

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

Duke Energy Corporation	)	
	)	Docket No. EC11-60-000
Progress Energy, Inc.	)	
	)	

**COMMENTS OF THE ELECTRIC POWER SUPPLY ASSOCIATION**

Pursuant to Rule 212 of the Federal Energy Regulatory Commission’s (“FERC” or the “Commission”) Rules of Practice and Procedure, 18. C.F. R. § 385.212 (2011), the Electric Power Supply Association (“EPSA”)<sup>1</sup> respectfully submits comments on the Duke Energy Corporation (“Duke”) and Progress Energy, Inc. (“Progress”) (collectively, the “Applicants”) October 17, 2011 filing<sup>2</sup> of a plan to mitigate the horizontal market power that will result from their pending merger. The Applicants’ proposal is insufficient, and should be rejected. The Applicants have stated several times in this proceeding that their main goal is to gain merger approval as quickly as possible. Yet, instead of proposing a comprehensive and detailed mitigation plan that would address demonstrable and legitimate market power issues identified in the Commission’s

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<sup>1</sup> EPSA is the national trade association representing competitive power suppliers, including generators and marketers. Competitive suppliers, which, collectively, account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities. EPSA seeks to bring the benefits of competition to all power customers. The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue. EPSA intervened in this docket on June 3, 2011. The Commission accepted EPSA’s intervention in its September 30, 2011 Order.

<sup>2</sup> Compliance Filing of Duke Energy Corporation and Progress Energy, Inc., Docket No. EC11-60-000 (filed Oct. 17, 2011) (the “October 17 Filing”).

September 30, 2011 Order,<sup>3</sup> the Applicants have submitted a vague and likely ineffective proposal that fails adequately to address those market power concerns.

The Applicants have filed a comprehensive request for rehearing adamantly insisting that the Commission's assessment of potential market power is incorrect and that the proposed merger does not raise competitive concerns.<sup>4</sup> The same belief informs the Applicants' October 17 Filing inasmuch as it is clear that the Applicants have proposed a "non-solution" to what they perceive, wrongly in EPSA's view, as a "non-problem." Unless and until the Commission grants rehearing and accepts the Applicants' position, however, they are obligated to comply with the Commission's September 30 Order. Consequently, if the Applicants want to finalize this proceeding expeditiously, they need to comply. EPSA submits that the most effective way to do so would be for the Applicants to join an existing Regional Transmission Organization ("RTO"). Even if they are unwilling to do so, they must propose a workable solution to remedy the market power issues arising from their proposed merger if they wish to move forward in the absence of a Commission order granting their request for rehearing.

## **I. COMMENTS**

### **A. Flaws and Insufficiencies with the Mitigation Plan**

In the September 30 Order, the Commission found that the proposed merger between Duke and Progress "will increase *already excessive* levels of market

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<sup>3</sup> *Duke Energy Corp. & Progress Energy, Inc.*, 136 FERC ¶ 61,245 (2011) (the "September 30 Order").

<sup>4</sup> See Request for Rehearing of Duke Energy Corporation and Progress Energy, Inc., Docket No. EC11-60-002 (filed Oct. 31, 2011) ("Duke/Progress Rehearing Request").

concentration in the Duke Energy Carolinas and Progress Energy Carolinas-East BAAs.”<sup>5</sup> The Commission identified five potential options for mitigation: (1) membership in an RTO; (2) implementation of an ICT arrangement; (3) physical generation divestiture; (4) virtual divestiture; and, (5) transmission upgrades.<sup>6</sup> The September 30 Order also emphasized that any option that the Applicants may choose remains subject to Commission approval. There were no guarantees in the September 30 Order as to how long Commission approval of any option may take.

The Applicants’ October 17 Filing proposed virtual divestiture and requested that the Commission accept the proposal by December 15, 2011.<sup>7</sup> The virtual divestiture plan as proposed in the instant proceeding will fail to mitigate market power concerns in a number of key ways. First, the proposal is an ineffective remedy as there are opportunities for the offered megawatts to remain in the control of the Applicants. Second, the buyer pool for the offered megawatts is extremely limited. Finally, the plan is extremely vague, lacking sufficient information to support Commission approval, particularly regarding the proposed market monitoring arrangement.

*i. Megawatts may not be virtually divested and may instead be sold regularly under the Applicants’ tariff.*

Under the proposed mitigation plan, there is still the very real potential for the exertion of market power in the Carolinas. The Commission has clearly found that the Applicants’ merger would result in market power, and has required that the Applicants

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<sup>5</sup> September 30 Order at P 139 (emphasis added).

<sup>6</sup> *Id.* at P 1.

<sup>7</sup> October 17 Filing at 1. Virtual divestiture, as the Commission has defined it, refers to transactions in which a generation owner sells rights or entitlements to all or a portion of a generating plant’s output, rather than selling the generating plant outright. *See September 30 Order, n. 277.*

propose sufficient mitigation, namely mitigation that will ensure that Herfindahl-Hirschman Index (“HHI”) increases attributable to the merger do not exceed 50 points for highly concentrated markets and 100 points for moderately concentrated markets.<sup>8</sup> Nonetheless, the Applicants’ proposed virtual divestiture plan suffers from several major flaws and falls short of mitigating that market power.

In order for the Applicants’ mitigation proposal to satisfy the HHI requirements of the September 30 Order, they would have to sell most of the energy from Available Economic Capacity (“AEC Energy”) that they propose to virtually divest in each proposed divestiture hour. But there is no assurance that they will, in fact, do so, in which case the merged company will be free to sell that energy at a market-based rate to any buyer and the HHI limits will clearly be exceeded. Given the very limited pool of buyers to whom the 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 the Applicants’ own terms.

This highlights the most obvious flaw in the Applicants’ mitigation proposal, the Applicants’ failure to relinquish dispatch control of the AEC Energy megawatts. In fact, the proposal states:

If the full amount of AEC Energy offered at the cost-based prices is not purchased in a particular hour, the Applicants can offer to sell the unsold amount to other parties either inside or outside the Applicants’ BAAs consistent with their applicable tariffs.<sup>9</sup>

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<sup>8</sup> September 30 Order at P 117.

<sup>9</sup> October 17 Filing at 4.

As a result, if there is no buyer under the must offer obligation, those megawatts return to the functional control of the merged entity and can be sold pursuant to the normal conditions of the tariff. Thus, there is no way to truly tell what the HHI level will be of the merged entity in any given hour. This problem is exacerbated by the fact that the proposal severely limits the pool of proposed buyers to only “entities ultimately serving load located in the PEC East and DEC BAAs.”<sup>10</sup> This restriction increases the likelihood that the AEC Energy will not be sold at the mitigated rate.

Finally, the mitigation plan specifies that the must offer obligation is interruptible if reliability obligations are at stake.<sup>11</sup> The October 17 Filing, however, provides no specific details as to what may constitute a reliability interruption. If the Applicants are left with unfettered discretion to determine what sort of reliability obligations are sufficient to interrupt AEC Energy sales, they will be in a position to retain and sell the AEC Energy outside of the must offer obligation under the guise of reliability for any number of reasons. The existence of a vague right to interrupt will also reduce the marketability of the AEC Energy and increase the likelihood that the plan fails to satisfy the Commission’s HHI requirements.

At the end of the day, there are simply too many ways the must offer obligation could disintegrate into a straight power sale between the merged entity and any buyer of its choosing at market-based rates. The HHI levels outlined in the proposal are therefore irrelevant to what the actual market concentration of the merged entity will be in any given hour. The virtual divestiture plan should include a concrete way to reduce

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<sup>10</sup> *Id.* at 6.

<sup>11</sup> *Id.* at 5 (describing the “Obligation to Deliver AEC Energy”).

the HHI levels to assuage the market power concerns the Commission has correctly identified.

*ii. The market monitoring plan is too vague.*

The discussion of the market monitoring plan in the October 17 Filing consists of two paragraphs and does not specify any date by which the merged entity will provide the Commission with further details. The October 17 filing states that “the Applicants have not yet selected the independent monitoring entity.”<sup>12</sup> Further, the Applicants do not even commit to provide specific details of the market monitoring arrangement, stating only that they “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 the Applicants’ mitigation proposal takes effect” in an “informational filing” to be made sometime “prior to the first offer under this proposal.”<sup>13</sup> The Commission cannot and should not approve the mitigation plan without obtaining details of the market monitoring arrangement for assessment and approval. Notwithstanding the implication of the Applicants’ suggestion that additional information about the mitigation plan be provided through an “informational filing,” it is also essential that market participants and other stakeholders be afforded a full opportunity to review and comment on the plan. The market monitoring function is essential to ensuring that there is no exercise of market power, particularly given the various gaps in the divestiture proposal. Insufficiencies of the proposed divestiture plan aside, the arrangement between the merged entity and the independent market monitor is as important as the details of the

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<sup>12</sup> *Id.* at 6.

<sup>13</sup> *Id.*

must offer obligation under the virtual divestiture plan. The Commission has a history of conditioning mitigation plans on the sufficiency of the market monitoring arrangement.<sup>14</sup> Two vague paragraphs (one of which simply says that an informational filing is forthcoming) in an already flawed proposal should not satisfy the Commission in a proceeding in which the merger in question falls largely outside of independently operated competitive organized wholesale electricity markets and “results in significant screen failures in the horizontal market power analysis and will thereby have an adverse effect on competition.”<sup>15</sup>

### **B. The Commission Should Reject the Applicants’ Mitigation Plan**

As the virtual divestiture plan fails to mitigate the market power created by the pending merger, the Commission should reject the Applicants’ proposal. In addition, the Commission should, to the extent necessary, ensure that appropriate and sufficient mitigation measures are in place, even if this necessitates a hearing process.

While the Applicants have repeatedly emphasized the importance of obtaining approval by the end of 2011, they have only themselves to blame if this goal is not achieved. It was their choice to propose an unprecedented and largely unsupported mitigation plan, rather than other mitigation measures, such as joining an RTO, that would clearly have satisfied the requirements of the September 30 Order.

The September 30 Order expressly contemplates that the Commission can and will take further steps to ensure that whatever was proposed in response to that order adequately addresses its concerns. The September 30 Order states that “after

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<sup>14</sup> See, e.g. *Entergy Servs., Inc.*, 115 FERC ¶ 61, 095, *order on reh’g*, 116 FERC ¶ 61, 275, *order on compliance*, 117 FERC ¶ 61, 055 (2006), *order on clarification*, 119 FERC ¶ 61, 013 (2007).

<sup>15</sup> September 30 Order at P 1.

analyzing these new submissions and comments, the Commission will make a finding as to whether the proposed mitigation measures remedy the screen failures identified below and determine what further steps, if any, are necessary.”<sup>16</sup> In light of what the Applicants opted to propose, instituting hearing procedures would be perfectly reasonable and is certainly consistent with the approach taken in past proceedings involving transactions of this size that have been shown to raise market power concerns. The September 30 Order (quoting the Commission’s Merger Policy Statement) noted that “proposing mitigation measures could ‘avoid the need for a formal hearing on competition issues and thus result in a quicker decision.’”<sup>17</sup> While the Commission abided by its merger policy to allow the Applicants an opportunity to propose mitigation in order to avoid the need for a hearing, the Applicants have failed to do so sufficiently. The Commission should set the virtual divestiture proposal for hearing to explore what modifications could properly and sufficiently mitigate the problems posed by the transaction.<sup>18</sup> In the meantime, the Applicants could always propose other mitigation plans, including joining an RTO.

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<sup>16</sup> September 30 Order at P 117.

<sup>17</sup> *Id.*

<sup>18</sup> For example, the Commission could look at the virtual divestiture clauses in several Canadian Alberta PPAs. The key to this virtual divestiture is that the entity divesting the power must fully give up dispatch control. When the Alberta power market deregulated in 2000, the owners of regulated generating units were allowed to retain ownership of such assets; however, in order to foster competition with the sale of electricity into the Power Pool, power from these regulated units was decoupled from asset ownership. The government of Alberta required various power purchase arrangements from the assets to be made available by auction to qualified bidders. Successful bidders purchased a specific power product and, subject to certain conditions, were able to resell the energy into the marketplace and/or consume the energy directly. The PPAs are long-term arrangements (maximum of 20 years or the end of the useful life of the unit) between the regulated generating unit and the buyer. The PPAs were developed to allow the owner of generated units to recover investments made in a regulated environment while allowing for increased competition within the industry. There is a distinction between the rights to the benefit of energy anticipated within the PPA and to the benefit of so-called “excess energy” over and above that

To be clear, EPSA is not universally opposed to virtual divestiture as an appropriate and effective mitigation method, and EPSA does not advocate undue delay in the processing of applications under Section 203 of the FPA. EPSA simply shares the concerns stated in the September 30 Order about this merger's negative effects on competition in an area that already has little to no competition today.<sup>19</sup> If expedition is truly a top priority for the Applicants, EPSA maintains that joining an existing RTO is the best solution going forward, as the virtual divestiture plan they have proposed in this docket is wholly insufficient.

### C. Joining an RTO: The Most Efficient and Timely Solution

The Applicants have repeatedly stated their desire to “obtain all FERC approvals needed by the end of this year to close the merger transaction.”<sup>20</sup> EPSA appreciates that the September 30 Order gave the Applicants several choices for market power mitigation. However, by laying out a list of options, the September 30 Order did not imply that each option would be equal in effectiveness or timeliness for analysis and approval. Virtual divestiture can resolve market power screen failures and mitigate concerns arising under a Section 203 application only when it is properly and

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anticipated. There is both a temporal and volume limit on the energy to be covered by the PPAs. The owners are free to enjoy the benefits associated with the output of the plant in excess of that under PPA, accepting the risks associated with the competitive market.

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<sup>19</sup> See Motion to Intervene and Comments of the Electric Power Supply Association at 2, Docket No. EC11-60-000, et al. (filed June 3, 2011) (“Of note, the Application indicates, with minor exceptions, that Progress Energy makes competitive purchases from **only four** suppliers.”).

<sup>20</sup> October 17 Filing, n. 3.

transparently structured to ensure it achieves the desired result. As mentioned above, however, there are obvious flaws in the Applicants' proposed mitigation plan. The Commission must fully assess the Applicants' plan and explore ways to address its flaws because the proposed solution outlined in the compliance filing may not be effective in addressing market power concerns and lacks sufficient detail for this to currently be determined.

If the Applicants were serious about fixing the problem in order to obtain all FERC approvals by year end 2011, they should have joined an RTO as this would have been the most concrete way to satisfy the Commission's market power concerns. For example, joining an RTO puts the Applicants in a much larger market footprint. If a speedy merger approval is the top priority for Applicants, it is unclear why they did not pursue RTO membership. Duke Energy is on record praising the benefits of RTOs and competitive markets. And as additional incentive, joining an established RTO as a condition of a merger has precedent as an effective way to mitigate market power concerns. For example, when AEP merged with CSW, the merging companies committed to "joining a Commission-approved RTO and transferring to the RTO functions related to transmission service, transmission security and reliability, and control area responsibilities."<sup>21</sup> AEP and four other utilities first attempted to create an RTO, which also was a potential option that the Commission offered in the instant proceeding. However, the Commission found that this new RTO (the "Alliance RTO")

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<sup>21</sup> *American Electric Power Co., et al.*, Opinion No. 442, 90 FERC ¶ 61,242, p. 4 (2000), *order on reh'g*, 91 FERC ¶ 61,129 (2000) (affirmed in relevant part), *appeal denied sub nom. Wabash Valley Power Ass'n v. FERC*, 268 F.3d 1105 (D.C. Cir. 2001).

lacked the necessary criteria for Commission approval.<sup>22</sup> AEP then proposed to join PJM and the Commission accepted. AEP's example illustrates two lessons relevant to the instant proceeding: (1) forming a new RTO requires time with a high bar for Commission approval; and (2) joining an existing RTO can alleviate market power concerns pertaining to a Section 203 merger application.

Duke's assets in Ohio are not only part of the PJM RTO, but the state-mandated Electric Security Plan is compiled through settlement discussions with all interested stakeholders. On October 24, 2011, Duke Energy Ohio issued a news release touting the "advantage of today's low market rates" resulting from a "focus on the long-term competitiveness of [Duke's] generation assets in Ohio."<sup>23</sup> The news release further notes that working with interested stakeholders "was instrumental."<sup>24</sup> While the Applicants have several options available to mitigate their market power concerns, a clear and beneficial path for Duke's Carolina consumers would be to join a competitive market, similar to that which has proven so beneficial for Duke's Ohio consumers.

EPSA obviously understands that RTO membership is voluntary. As the insufficient virtual divestiture proposal submitted by Duke and Progress does not properly address the Commission's concerns and the Applicants have placed a clear priority on speed, however, joining an RTO would be the most definitive way to balance the Commission's market power concerns with the Applicants' desire for speedy approval of a mitigation plan and their proposed merger. The Commission should

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<sup>22</sup> *Alliance Companies, et al.*, 97 FERC ¶ 61,327 (2001).

<sup>23</sup> The news release is available at: <http://www.duke-energy.com/news/releases/2011102401.asp>

<sup>24</sup> *Id.*

therefore encourage Applicants to reconsider RTO membership, as it would be the most viable way to achieve Commission approval under the Applicants' stated time constraints.

## **II. CONCLUSION**

**Wherefore**, for the reasons stated herein, EPSA respectfully requests that the Commission reject the Applicants' virtual divestiture proposal as insufficient. EPSA further suggests that joining an RTO may provide the most viable solution for resolving the market power concerns identified by the Commission with the Applicants' desire to receive expeditious final approval of a mitigation plan and their proposed merger.

Respectfully submitted,




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Nancy E. Bagot, Vice President of Regulatory Affairs  
Electric Power Supply Association  
1401 New York Avenue, NW  
12<sup>th</sup> Floor  
Washington, DC 20005  
(202) 628-8200

Dated: November 16, 2011

## CERTIFICATE OF SERVICE

I hereby certify that I served a copy of the foregoing pleading this 16<sup>th</sup> day of November 2011, upon each person designated on the official service list compiled by the Secretary in this proceeding.

  
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Nancy E. Bagot, VP of Reg Affairs