

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

FPL) Docket No. EC06-77
Constellation Energy)

NOTICE OF INTERVENTION AND PROTEST OF
PUBLIC CITIZEN, AFSCME COUNCIL 67, BALTIMORE ACORN, FLORIDA
CONSUMER ACTION NETWORK, FLORIDA ACORN, MARYPIRG,
PROGRESSIVE MARYLAND AND SEIU 1199E-DC

April 10, 2006

Pursuant to Rules 212 and 214 of the Rules of Practice and Procedure of FERC, 18 CFR §§ 385.212 and 385.214, and FERC’s February 13, 2006 Notice of Filing, Public Citizen, AFSCME Council 67, Baltimore ACORN, Florida Consumer Action Network, Florida ACORN, MaryPIRG, Progressive Maryland and SEIU 1199E-DC (“Public Citizen et al”) respectfully move to intervene and protest the merger application in the above captioned proceeding.

I. Motion to Intervene and Protest

Public Citizen is a nonprofit, nonpartisan consumer rights organization based in Washington, DC with 105,000 dues-paying individual members nationwide. Our Energy Program does extensive work at the federal and state levels to promote energy policies that best protect consumers.

AFSCME Council 67 represents 15,000 city and state workers in Maryland and 1.1 million members nationwide.

Baltimore ACORN represents 4,000 low to moderate income families in the Baltimore region and 250,000 members nationwide.

Florida ACORN represents 5,000 members in FPL’s distribution area and 250,000 members nationwide.

Florida Consumer Action Network (FCAN) is the state’s largest consumer group with 40,000 members from Key West to Tallahassee. FCAN works on consumer issues including utilities, insurance, health care, and environmental protection. Founded in 1984, FCAN is the leading voice for consumers in Florida.

Maryland Public Interest Research Group (MaryPIRG) is a statewide, non-profit, non-partisan organization that advocates on behalf of the public on issues concerning environmental protection, consumer rights, and the democratic process. MaryPIRG has 12,000 members throughout the Maryland.

Progressive Maryland is a grassroots organization of thousands of members strengthened by 50 religious, community, and labor organizations. Through research, public education, and direct political action, Progressive Maryland strives to improve the lives of working families in Maryland.

SEIU represents 8,000 hospital and health care workers in Maryland.

Together, we represent consumers and workers directly impacted by this proposed merger. Our participation in this proceeding is unique and in the public interest, and we will not be adequately represented by any other party to this proceeding. This intervention and protest raises a number of facts that dispute assertions made by Constellation and FPL that can only be resolved in an evidentiary hearing.

II. Argument

1. FERC must investigate whether prices charged by Constellation Energy's coal, nuclear and hydro power plants formerly controlled by Baltimore Gas & Electric violate the Federal Power Act's "just and reasonable" standard. Failure to hold evidentiary hearings on this question will make it impossible to determine the full extent of adverse impacts on BGE's rates from the merger.

In 1999, Maryland passed deregulation legislation that allowed Baltimore Gas & Electric to form a holding company, Constellation Energy, that transferred assets within the company. This asset swap involved 12 power plants with nearly 6,200 MW of capacity, replacing Maryland's cost-of-service regulation over these power plants with FERC's ultra-statutory¹ market-based regulatory regime, allowing Constellation Energy to charge whatever price the "market" would bear, so long as FERC finds Constellation not to have "market power."

Constellation Energy transferred 11 fossil fuel and hydro facilities to a new subsidiary, Constellation Power Source Generation, and one nuclear power plant to its Calvert Cliffs Nuclear Power Plant subsidiary. These two subsidiaries sell the output of the power plants to Constellation Power Source, an affiliated power marketer.

A majority of these power plants (seven, representing nearly 5,300 MW of capacity) are coal, nuclear or hydro facilities. In just the last few years, after the deregulation craze in which two dozen states and FERC embarked upon an untested theory of electric utility deregulation, market prices for natural gas have skyrocketed. Because natural gas plays a major role in setting the market price of electricity, companies with generation assets fueled by anything but natural gas are able to sell their power at natural gas prices, which far exceeds the cost to produce power from their non-natural gas sources. As a result, owners of non-natural gas facilities are likely reaping windfall profits, even though these

¹ See *Colorado Consumers Counsel, et al.*, D.C. Circuit No. 04-1238, consolidated under Cinergy Marketing and Trading LLP, No. 04-1168.

nuclear, coal and hydro facilities are decades old and were initially paid for by Maryland ratepayers.

Indeed, the Bush Administration concludes that “customers in states with competitive retail markets for electricity see the effects of natural gas prices in their electricity bills more rapidly than those in regulated states, because their prices are determined to a greater extent by the marginal cost of energy—the average operating cost of the last, most expensive unit run each hour—rather than the average of all plant costs. Natural gas plants, with their higher operating costs, often set the hourly marginal price.”²

PJM³ concludes in its *2005 State of the Market Report* that high natural gas prices have helped produce the biggest profits for power plant generators in the history of deregulation in PJM: “the Energy Market net revenue curve was higher in 2005 for every level of unit marginal costs compared to 2004. The 2005 net revenues for units with marginal costs equal to, or less than, \$80 were higher than for any year since PJM introduced markets in 1999.”⁴

Power Plants Transferred from Baltimore Gas & Electric to its Parent Company, Constellation Energy, As Part of Maryland's 1999 Deregulation Law

Power Plant	Location	Fuel	MW	Notes
Brandon Shores	Anne Arundel Co, MD	coal	1,286	
Herbert Wagner	Anne Arundel Co, MD	coal	1,009	
Charles Crane	Baltimore Co., MD	coal	399	
Keystone	Pennsylvania	coal	359	MW represents Constellation's 21% share
Conemaugh	Pennsylvania	coal	181	MW represents Constellation's 10.6% share
Calvert Cliffs	Calvert Co., MD	nuclear	1,735	
Safe Harbor	Pennsylvania	hydro	278	MW represents Constellation's 66.7% share
Perryman	Harford Co., MD	oil/gas	360	
Riverside	Baltimore Co., MD	oil/gas	249	
Notch Cliff	Baltimore Co., MD	gas	128	
Westport	Baltimore City, MD	gas	121	
Philadelphia Rd	Baltimore City, MD	oil	64	
total coal, nuclear & hydro			5,247	
total generation			6,169	

In 2005, an owner of a power plant in PJM with a marginal cost of \$30 per installed MW-year earned \$241,977 per installed MW-year in net revenue from the Energy Market alone (which doesn't include additional payments for reactive power and other reliability incentives)—a 305% increase from the \$59,776 per installed MW-year in net revenue that same facility earned in 2000.⁵

² *Annual Energy Outlook 2006*, U.S. Energy Information Administration, page 82
www.eia.doe.gov/oiaf/aeo/pdf/trend_3.pdf

³ “PJM Interconnection is a regional transmission organization that coordinates the movement of wholesale electricity in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.” www.pjm.com/about/overview.html

⁴ Page 121, www.pjm.com/markets/market-monitor/som.html

⁵ Table 3-1, page 119, www.pjm.com/markets/market-monitor/som.html

Rising natural gas prices vastly increase the marginal costs of power plants fueled by natural gas relative to competing fuels like coal. In 2004, the average cost for a coal power plant was \$1.36 per 10⁶ Btu, while the average cost for a natural gas power plant was 438% higher, at \$5.96 per 10⁶ Btu. As recently as 1999—the year Maryland passed deregulation legislation—the average cost of a natural gas power plant was only \$2.56 per 10⁶ Btu (compared to \$1.22 per 10⁶ Btu for the average coal plant).⁶

The same is true for nuclear power plants that were built 30 years ago.⁷ A recent presentation by the Nuclear Energy Institute⁸ boasts of a similar cost gap between nuclear power and natural gas: nuclear power busbar cost averages \$23 per megawatt hour, compared to \$71.40 per megawatt hour for a 7,500 Btu natural gas fired power plant.

We therefore request that FERC require Constellation to provide all financial details of its power plant operations to determine whether or not the company is earning unjust and unreasonable windfall profits on its facilities, particularly its non-natural gas power plants.

There is one Constellation facility that does release some financial information: the 415 MW Safe Harbor Water Power Corp. hydro facility, of which Constellation owns 66.7%. According to Public Citizen compilations from FERC filings,⁹ Constellation's share of earnings is \$66 million (on \$109 million of revenue) since the facility was transferred from Baltimore Gas & Electric to Constellation in 2000. Meanwhile, the salary of Safe Harbor's CEO, Marshall J. Kaiser, increased 40% since 2000 (from \$145,109 in 2000 to \$203,719 in 2004).

These massive cost discrepancies are most likely allowing Constellation Energy to charge rates that are not “just and reasonable” because at the same time that Constellation Energy is earning these record profits from its coal and nuclear power plants, its subsidiary Baltimore Gas & Electric is asking Maryland ratepayers for a 72% rate increase.

These rates are not “just and reasonable,” and this can particularly be seen because just recently consumers were receiving power from these facilities at vastly lower prices. The difference is not due to rising costs, but because the structure of the market that FERC has approved and regulates is dysfunctional and tolerates gross differences of profit margins between generators. If FERC is to allow utilities to charge rates “by agreement,” at a minimum it must oversee such rates to determine whether “competition” is in fact driving rates to within a “zone of reasonableness,” and if not, to provide a check on such rates to ensure that they are “just and reasonable” and, therefore, lawful. FERC, having made a wrong assumption in 2000 about the growth of competition in Maryland (see

⁶ www.eia.doe.gov/cneaf/electricity/epa/epat4p5.html

⁷ It is important to note that the biggest cost of nuclear power is the capital costs, so building new nuclear plants won't guarantee price advantages because the costs to build new plants are so high.

⁸ “Nuclear Energy 2006: A Solid Business Platform for Future Growth”, February 2006, www.nei.org/documents/Wall_Street_Briefing_2-2-06.pdf

⁹ Safe Harbor Water Power Corporation *Form 1 Annual Report for Major Electric Utilities, Licensees & Others*, <http://elibrary.ferc.gov/>

below), must do a “reality check” here and determine whether the wholesale rates from Constellation to Baltimore Gas & Electric are in fact “just and reasonable” before approving a merger that will increase the potential market power of the merged company, as discussed below.

This discrepancy among the rates of return for the various fuel-use generators also harms regulation because the State of Maryland is actively considering measures to return these facilities to cost-of-service ratemaking;¹⁰ has expressed an overwhelming vote of no confidence in the state’s Public Service Commissioners;¹¹ has overruled the authority of the Public Service Commission on the merger;¹² has voted to take numerous other regulatory actions;¹³ and there is a possibility of a special session where legislation may be enacted with a direct bearing on the outcome of the Constellation-FPL proposed merger. If FERC approves this merger, the ability of Maryland lawmakers to consider such moves will be undermined because Constellation will be able to structure itself in ways to incorporate these facilities out-of-state and therefore beyond the reach of state regulators. Since FERC is now charged with providing some of the merger protections that were previously supplied by the Public Utility Holding Company Act of 1935, it must not allow an interstate holding company to quickly complete a merger that raises significant market power concerns in order to avoid State regulation.

In addition, Section 214 of the Federal Power Act requires that FERC find unlawful, after notice and opportunity for hearing, any EWG rate or charge that results from the receipt of any undue preference or advantage from an electric utility which is an associate company or an affiliate of the exempt wholesale generator. The Commission must therefore examine the rates that Baltimore Gas & Electric has agreed to pay its affiliate, Constellation, to determine whether any undue influence resulted in rates that are not “just and reasonable.” Baltimore Gas & Electric can simply claim that it must pass through to retail consumers any wholesale prices accepted by FERC, and the parent of BGE—Constellation—collects the profits, regardless of which subsidiary makes them. FERC must investigate Constellation’s rates to BGE to ensure that they are not only in fact within a zone of reasonableness, but also that they are not unduly preferential or advantageous to BG&E’s affiliate, Constellation.

2. Baltimore Gas & Electric has captive consumers, and therefore FERC must require safeguards for affiliate transactions between BGE and both Constellation Energy and FPL.

FERC currently has special rules restricting the sales and other activities of Exempt Wholesale Generators (EWGs) and Qualifying Facilities (QFs) and other “non-regulated” power plants—these are wholesale (sale for resale) power plants that are allowed to charge any price they want to—when they are controlled by the owner of a utility with

¹⁰ <http://mlis.state.md.us/2006rs/billfile/sb0972.htm>; <http://mlis.state.md.us/2006rs/billfile/hb1736.htm>

¹¹ <http://mlis.state.md.us/2006rs/billfile/sb1102.htm>

¹² <http://mlis.state.md.us/2006rs/billfile/hb1713.htm>; <http://mlis.state.md.us/2006rs/billfile/sb1020.htm>

¹³ <http://mlis.state.md.us/2006rs/billfile/hb0443.htm>; <http://mlis.state.md.us/2006rs/billfile/hb1711.htm>; <http://mlis.state.md.us/2006rs/billfile/sb1077.htm>

captive ratepayers in the region. Through the proposed merger, Constellation Energy's existing 8,800 MW of capacity in the region will be supplemented by FPL's 2,100 MW of additional EWGs and QFs and other "deregulated" power plants in the PJM region.

Constellation Energy argues that "Baltimore Gas and Electric has no captive energy commodity customers, as the State of Maryland has adopted retail choice."¹⁴ FERC made an original determination back in 2000, just months after Maryland passed its deregulation law certifying that BGE had no captive ratepayers under the assumption that retail "choice" would flourish, and cancelled strict code of conduct rules that would have governed affiliate transactions between Constellation's unregulated power plants and Baltimore Gas & Electric.¹⁵

But six years later the facts show that FERC's assumptions were wrong because household consumers in BGE's service area *are* captive. As of February 2006, only 30 households, out of a total of 1,087,285 eligible, were served by alternative suppliers to BGE (for a "choice", or "switching", rate of 0.003%).¹⁶ We can think of no legal or common sense methodology that could conclude that 99.997% of households in BGE's service territory that remain under contract to BGE are anything other than "captive" ratepayers.

This issue must be addressed as part of the merger proceeding because the union of the two companies involves the addition of over 2,100 MW of generation capacity controlled by FPL—a huge new addition of power plants that must adhere to code of conduct rules to ensure no affiliate transaction abuses that threaten the nearly 1.2 million captive BGE ratepayers in Maryland.

We therefore request that FERC determine that BGE has *de facto* captive ratepayers and that therefore both Constellation and FPL must be subject to code of conduct regulations that provide affiliate transaction safeguards for captive consumers in Maryland.

- 3. The number of bidders in Maryland's power auction is declining, indicating a reduced level of wholesale competition. The proposed merger will only increase consolidation in the regional market, thus eroding competition further. Therefore, an evidentiary hearing must be scheduled in order to properly evaluate the reasons behind the lack of adequate competition in the regional auction and what impact adding 2,100 MW of generation to Constellation's regional portfolio will have before the merger is approved.**

The Maryland Office of the People's Counsel has concluded that the state's power auction is featuring fewer bidders, meaning competition has been reduced, thereby

¹⁴ FPL and Constellation filing under EC06-77 on February 9, 2006, page 9, <http://elibrary.ferc.gov/>

¹⁵ *Order Denying Late Motion to Intervene and Denying Rehearing*, issued June 15, 2000, docket ER00-1598-001, <http://elibrary.ferc.gov/>

¹⁶ www.psc.state.md.us/psc/electric/enrollmentrpt.htm

harming consumers: “The recent auctions held pursuant to this process have produced striking results that provide strong evidence that electric deregulation has not worked.”¹⁷

The *2005 PJM State of the Market*, released in March 2006 by the PJM Market Monitoring Unit (MMU) concludes that many elements of PJM are not competitive *prior* to the merger of Constellation and FPL:

Market power in the Capacity Markets remains a serious concern given the structural issues of high levels of supplier concentration, frequent occurrences of pivotal suppliers and extreme inelasticity of demand. *Market power remains endemic to the structure of PJM Capacity Markets...*

The Ancillary Service Markets in PJM are generally not structurally competitive, as they are characterized by various combinations of high levels of supplier concentration, high individual market shares, frequent occurrences of individual or jointly pivotal suppliers and inelastic demand...Structural analysis of the PJM Capacity Credit Market found that, on average, its daily markets exhibited moderate concentration levels while its monthly and multimonthly markets exhibited high concentration levels during the period May through December 2005...

The structure of the Mid-Atlantic Region and Western Region Regulation Markets was evaluated and the MMU concluded that these markets are not structurally competitive as they are characterized by a combination of one or more structural elements including high levels of supplier concentration, high individual company market shares, significant hours with pivotal suppliers and inelastic demand...

*The structure of each of the Spinning Reserve Markets has been evaluated and the MMU has concluded that these markets are not structurally competitive as they are characterized by high levels of supplier concentration and inelastic demand...Congestion increased in 2005 in approximate proportion to the total increase in total billing as PJM continued to expand its footprint...[and there has been] a dramatic change in the nature of the power system managed by PJM...reveal[ing] the underlying limitations of the ability of the transmission system over the broad [PJM] footprint to transfer the lowest cost energy on the system to all parts of the system for all hours.*¹⁸ [emphasis added]

PJM currently has market regulations in place in an attempt to address the structurally uncompetitive nature of many PJM markets, but it is not known, without evidentiary hearings, whether PJM could ensure “just and reasonable” prices should the merger between Constellation and FPL go forward.

Given the inadequacy of the market power analysis provided by Constellation Energy and FPL (as described below), conducted by an analyst paid for by the companies, and given the fact that PJM is uncompetitive *prior* to the merger, FERC cannot approve the

¹⁷ www.opc.state.md.us/c/177/Electric-Deregulation-OPC-Pusues-Comprehensive-Analysis-Change

¹⁸ www.pjm.com/markets/market-monitor/som.html

consolidation of any generation assets that result in Constellation and FPL increasing their control over power plants in PJM.

4. In light of the failure of deregulation to deliver “competition” and just and reasonable prices in Maryland, the power plants formally controlled by Baltimore Gas & Electric must return to cost-of-service generation as a condition of merger approval.

We have already demonstrated that Constellation Energy is likely charging rates that are not “just and reasonable” from power sold from its coal, nuclear and hydro facilities that used to be controlled by Baltimore Gas & Electric and therefore were once subject to cost-of-service rates. These likely “windfall profits” that Constellation is earning is not due to any remarkable business innovation or grand new efficiencies achieved by visionary leaders, but by the simple fact that older generating units like coal, nuclear and hydro can sell power for far cheaper than the market price that is largely set by the price of natural gas-fired generation.

We have already noted that there are several ongoing efforts by lawmakers in Maryland to re-regulate and otherwise radically alter the state’s original deregulation law. All of these state efforts would be unduly compromised if FERC approves the merger before state lawmakers have a chance to fully investigate and exhaust their proposed legislative remedies. That is because once the merger is consummated, Constellation will no longer be a Maryland-based corporation but a Florida-based one, and this fact will directly undermine the ability of Maryland lawmakers to restore sanity to the state’s failed deregulation model. Because the merger will adversely impact regulation and rates, a transfer of original BGE generating assets from Constellation back to BGE must be completed as a condition of merger approval.

Baltimore Gas & Electric would reimburse its parent company for the return of the facilities, paying the exact value of the original transaction, minus depreciation.

5. The companies’ claim “that the proposed Transaction will not result in cross-subsidization of a non-utility company by Florida Power & Light or Baltimore Gas and Electric” is false. As a result, “ring fencing” protections must be implemented as a condition of merger approval.

Seventy year old consumer and investor protections in the Public Utility Holding Company Act were repealed when Congress and the President passed and signed into law H.R. 6 in the 109th Congress. In its place, FERC has new rules prohibiting transactions that result in a cross-subsidization of a non-utility company by a utility company.

Statements by Constellation CEO Mayo Shattuck and FPL CEO Lewis Hay imply that their primary motivation for the merger is the indirect cross-subsidization that will occur: ratepayers of the regulated utilities will be subsidizing the unregulated portions of the companies’ operations.

Hay informed the public during a December 19, 2005 conference call to Wall Street analysts that “the primary driver of this transaction is our mutual desire to build the premier competitive energy business. This will be far and away the most effective and efficient competitor in the deregulated markets of this country.”¹⁹ The CEO of the new company makes it clear that the priority will be the unregulated portions of the company, and not strengthening the regulated entities like Baltimore Gas & Electric. This prioritization of the unregulated divisions will come at the direct expense of regulated entities like Baltimore Gas & Electric.

According to the *Wall Street Journal*, “the fact that Constellation derives so little profit from the Baltimore utility has resulted in a credit rating that is several notches lower than FPL.”²⁰

Another article describes the threat to ratepayers in more detail:

FPL Group Inc. and Constellation energy Group Monday announced an \$11 billion combination creating the industry’s highest-octane merchant power business *on top of a solid financial foundation provided by steady, cash-generating regulated utilities in Florida and Maryland*. . . For Constellation, Chairman, President and Chief Executive Officer Mayo Shattuck said the transaction solved his company’s looming problem of lacking the financial and generation heft to fully pursue growth in competitive energy markets. He noted that Constellation was financially “constrained” by concerns expressed by credit rating agencies about the risks of Constellation’s reliance on its competitive business, which provides about two-thirds of the Baltimore-based company’s revenues. Constellation’s unregulated business has been highly profitable, but rating analysts still tend to view such activities with suspicion because they got burned by the Enron Corp. and other energy trading scandals of the recent past. As a result, Constellation has not enjoyed the strong credit ratings awarded to more predictable energy companies that are heavy on regulated operations. “We’ve had some concern that the requirements to growth might be constrained by the moving targets of rating agencies.”²¹ [emphasis added]

Thus, it is no exaggeration to say that the merger is intended to enlist Florida and Maryland regulated utility ratepayers together in funding the expansion of the merged company’s non-utility businesses nationwide. This violates FERC’s regulation forbidding cross-subsidization.

As a result, so-called “ring fencing” protections must be implemented to shield the captive ratepayers of both Florida Power & Light and Baltimore Gas & Electric from directly or indirectly subsidizing the non-utility operations of the holding company. Simply accepting assurances from the companies that they won’t engage in cross-

¹⁹ George Lobsenz, “FPL-Constellation Deal Powered by Merchant Ambitions,” *The Energy Daily*, December 20, 2005, Vol. 33 No. 241.

²⁰ Rebecca Smith, “FPL, Constellation Reach Agreement on \$11 Billion Deal,” December 19, 2005.

²¹ George Lobsenz, “FPL-Constellation Deal Powered by Merchant Ambitions,” *The Energy Daily*, December 20, 2005, Vol. 33 No. 241

subsidization is inadequate and unenforceable, as such cross-subsidization can occur indirectly.

The only way to ensure ratepayers are adequately protected is for FERC to mandate the establishment of a ring fencing provision, whereby a holding company (Constellation) would be prevented from investing more than 25% of the combined assets of its utilities (Florida Power & Light and Baltimore Gas & Electric) into businesses unrelated to the utility industry.

6. Consumers are harmed when only one consulting firm, paid for by applicants, performs a market power analysis unchallenged in evidentiary hearings.

Dr. William Hieronymus and his firm, Charles River Associates, appear to have a monopoly on providing the market power analysis that FERC relies on to determine whether the merger complies with the Commission's Merger Policy Statement, as they alone have performed this same analysis for each of the last four proposed major utility mergers in the United States (Exelon-PSEG, MidAmerican-Pacificorp, Duke-Cinergy and Constellation-FPL). We have questioned how the public interest is served by having only one private firm—hired by the applicants—provide the only market power analysis without the opportunity to challenge it in an evidentiary hearing²² and we continue our complaint in this proposed Transaction.

FERC has argued “that it does not have the authority to determine the individual or the consulting firm that applicants use to perform their merger analysis.”²³ But FERC does have the authority to schedule evidentiary hearings to provide opportunity for the experts hired by others, as well as FERC's own in-house experts, to challenge these monopolist consultants.

FERC's reliance on prejudiced analyses stands in stark contrast to the independent analyses used by other federal anti-trust agencies such as the Department of Justice and the Federal Trade Commission. A merger of this magnitude, creating one of the largest energy companies in the United States, should not be decided on analysis supplied by the companies that is allowed to be unchallenged due to FERC's failure to order evidentiary hearings.

7. The Competitive Analysis Screen performed by Dr. William Hieronymus to meet FERC's Appendix A of the Merger Policy Statement is faulty.

Dr. Hieronymus' reliance on FERC's Appendix A and HHI screen to assess market power is faulty, as “HHI is far too simplistic an index to measure market power in an

²² January 19, 2006 filing in EC05-103; January 6, 2005 filing in EC05-110; and July 29, 2005 filing in EC05-43, <http://elibrary.ferc.gov/>

²³ *Order Authorizing Merger*, December 20, 2005, EC05-103, at paragraph 71, <http://elibrary.ferc.gov/>

industry as complex as the electric industry,”²⁴ particularly with a merger as large as the one proposed by Constellation and FPL. For example, FERC’s Appendix A analysis lacks the “causal connection between market concentration and market power...[as] there is no link between the HHI indicator or changes in market concentration, and changes in market power.”²⁵

Indeed, the Midwest ISO identifies the limitations of relying on HHI to detect market power:

Although HHI statistics can provide reliable competitive inferences for many types of products, this is not generally the case in electricity spot markets. The HHI’s usefulness is limited by the fact that it reflects only the supply-side, ignoring demand-side factors that affect the competitiveness of the market. The most important demand-side factor is the level of demand. Since electricity cannot be stored economically, production must match demand on a real-time basis. When demand rises, an increasing quantity of generating capacity is utilized to satisfy the demand, leaving less capacity that can respond to higher prices in the event a large supplier withholds resources...In addition, the scope of the geographic market can change hour to hour as the loadings on the transmission network change...It is true that the DOJ and FTC evaluate the change in HHI as part of its merger analysis. However, this is only a preliminary analysis that would typically be followed by a more rigorous simulation of the likely price effects of the merger. It is also important to note the HHI analysis employed by the antitrust agencies is not intended to determine whether a supplier has market power.²⁶

In order for consumers to be adequately protected under this proposed merger, FERC’s Appendix A analysis must be expanded to more accurately measure market power and the damaging effect it has on wholesale, and in turn, retail, prices. Specifically, use of simulation modeling that directly measures market power, with a Price-Cost Margin Index (capturing examples of market power by documenting when prices are charged above marginal costs, or the “perfectly competitive” price); calculating the effects of generator’s and power marketer’s strategic behaviors to exercise market power (such as the use of strategic bidding and capacity withholding, neither of which HHI adequately measure); and additional variables, such as modeling the impact the merger will have in light of the region’s specific market structure, must be included.

We are also concerned about the inaccurate results Dr. Hieronymus’ market power analysis provides. One problem is that his market power analysis treats all generation capacity the same, regardless of fuel source. For example, his analysis appears to assume that, all other things being equal, one company owning 1,000 MW of natural gas fired capacity and one company with 1,000 MW of coal capacity have the same exact level of market power. But the analysis we just provided in issue number 1 shows that because of

²⁴ Heidi Kroll and Dr. Richard Rosen, *A Critique of FERC’s New Merger Guidelines: Implications for Analyzing Market Power, Mergers and Deregulation*, May 30, 1997, www.tellus.org

²⁵ Dr. Aleksandr Rudkevich and Dr. Richard A. Rosen, *Use of Computer Simulation Models to Analyze Market Power in Electricity Markets*, Docket PL98-6, June 13, 1998, <http://elibrary.ferc.gov/>

²⁶ *2004 State of the Market Report*, Page 10, www.midwestiso.org

the tremendous cost differences between coal- and natural gas-fired generation, the two different generation facilities have radically different abilities to sell into the market, and therefore have very different impacts on market power.

The market power analysis also ignores the relationship between EWGs and distributional utilities with millions of captive ratepayers. Having so much market-based generation in the midst of a distributional utility with nearly 1.2 million captive household ratepayers presents too many opportunities for the combined operations of FPL and Constellation to engage in transactions that abuse commitments BGE has to its captive ratepayers.

In addition, Dr. Hieronymus' analysis appears to ignore the impact of sales of power from FPL and Constellation facilities to power marketers. Non-affiliated power marketers—such as Goldman Sachs' J. Aron subsidiary, Morgan Stanley, Royal Dutch Shell's Coral Power, BP Energy and others—are not retail consumers of energy, but rather re-sellers of power. Dr. H's analysis does not trace this “laundering” of energy sales, and therefore the exact market power measurement of FPL and Constellation's impact on these markets is incomplete. In order for Dr. Hieronymus' analysis to accurately track Constellation and FPL's impact on market power, the analysis must also consider the contractual relationships between power sellers and the power marketers. After all, FERC is still trying to figure out, five years after the fact, how a company like Enron that owned no power plants in California but was able to control enough of the market through contractual relationships with owners of power plants to help orchestrate intentional power outages and other nefarious activities. Evidentiary hearings are required in order to give interveners access to more details of the relationships between owners of power plants and unaffiliated power marketers.

Constellation Energy and FPL also sell output from their power plants to their affiliated power marketing subsidiaries. In the case of Constellation, Constellation Power Source is North America's largest power marketer, and it controls and re-sells much of the output from Constellation's power plants. Dr. Hieronymus' analysis does not appear to take into account the role Constellation Power Source and other affiliated power marketers may have in contributing to market power issues.

There is also confusion as to the exact extent of Constellation's holdings in PJM. For example, Constellation states that its subsidiaries Constellation Power, Inc. and Constellation Investments, Inc. “indirectly hold partial ownership interests in...[certain] Qualifying Facilities”, and then lists several, including a 50% interest in Panther Creek Partners, a waste coal power plant in Carbon County, Pennsylvania (at Exhibit B-2, pages 3-5). But a search of Panther Creek Partners most recent FERC filing²⁷ details the ownership structure of Panther Creek Partners but makes no mention of Constellation Energy; rather, it lists Goldman Sachs, Ford Motor Company and BankAmerica Corporation as owners.

²⁷ QF87-59 filed at FERC on August 3, 2005 <http://elibrary.ferc.gov/>

This is just one example of the confusion inherent in FERC's lackadaisical regulatory oversight. Because of this discrepancy, we are unsure as to what power facilities Dr. Hieronymus is and is not including in his market power analysis. Therefore, we need a far more detailed accounting of Constellation's ownership stakes of every facility, including docket numbers that detail its joint ventures in these facilities.

- 8. We request access to the cd containing the proprietary computer model (CASm) used by Dr. Hieronymus. We will agree to the terms of non-disclosure so long as we can share the data with an outside consultant of our choosing to help perform an independent analysis of the computer model.**
- 9. Stranded costs for facilities currently under FERC jurisdiction must be refunded back to consumers as a condition of merger approval.**

As part of the asset transfer authorized under Maryland's 1999 deregulation law, Constellation was allowed to collect \$528 million from Maryland ratepayers under a claim that the coal, nuclear and hydro power plants they transferred from Baltimore Gas & Electric would lose value. Considering that these power plants have actually gained in value, this money must be refunded to consumers as a condition of merger approval.

In fact, the Maryland General Assembly is considering such an action, with the Senate passing such a bill by a vote of 42 to 5.²⁸ FERC should defer to State legislators regarding Maryland retail rates and should not attempt to rush through a merger that may be used to resist such Maryland actions.

- 10. An evidentiary hearing is required in order to investigate whether either Constellation or FPL is involved in abusing tax collection programs.**

A recent *New York Times* investigation²⁹ found that many utilities are charging ratepayers money to pay a phantom obligation that will never be incurred or paid to any third party by the utility or the parent company. It is therefore imperative that interveners have an understanding as to whether or not such practices are occurring at FPL and/or Constellation as a result of the proposed merger. Indeed, since the Maryland General Assembly has been considering action on the subject³⁰ FERC must fully investigate this matter prior to granting approval for the merger.

III. Conclusion

For the reasons discussed above, FERC must set the proposed Constellation and FPL merger for an evidentiary hearing and agree to the conditions we propose in this intervention and protest.

²⁸ <http://mlis.state.md.us/2006rs/billfile/sb1099.htm>

²⁹ David Cay Johnston, "Many utilities collect for taxes they never pay," March 15, 2006.

³⁰ <http://mlis.state.md.us/2006rs/billfile/sb1101.htm>

Respectfully submitted on behalf of all parties in this intervention and protest,

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