost of keeping the unit online (minus net revenues from sales of energy and ancillary services), and to make generating resources available consistent with availability over the previous three years); *Allegheny Energy, Inc.*, 84 FERC ¶ 61,223 (1998) (rejecting, as interim mitigation, a proposal to

(continued...)

92. Accordingly, the Commission continues to find, pursuant to the Merger Policy Statement and related regulations and precedent, that the Proposed Transaction, as initially submitted by Applicants and supplemented by the Mitigation Proposal, will have an adverse effect on competition. The Proposed Transaction thus remains conditionally authorized, subject to Commission approval of market power mitigation measures that remedy the screen failures identified in the Merger Order. Until Applicants correct the adverse effect of the Proposed Transaction, the Commission cannot unconditionally authorize it. Finally, although the Commission rejects the Mitigation Proposal, that rejection is without prejudice to Applicants proposing mitigation measures that remedy the screen failures identified in the Merger Order.

The Commission orders:

The October 17 Compliance Filing is rejected, as discussed in the body of this order.

By the Commission. Commissioner Spitzer is not participating.

(S E A L)

Kimberly D. Bose,
Secretary

sell output of specific generating facility through short-term power sales in a request for proposals because applicants would retain control over output).