UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Duke Energy	)	**Docket No.** EC05-103
Cinergy	)	

January 19, 2006

REQUEST FOR REHEARING
OF ORDER AUTHORIZING DUKE ENERGY/CINERGY MERGER
OF
PUBLIC CITIZEN'S ENERGY PROGRAM, CITIZENS ACTION COALITION OF INDIANA, OHIO PARTNERS FOR AFFORDABLE ENERGY AND THE SOUTHERN ALLIANCE FOR CLEAN ENERGY

Pursuant to Section 313 of the Federal Power Act, 16 USC § 8251, and Rules 212 and 713 of the Rules and Regulations of FERC, 18 CFR §§ 385.212, .713, Public Citizen's Energy Program, Citizens Action Coalition of Indiana, Ohio Partners for Affordable Energy and the Southern Alliance for Clean Energy ("Public Citizen") hereby request a rehearing of FERC's December 20 order in the above-captioned proceeding authorizing the Duke and Cinergy request for a disposition of jurisdictional facilities.

The order harms the public interest and consumers in that it results from unlawful *ex parte* meetings with energy company executives and it denies consumers due process of law by authorizing such a huge merger without an evidentiary hearing.

I. SPECIFICATION OF ERRORS

a. FERC Commissioners are forbidden by the Administrative Procedure Act (APA) to hold off-the-record, secret meetings when the Commissioners know that the subject of those meetings, the Duke Energy-Cinergy merger, "will be noticed for hearing."
b. The May 9, 2005 filing by the companies with the U.S. Securities and Exchange Commission provided public notice that the merger would be filed for approval under the Federal Power Act (FPA). Because Section 203 of the FPA requires "notice and an opportunity for hearing" before such mergers can be approved by FERC, the SEC filing provided the FERC Commissioners "knowledge" that the merger would "be noticed for hearing" before the FERC. Therefore, the multiple off-the-record meetings company executives had with FERC Commissioners from May 23 through July 6 are in violation of the APA.
c. An evidentiary hearing is required to allow effective challenges to the subject matter discussed during these multiple off-the-record meetings to determine if FERC Commissioners were unduly prejudiced. Public Citizen requested a remedy

of requiring all participants in the *ex parte* meetings to testify under oath as to who said what during all meetings as part of the evidentiary hearing.

d. FERC's reliance on one consulting firm to provide the merger review analysis in this and every other major merger filed in 2005 requires evidentiary hearings to provide interveners with the opportunity to challenge such analyses.
e. Failure to include power marketing activities underrepresents the companies' ability to exercise market power. This problem can be corrected by holding evidentiary hearings in order to obtain more information about the companies' power marketing activities.
f. The transfer of Duke's DENA power plants to Cinergy's public utility subsidiary in Ohio poses significant and unnecessary risks that rates will be raised for retail consumers. Evidentiary hearings must be held in order to provide all internal company documentation of the plan to pass these costs unfairly to ratepayers.
g. FERC did not address our corporate governance and control fraud reform requests in light of Duke Energy's troubling track record of cheating consumers.
h. FERC did not address our contention that the merger poses risks to the environment.
i. The merger impairs the effectiveness of state regulation in Indiana by terminating the coordinated, cooperative system of state-federal regulation so carefully crafted —at the Commission's prompting—by the 1994 Indiana settlement agreement which was one of the principal underpinnings for the Commission's approval of the merger that created Cinergy.

Argument

I. *Ex Parte* pre-filing meetings are unlawful and create a perception of FERC bias

According to documents obtained by Public Citizen through the Freedom of Information Act[1], Duke-Cinergy executives held multiple private meetings with FERC Commissioners <u>before</u> the companies' July 12 filing at FERC but <u>after</u> the companies filed details of the merger with the U.S. Securities and Exchange Commission on May 9, 2005.[2]

Representatives of Duke and Cinergy held multiple meetings with FERC Commissioners between May 23 and July 6 to discuss their proposed merger. On May 23, 2005, Duke Energy CEO and Board Chairman Paul M. Anderson and Cinergy President & CEO James E. Rogers held meetings with at least two FERC Commissioners. At noon, they met with Suedeen G. Kelly. At 2:00 pm, they met with Joseph Kelliher. The notes arranging the meeting indicate the purpose was to "discuss [the] Cinergy/Duke Energy merger." There may have been other meetings that day with the other FERC Commissioners, but Public Citizen never received confirmation. Our July 14 filing requested confirmation of whether Anderson and Rogers met with other FERC

[1] FOIA No. FY05-101.
[2] www.sec.gov/Archives/edgar/data/30371/000095017205001467/nyc591515.txt

Commissioners on May 23, but FERC never granted it. We renew our request at this time.

On June 28, 2005, Duke Energy invited all FERC Commissioners to a reception at the LBJ Room in the U.S. Capital. From the documents Public Citizen received through FOIA, it is unknown how many FERC Commissioners, if any, attended this private reception hosted by Duke. Again, we respectfully renew our request to be informed of whether any FERC Commissioners attended this private Duke Energy reception.

On Wednesday, July 6, 2005, James E. Rogers, Richard Osborne (Vice-President of Duke Energy), and Michael Naeve (attorney with Skadden Arps), met with FERC Commissioners. At 11:45 am, the Duke-Cinergy delegation met with Joseph Kelliher and members of his staff: Larry Gasteiger, Leonard Tao and Cathy Tripodi. At 4:30, the Duke-Cinergy delegation met with Commissioner Suedeen Kelly. Again, there may have been additional meetings that day with the other FERC Commissioners, but Public Citizen has yet to receive confirmation. We respectfully renew our request to be informed of whether the Duke-Cinergy delegation met with other FERC Commissioners on July 6.

In its December 20 "Order Authorizing Merger," FERC rejects "Public Citizen's argument that the Commissioners' pre-filing meetings were in violation of either the Commission's regulations or the APA." (Order at 136).[3]

But Public Citizen never claimed that "Commissioners' pre-filing meetings were in violation of…the Commission's regulations." Rather, we argued that FERC's regulations, as applied in this case, conflict with federal law. The Administrative Procedure Act limits the ability of federal agencies to conduct "off-the-record" private meetings, and specifically provides that "the prohibitions of this subsection shall apply beginning at such time as the agency may designate, but in no case shall they begin to apply later than the time at which a proceeding is noticed for hearing *unless the person responsible for the communication has knowledge that it will be noticed, in which case the prohibitions shall apply beginning at the time of his acquisition of such knowledge*"[4] (emphasis added).

Thus, the plain language of the Administrative Procedure Act mandates that if any FERC commissioner "has knowledge" that a proceeding "will be noticed for hearing," then it is unlawful for that Commissioner to meet with the parties in private (and there can be no question that the merger applicants will be "parties" in any hearing). It was clear to FERC Commissioners beginning on at least May 9, 2005 that the merger between Duke and Cinergy would be filed for approval at FERC and would, under FPA Section 203(a), have to be "noticed for hearing." Section 203(a) mandates that FERC must provide "notice and opportunity for hearing" prior to approval of any merger application. Because FERC contends that the only "hearing" that need be

3 FERC's failure to record the conversations in the meetings comes after Public Citizen's March 28, 2005 filing with FERC where we raised similar concerns with private meetings held between company executives and FERC Commissioners related to the Exelon-PSEG merger. Docket EC05-43, http://elibrary.ferc.gov/. It also follows a June 2003 U.S. Department of Energy Office of Inspector General report that scolded FERC for related abuses. Special Inquiry: Federal Energy Regulatory Commission Communications, DOE/IG-0610, www.ig.doe.gov/pdf/ig-0610.pdf

4 5 USC § 557(d)(1)(E), www.gpoaccess.gov/uscode/

provided in this case is the filing of comments, the "notice" of the merger application filing that calls for such comments is the only "notice for hearing" provided in this case. Because such notice *must* be provided for all merger applications, by statutory mandate under section 203(a), FERC had knowledge that this merger would be "noticed for hearing" from at least the time that the merger applicants publicly told the SEC that they would seek FERC's approval for the merger. The clear language of the APA provides that the *ex parte* restrictions "shall apply" from the time of such knowledge.

FERC's Order states that the off-the-record meetings did not violate the Administrative Procedure Act because "when the pre-filing meetings occurred, there was no proceeding, so the pre-filing meeting was not an *ex parte* communication. The APA defines an '*ex parte* communication' as 'an oral or written communication not on the public record with respect to which reasonable prior notice to all *parties* is not given.' A 'party' is 'a person or agency named or admitted as a party, or properly seeking and entitled as of right to be admitted as a party, in an agency *proceeding*.' Prior to filing, as there was no Commission proceeding, the APA's prohibition on *ex parte* communication could not apply." (Order at 138)

This argument twists the apparent legislative intent of Congress. FERC's interpretation would negate the language and legislative intent of 5 USC § 557(d)(1)(E): "the prohibitions of this subsection shall apply beginning at such time as the agency may designate, but in no case shall they begin to apply later than the time at which a proceeding is noticed for hearing *unless the person responsible for the communication has knowledge that it will be noticed, in which case the prohibitions shall apply beginning at the time of his acquisition of such knowledge*." [emphasis added]

According to FERC, the definitions of "*ex parte* communication" and "party" require that any "parties" involved in such communications must be already part of a proceeding, thereby nullifying the language of 5 USC § 557(d)(1)(E) that explicitly discuss the circumstances banning such *ex parte* communications once a Commissioner "has knowledge" that the subject matter of the discussions "will be noticed." The text and intent of the Administrative Procedure Act are crystal clear: off-the-record communications are forbidden once a Commissioner "has knowledge that" the subject of the communication "will be noticed" for hearing. The companies' May 27, 2005 SEC filing describing the merger provided such notice, and therefore any *ex parte* off-the-record communications after that point were in conflict with the Administrative Procedure Act—regardless of whether FERC's rules purport to permit such communications. Moreover, "parties" are defined as those "entitled as of right to be admitted as a party," and there can be no question that the merger applicants meet this requirement as regards any proceeding that follows their merger approval request under Section 203.

The public must have a detailed description of what was said by whom at these meetings because they may have served as a de facto negotiation, where Commissioners may have made comments or commitments or suggestions that compromise their objectivity or bias during the public hearing.

Public Citizen therefore renews its request that all participants in any and all of these meetings with FERC Commissioners—including FERC Commissioners themselves—testify under oath about what was discussed at the meetings, and that such testimony be made part of the public record of this proceeding.

Furthermore, FERC's Order asserts "that Public Citizen makes no effort to explain when, in its view of the APA, a 'proceeding' begins. Under Public Citizen's view, there is no limit to how early a 'proceeding' begins." (Order at 138)

The Commission's view that Public Citizen has failed to explain when the prohibition on ex parte communications begins is incorrect. Consistent with the clear terms of the statute, we explained that the prohibition begins when a party to a communication knows that the matter will be noticed for hearing. We further noted that the May 9, 2005 merger announcement and SEC filing by the two companies served notice to FERC Commissioners that the topic of communication would "be noticed" for hearing. That filing noted that the merger is contingent upon "the consent and approval of the Federal Energy Regulatory Commission." This official notice describing the merger is when the "clock started ticking," triggering the prohibition on any off-the-record discussion on the matter.

FERC also mischaracterizes our citation of *Electric Power Supply Association v. FERC*, claiming that we mention the case to support our "argument that the Commissioners' pre-filing meetings violated the APA. However, *EPSA* dealt with *ex parte* communications related to a specific 'pending on-the-record proceeding' and post-filing meetings…In the situation at hand, there was no 'pending on-the-record proceeding' because no application had yet been filed." (Order at 140)

The Order reflects FERC's failure to understand that we cited *Electric Power Supply Association v. FERC*, not to establish that pre-filing meetings violate the APA, but to remind FERC that the APA trumps whatever rules FERC has on *ex parte* communications: "FERC's rules are not the last word on whether an *ex parte* contact is lawful." The U.S. Court of Appeals for the DC Circuit ruled that "the Sunshine Act is a statute of general applicability governing FERC and all other federal agencies within its compass. FERC has no authority whatsoever to change the terms of the Act; rather, FERC must conform its regulatory activities to comply with the overriding terms of the Sunshine Act…The key to exclusion under the Sunshine Act is not the label given the communication, but rather whether there is a possibility that the communication could effect the agency's decision in a contested on-the-record proceeding."

FERC's Order also states "that the current proceeding is not the proper venue for Public Citizen to challenge the validity of the Commission's regulations; its arguments are, in fact, a collateral attack on those regulations…If Public Citizen believes that the Commission should amend its regulations, Public Citizen should submit a petition for rulemaking setting forth the changes it believes are necessary." (Order at 141)

Again, FERC's assertions are misguided. This merger proceeding is absolutely the proper venue to raise the issue of the legality of *ex parte* communications, because these *ex parte* communications play a significant role in creating the perception that FERC Commissioners have been biased, causing us harm. This proceeding is the only relevant venue for us to offer our remedy (asking all meeting participants to testify under oath who said what during the illegal meetings).

Finally, regardless of whether or not the Sunshine Act was violated, our right to due process was violated, along with our rights under the Administrative Procedure Act to an impartial decision maker, since the private meetings with interested parties have left the Commissioners biased.[5]

II. FERC finds nothing "inherently wrong with a particular firm or individual performing analyses in a number of cases." (at 71)

FERC's Order fails to adequately explain why consumers are not harmed by having one consulting firm, paid for by the applicants, provide analysis *unchallenged by evidentiary hearings* that forms the basis of FERC's approval of the merger. As we noted, Dr. William H. Hieronymus provided not only the merger analysis for the Duke-Cinergy merger, but also for the Exelon-PSEG merger and his firm, Charles River Associates, provided the analysis for the MidAmercian-Pacificorp merger. That means that the analysis provided to justify all three of the biggest electric utility mergers of 2005 were conducted by Dr. Hieronymus or his firm, Charles River, without any opportunity for the public to challenge the analysis in an evidentiary hearing. It is an unfortunate irony that a regulatory commission like FERC that pushes for "competitive" energy markets tolerates a monopoly of consultants.

Furthermore, FERC claims "that it does not have the authority to determine the individual or the consulting firm that applicants use to perform their merger analysis." But FERC does have the authority to schedule evidentiary hearings to provide opportunity to challenge these monopolist consultants, and that's why we have called for such hearings.

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.

The public interest is not served by allowing one individual or one firm to hold a monopoly on merger analyses. Therefore, Public Citizen submits that evidentiary hearings are required in order to challenge whether the analysis provided by Dr. Hieronymus is prejudiced in favor of the companies that pay his fees.

III. Power marketing is excluded from market concentration analysis

FERC denies our "request that a new market power analysis be performed that includes all of Applicants' power marketing activities. The Commission's Appendix A analysis focused on capacity *controlled* by all potential sellers in the relevant market. Without control of capacity,

[5] *Cinderella Career & Finishing Schools v. FTC*, 425 F.2d 583 (D.C. Cir. 1970)

whether through ownership of physical assets or through power purchase agreements, sellers cannot harm competition in wholesale energy markets. If Applicants (or any other potential suppliers) gain control of generation capacity through power marketing activities, the Appendix A analysis does consider power marketing activity, but the mere presence of a large power marketing operation, *per se*, does not, in itself, confer any additional market power." (Order at 73)

These assertions by FERC conflict with recent documented practices of disgraced power marketers like Enron. First, FERC is denying that power marketing activities have the effect of controlling power plant capacity. Has FERC already forgotten the lesson learned by Duke Energy and Enron's market manipulation? Enron was able to control significant market share in California without owning a single power plant because of its power marketing activities. The recent release of Enron tapes describing that company's successful efforts to manipulate a market under the direct regulatory control of FERC implies that market power may be obtained by controlling, through power marketing, as little as 52 megawatts of generation (as opposed to owning plants outright).[6] This forces one to conclude that at certain peak hours, control over small amounts of generation can lead to large control of market power.

The market power impact of power marketing can be temporary in nature, with contracts entered into for short-term purposes with sellers exploiting needs at peak hours. FERC claims that "the Appendix A analysis does consider power marketing activity," but that may amount to a snapshot at one particular time, ignoring larger trends showing bigger positions and therefore inaccurately recording the true market power reflected in power marketing. Indeed, the data contained in the Electric Quarterly Reports provides inadequate detail of the company's power marketing activities.

Failure to include power marketing activities underrepresents the companies' ability to exercise market power. This problem can be corrected by holding evidentiary hearings in order to obtain more information about the companies' power marketing activities.

IV. **Transferring power plants to Cinergy raises problems**

We argued that the transfer of Duke's unregulated generation assets, DENA, "will likely be folded into Cinergy's regulated revenue requirement, raising the potential for rate increases for Cinergy customers. This presents a particular problem since Cinergy holds a virtual monopoly over its residential customers." (Public Citizen, page 9) Of the 588,684 residential customers in Cinergy's Cincinnati Gas & Electric utility's service area, over 97% (or 573,087) continue to be served by Cinergy.[7] As a result, residential customers effectively have no option to choose alternative suppliers.

Duke Energy's financial performance in its operation of these "unregulated" merchant plants has

6 Jonathan Peterson, "Tapes Reveal Enron's Power Plant Rigging," *Los Angeles Times*, February 4, 2005.
7 www.puco.ohio.gov/Puco/StatisticalReports/Report.cfm?doc_id=365

been poor, so this is a clear attempt to save the company money and charge consumers more by sticking the power plants in Cinergy's regulated revenue requirement, forcing consumers to pay for them. Indeed, we foresee a scenario where Cinergy's Indiana and Ohio utilities will be buying more intra-company power than they should when market prices are high (especially from the DENA merchant plants being transferred to CG&E) and selling more than they should when market prices are low.

The Duke-Cinergy merger proposal must be rejected because this transfer of assets from Duke Energy to Cinergy is in violation of FERC's own rules regarding the transfer of assets between affiliates and will lead to higher rates for consumers, harming the public interest. (Public Citizen, pages 9-10).

FERC's Order rejected this argument, claiming that "CG&E would not be able to pass on inflated costs to captive ratepayers [stemming from the DENA transfer] because the Ohio restructuring limits CG&E to the recovery of certain costs associated with its existing generation, not newly-acquired generation." (Order at 115)

FERC's assertion, made without supporting documentation, is erroneous. As clearly stated in a recent Ohio filing:[8]

> *CG&E intends to enter into an unspecified "financial arrangement" [with Duke Energy that will] recognize that currently the revenues from the dispatch of these generating assets do not meet the cash costs associated with operating the [DENA] generating assets…the pre-filed testimony refers to mitigating "potential cash shortfalls" relating to the DENA Midwest Assets…Cinergy and Duke seek to shift the costs and risks associated with the DENA Midwest Assets away from Duke's shareholders and towards the ratepayers of CG&E…it is not clear that the current RSP or Commission rules would prevent CG&E from passing through to customers the uneconomic power from these assets…the [Public Utilities Commission of Ohio] should be deeply concerned that CG&E may attempt to charge customers for high costs associated with the DENA Midwest Assets in the System Reliability Tracker ("SRT") and the Fuel and Economy Purchased Power ("FPP") clause of CG&E's jurisdictional retail rates…CG&E has not been willing to commit in writing to cure this potential issue.*

This filing by the Ohio Consumers' Counsel is remarkable for how much key information is gleaned from internal company emails and other communications obtained through discovery—the exact same discovery FERC has denied Public Citizen by failing to hold evidentiary hearings. The key references in the OCC filing have been redacted due to Cinergy-Duke claims of proprietary information. As a result, Public Citizen is currently denied access to such "smoking gun" company memos outlining their strategy to stick ratepayers with the uneconomic costs of the DENA assets. Therefore, FERC must hold evidentiary hearings so Public Citizen can obtain these documents in this FERC proceeding to help determine whether ratepayers will be harmed by the merger.

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8 *Initial Comments on Staff Recommendations by the Office of the Ohio Consumers' Counsel*, Case No. 05-732-EL-MER, December 1, 2005, www.puco.ohio.gov

V. The companies have a track record of cheating consumers

FERC failed to address concerns Public Citizen raised about Duke Energy's track record of cheating consumers. As we stated previously (Public Citizen, pages 7-8), in their FERC filing, the companies claim the merger "will build on the reputations of both Duke Energy and Cinergy as responsible corporate citizens."

But Duke Energy does not have a reputation of being a responsible corporate citizen. Rather, Duke Energy has a track record of manipulating markets and misleading regulators. Duke Energy has been forced to pay $257 million to settle allegations of market manipulation and other misdeeds:

- In July 2004, the California Attorney General announced a $207.5 million "electricity price gouging settlement" with Duke Energy for the company's role in ripping off the state's consumers during the crisis that led to forced blackouts.[9]
- In September 2003, the U.S. Commodity Futures Trading Commission fined Duke Energy a "civil monetary penalty" of $28 million for manipulating natural gas markets.[10]
- In December 2003, FERC fined Duke Energy $2.5 million for intentionally withholding electricity from the California market in a successful scheme to drive prices up and make more money. In the process, Duke Energy's actions helped plunge millions of Americans into corporate-sponsored blackouts.[11]
- In September 2004, FERC forced Duke to pay $549,973 for violating California energy market rules.[12]
- The California Independent System Operator rescinded $14.4 million in payments Duke Energy had received after the company did not make its power plants available for the California market. The CAISO then issued a $4.5 million fine against Duke for failing to follow California market rules during a declared system emergency.

In July 2005, the Securities and Exchange Commission imposed a cease-and-desist order on Duke Energy because the company engaged in power and natural gas trading "without having internal accounting controls that were sufficient to ensure the company's traders properly" recorded their speculative deals. As a result, Duke Energy illegally classified $56.2 million of the company's speculative power and natural gas trading operations.[13] The investigation into Duke Energy's energy trading operations resulted in criminal charges against three Duke employees.

In addition, Cinergy was forced to pay a $3 million "civil monetary penalty" in November 2004

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9 http://caag.state.ca.us/newsalerts/2004/04-073.htm
10 www.cftc.gov/opa/enf03/opa4840-03.htm
11 http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=10036413
12 http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=10249362
13 www.sec.gov/litigation/admin/34-51995.pdf

to the U.S. Commodity Futures Trading Commission for manipulation of natural gas prices.[14]

In light of this horrendous track record, Public Citizen renews our demand that Duke Energy provide a detailed description of what management changes have occurred that will convince consumers that the company can be trusted. Such a description should include a list of all executives who continue to serve in management positions who had similar positions at the time that the company was engaged in manipulating markets and falsifying its accounting, and defend why these executives can be trusted today. As long as the same executives who helped perpetrate one of the greatest frauds upon the American people are still in a decision-making capacity at the company, the merger is not in the public interest.

VI. The Merger poses greater risks to the environment

Again, FERC failed to even address our contention that the merger poses risks to the environment. In Duke-Cinergy's merger filing with FERC, the companies boast on page 17:

> The Transaction will create a stronger platform from which to continue the Applicants' leadership in finding practical solutions to the environmental challenges facing the industry and the nation. The demonstrated commitment by the Applicants to proactively shape the climate change debate forms the basis for a substantial contribution to the development of a long-term carbon reduction strategy that will benefit both shareholders and the larger public interest.

This is quite an inspiring message, until further review of the Merger proposal reveals that it contains no information on how exactly the merger will in fact provide "practical solutions to the environmental challenges facing the industry and the nation."

In fact, the merger will simply solidify the company's investments in using fossil fuels for electric power. Now, we wouldn't normally make climate change demands before FERC, but it was the companies themselves who raised the issue of their commitment to solving climate change.

A recent paper[15] outlines the pending financial risks to the electric utility industry due to compliance with regulations to address climate change. The report suggests that utilities can protect their shareholders and consumers from these financial risks by implementing an assessment of the cost that emissions will have when evaluating the company's resource options. That way, the true costs of a company's investments in coal and natural gas fired power plants can be more accurately compared to alternatives such as renewable energy or demand reduction programs.

We therefore request that, as a condition of the merger's approval, Duke-Cinergy adopt such a

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14 www.cftc.gov/opa/enf04/opa5020-04.htm

15 Karl Bokenkamp, Hal LaFlash, Virinder Singh, Devra Bachrach Wang, "Hedging Carbon Risk: Protecting Customers and Shareholders from the Financial Risk Associated with Carbon Dioxide Emissions," *The Electricity Journal*, Vol. 18, Issue 6, July 2005.

strategy in order to best serve consumers.

VII. The merger violates Cinergy's prior settlement agreement

An informational filing made by Duke Energy with the SEC on December 20[16]—just five days after FERC's approval of the merger— disclosed new information revealing that the merger violates a Commission-approved settlement agreement that Cinergy entered into in 1994.

On December 23, 1992, PSI Energy, Inc. and the Cincinnati Gas & Electric Co. filed an application under Section 203 of the Federal Power Act for approval of their merger into the newly formed Cinergy Corp. in FERC Docket No. EC93-6. FERC issued an Order conditionally approving the merger on August 16, 1993. On September 3, 1993, PSI and CG&E accepted the conditions. However, various parties filed rehearing applications and the Commission became concerned about the authority of the affected state utility regulatory commissions – including specifically the Indiana state commission – to approve the merger. State regulatory jurisdiction had been affected in July 1993 when the merger was amended to reflect Cinergy's election to become a holding company owning public utility stock, rather than remain a utility directly owning CG&E's and PSI's utility assets, works and franchises. As a result, on January 12, 1994, FERC withdrew its conditional approval and established a 60-day, Commission-sponsored settlement process. If by March 21, 1994, the settlement judge assigned to the case had not reported that a settlement had been reached, the Commission stated its intent to set for hearing the issue of whether the Cinergy merger would impair the effectiveness of state regulation.

As a result of FERC's January 12, 1994 order, representatives from the Indiana, Ohio and Kentucky state utility commissions, along with the Consumer Counselors' offices of Indiana and Ohio, the Citizens Action Coalition of Indiana, Inc., and certain of PSI's large industrial customers, participated in collaborative settlement discussions with PSI and CG&E. The proposal resulting from the collaborative process involved a global settlement of merger-related issues reflected in a number of documents to be reviewed and approved by FERC and the affected state commissions. One of the main components of this global settlement was a detailed system for cooperative, coordinated post-merger regulation of Cinergy by state and federal regulators.

By order issued October 3, 1994, the FERC approved this global settlement. In the order, FERC expressly noted that PSI and CG&E had settled their disputes with interested state commissions, including the IURC, thereby clearing the way for FERC's re-approval of the merger.

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16 *See* http://www.sec.gov/Archives/edgar/data/30371/000134100405000596/0001341004-05-000596.txt. (Disclosure of proposed settlement of Indiana proceedings on ratemaking, accounting and affiliate transactions which would become effective conditional upon consummation of merger). *See also* Notice of Settlement in Principle, filed by the Indiana Commission in this docket on December 22, 2005.

The 1994 System of Cooperative, Coordinated Regulation for Cinergy and PSI Energy

Under the Indiana settlement, included as an integral part of the Commission-approved 1994 global settlement, cooperative state-federal regulation of Cinergy between the Indiana Utility Regulatory Commission (IURC) and FERC is coordinated in three ways. First, the filing requirements of the Cinergy Affiliate Guidelines reconcile, from a timing and process standpoint, Indiana statutes requiring review and/or approval of contracts between PSI and its affiliates and federal statutes that required the approval of FERC (and/or the SEC) of these same contracts. The pre-filing of contracts with the Indiana commission required by the Indiana settlement was intended to allow the IURC and other interested Indiana parties to identify problem areas in affiliate contracts prior to their filing with one or both of the affected federal agencies. Certain contracts would receive a full review and express approval from the IURC before being filed at FERC or the SEC; others would be filed and deemed approved if not rejected by the IURC within a specified review period. If the IURC rejected or disapproved an affiliate contract before it was approved or accepted by FERC or the SEC, then the contract would be terminated or withdrawn, subject to whatever subsequent regulatory approval might then become necessary. Even after a contract had been approved or accepted by the FERC or the SEC, the Indiana settlement provided that a rejection or disapproval by the IURC under circumstances defined in the Affiliate Guidelines and not adversely affecting another state, required that PSI take steps to terminate or amend the contract to address IURC concerns. PSI was also expressly required to comply with the requirements of the Indiana statutes relating to integrated resource planning, certificates of need for new generation, and environmental compliance planning.

The second element of coordinated regulation established under the Indiana settlement addressed the fact that, under Cinergy's registered holding company structure, two or more state commissions may be affected. Balance must be achieved in weighing the need for sovereignty against the need for some measure of comity to another regulatory body in order to encourage the integrated operations necessary to maximize efficiencies and lower costs to customers in each affected State. In providing for the "upfront" reviews and approvals of affiliate contracts, capacity additions, and environmental compliance plans by the IURC, the Indiana settlement maximized the jurisdictional reach of the Indiana commission while also recognizing the coordinate authority of other affected state commissions. However, after-the-fact changes required comity to the interests of each affected state regulatory commission to resolve potential differences.

The third area where the Indiana settlement provided for coordinated regulation involved the jurisdictional relationships among the IURC and either FERC or the SEC. As a general matter, State commissions have often found certain of their retail ratemaking authority preempted in areas of overlapping state and federal jurisdiction. The Indiana settlement partially addressed this concern through the prefiling review and approval process of the Cinergy affiliate guidelines, such that, except for disputes over the allocation of costs of Clean Air Act Phase II compliance, any affiliate contract which is filed at the FERC or, heretofore, the SEC has first been reviewed by the Indiana state commission. As to the SEC, the Indiana settlement also included a provision (Section 13.2) in which PSI and Cinergy pledged that they would not raise federal preemption as a defense to a state rate order on the basis that an expense, charge, cost, allocation or contract has been filed with or approved by the SEC. This provision was included to mitigate concerns that had been raised due to the *Ohio Power* decision that traditional state ratemaking authority might by limited by SEC actions.

As to instances where FERC action might preempt state authority, the Indiana settlement carefully negotiated the wording to be inserted in related FERC-approved agreements so as to indicate the contractual intent to preserve the retail ratemaking authority of the IURC to the greatest extent possible. To avoid the unintended preemptive effect of FERC-approved contract provisions, the Indiana settlement included language specifically evidencing intent to preserve IURC authority in the sections relating to future capacity additions, emission allowance transfers, and Phase I compliance with the Clean Air Act Amendments of 1990. Any disputes among states over allocations of Phase II compliance costs would be resolved by FERC, with the IURC retaining jurisdiction over the prudency of implementation costs in Indiana. Indiana exercised its authority over other important areas, such as joint dispatch of the PSI and CG&E systems, split the savings formulae, interim capacity transfers and methodologies for allocating new capacity based on an agreed 17% planning reserve margin by reviewing and approving the Cinergy Operating Agreement prior to its filing at FERC.

Truly, as Cinergy CEO James E. Rogers testified to the Indiana Commission in 1994 (Cause No. 39897, Petitioners' Ex. A., at 35), the provisions of the global settlement approved by FERC relating to Indiana "together form a comprehensive regulatory system which protects and promotes the effectiveness of regulation." Moreover, as the Indiana settlement itself recognizes (Indiana Joint Stipulation and Agreement, at 8-12), once approved by the FERC, these provisions became "binding obligations" of PSI, Cinergy and their affiliates to the Indiana Commission and the other Indiana parties to the settlement, including Citizens Action Coalition of Indiana.

The Duke-Cinergy Merger's Effects on the 1994 System of Cooperative, Coordinated Regulation for Cinergy and PSI Energy

Duke and Cinergy have simply not addressed in their filings with the FERC the effects of their proposed merger on the 1994 system of cooperative, coordinated regulation established for Cinergy and PSI Energy. However, Cinergy and PSI have recently reached a proposed settlement with certain parties in the Indiana proceedings relating to ratemaking and accounting procedures to be applied following consummation of the merger[17] which purports to terminate and supersede the provisions of the 1994 Indiana settlement that established the system of cooperative, coordinated regulation established for Cinergy and PSI Energy. Indeed, this proposed settlement was filed in Indiana the very same day that FERC approved the merger, December 15, 2005. It

[17] As was the case in 1994, the IURC still does not have statutory authority to review and approve the pending merger itself inasmuch as the merger is being accomplished by a transfer of holding company stock rather than operating company assets. *See* Indiana Bell Tel. Co. v. Ind. Util. Reg. Comm'n, 715 N.E.2d 351 (Ind. 1999); GTE Corp. v. Ind. Util. Reg. Comm'n, 715 N.E.2d 360 (Ind. 1999).

is scheduled for hearing before the Indiana Utility Regulatory Commission beginning January 20, 2006.

Citizens Action Coalition of Indiana, which was a party to the 1994 Indiana settlement, is *not* a party to this recent Indiana settlement. Three of the principal reasons that CACI is not a party to this new settlement are:

1. The provisions of the new Indiana settlement which purport to terminate and supersede the provisions of the 1994 Indiana settlement do not protect the authority of the IURC to the same extent as the 1994 settlement, especially in view of the repeal of 1935 PUHCA and the passage of 2005 PUHCA;

2. The process by which the new Indiana settlement was reached does not comply with relevant provisions of the 1994 Indiana settlement, including the provisions of the 1994 settlement that require Cinergy and PSI to negotiate with the Indiana parties including CACI, regarding the implications of the repeal of 1935 PUHCA and the passage of 2005 PUHCA; and

3. The provisions of the recent Indiana settlement that purport to terminate and supersede the provisions of the 1994 Indiana settlement have *not* been presented to the FERC for its review and approval, despite CACI's repeated demands as a party to the 1994 Indiana settlement that it be done.

Accordingly, CACI hereby amends and supplements the Joint Petition in which it previously joined to request a hearing on the additional issue of whether the Duke-Cinergy merger, as proposed, would impair the effectiveness of Indiana state regulation with respect to PSI Energy and its affiliates.

CONCLUSION

For the reasons discussed above, the Commission should grant rehearing of its Merger Order, place an accounting (through testimony under oath by the meeting participants) of its *ex parte* meetings with executives from the merger Applicants on the record, and set the merger for an evidentiary hearing for all of the other reasons cited in this request for rehearing.

Respectfully submitted,

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