File

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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Utah Power & Light Company	)	
PacifiCorp	)	Docket No. EC88-2-000
PC/UP&L Merging Corporation	)	

PETITION FOR REHEARING

On Behalf of

United Mine Workers of America, International Union;
Environmental Action; Salt Lake Citizens Congress;
Salt Lake Area Community Action Program; and
Rogue Valley Fair Share

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PETITION FOR REHEARING OF UMWA, ET AL.

Pursuant to Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. sec. 385.713, the United Mine Workers of America, International Union; Environmental Action; Salt Lake Citizens Congress; Salt Lake Community Action Program; and Rogue Valley (Oregon) Fair Share ("UMWA, et al.") hereby request rehearing on the issues set forth below.

SUMMARY

I. TRANSMISSION ISSUES

A. The Commission's Firm Wheeling Conditions Require Clarification: The amount of capacity set aside for the merged company must be defined more closely to prevent abuse of monopoly power. Tier 1 membership should not be restricted to existing municipal or cooperative systems. Under the Commission's "proration-by-tier" plan, utilities needing capacity for survival could receive less favorable treatment than utilities desiring capacity for profitability; the plan therefore needs adjustment. Moreover, the Commission's treatment of undersubscribed capacity in all three tiers presents problems of timing and discrimination.

The Commission should require wheeling reciprocity in all situations. In addition, "participation" in the construction of facilities 345 kV or higher should include ownership, at the requestor's option. Finally, the merged company's construction obligation should not be limited to lines of voltages 345 kV or higher.

With respect to firm transmission pricing, "cost-based"

pricing should not include assignment to wheeling customers alone of incremental costs of transmission facilities beneficial to all customers. Lack of clarity on this point could make business planning for prospective wheeling customers extraordinarily difficult, and lead to anticompetitive results. Moreover, divisional pricing for transmission should not become "pancaked pricing."

Significant differences between the Commission's conditions and Bonneville Power Administration's Long-Term Intertie Access Policy have implications for environmental protection. These implications require careful investigation.

B. The Commission's Non-firm Wheeling Conditions Permit the Merged Company to Exploit Its Monopoly Power: The Commission was appropriately skeptical of "the merged company's assurances that it will not deny access to competitors in the future." Order at 37. Yet the Commission imposed no obligation to provide non-firm transmission service. The merged company remains free to grant or deny non-firm access at will, or to continue its monopolistic brokering practices, which the Commission expressly condemned. To prevent such practices, the Commission must require the merged company to offer non-firm wheeling on a nondiscriminatory basis. Mr. Russell's allocation method assigns access on the basis of seller efficiency, and ensures that consumers receive the least cost power at any point in time.

"Three-way sharing," in the context of an essential facility, is monopoly pricing. There is no dispute that

three-way sharing deviates from cost-based pricing. Absent explicit justification, deviation from cost-based pricing violates the Federal Power Act. Because no justification appeared on the record, three-way sharing cannot be approved. "Cost-based" rates for non-firm transmission are required.

C. The Commission May Not Leave PURPA Qualifying Facilities Exposed to the Merged Company's Monopoly Power: Exclusion of QFs has no basis in the record, and conflicts with the Commission's analysis of that record. The Commission concluded that the merger "would enhance the merged company's ability to foreclose competition for sales of bulk power." Order at 34. A QF's output is no less "bulk power" than a non-QF's output; therefore, the QF is vulnerable to the merged company's market power. The exclusion violates antitrust principles, Sections 203 and 205 of the Federal Power Act, and PURPA.

D. The Commission's Enforcement Procedure Should Provide for Damages: Under the Commission's complaint procedure, a successful complainant would obtain an order requiring only prospective obedience to the Commission's conditions. The merged company thus has an incentive to breach the conditions and reap monopoly profits until the complaint litigation ends. To eliminate that incentive, the complaint procedure must provide for damages.

II. MERGER BENEFIT ISSUES

A. The Commission Erred in Attributing to the Merger (1) "Pecuniary" Benefits and (2) Savings Attainable Through

Coordination Contracts: Attributing these benefits to a merger will lead, in Mr. Russell's view, to "[m]ore consolidations and acquisitions of utilities ..., with the loss of diversity in ownership and competitive pressure on prices." A policy of excluding from merger "benefits" efficiencies which prudent management is obligated to achieve will not deter mergers that can produce efficiencies. On the contrary, the policy will force hearing participants to focus on those efficiencies and costs truly produced by consolidation.

B. To Eliminate the Merged Company's Incentive to Withhold Merger Benefits, the Commission Should Continue Refund Protection Past 15 Months: The Commission properly concluded that where "a merger generates significant cost savings, there is very little incentive for the new utility to come forward with new rates that fully reflect those savings." Given the unusual incentives in merging companies to avoid or delay rate decreases, the Commission should make clear that the 15-month restriction of the Regulatory Fairness Act will not apply.

ARGUMENT

I. TRANSMISSION ISSUES

We set forth below comments on the Commission's transmission conditions, in five categories. First, the Commission's firm wheeling conditions require clarification or amendment. Second, the Commission's non-firm wheeling conditions permit the merged company to exploit its monopoly power. Third, the Commission may not leave PURPA qualifying facilities exposed to the merged

company's monopoly power. Fourth, the Commission's enforcement procedure should provide for damages. Fifth, the Commission's authority to impose wheeling conditions requires clarification.

A. The Commission's Firm Wheeling Conditions Require Clarification or Amendment

While we largely support the thrust of the Commission's firm wheeling conditions, we seek rehearing for the purpose of making certain clarifications or amendments to them. We address below four aspects of the Commission's firm wheeling conditions: (1) transition period access; (2) post-transition access; (3) pricing conditions; and (4) environmental implications.

1. Transition Period Access

The Commission provides for access during the transition period in two ways: access to existing capacity, and participation in new facilities. Comments on each topic follow.

a. Access to Existing Capacity

i. The amount of capacity set aside for the merged company's own use must not reflect monopoly power. In defining "Remaining Existing Capacity," the Commission reserves two types of capacity for the merged company's priority use: (1) capacity needed to serve "native load customers," and (2) capacity needed to serve "customers under firm contracts entered into prior to the merger application." Order at 40. To prevent abuse of monopoly power, the Commission should clarify or amend this language in several respects.

First, the Commission should make clear, as did Mr. Russell (Ex. 20 at 9, 26-27), that native load includes only "reasonable

projections of growth." The merged company must bear the burden of proving reasonableness. And if actual growth falls below projections, the excess capacity should become part of Remaining Existing Capacity at the earliest possible time. To enforce this requirement, the Commission should order the merged company to update its native load projections annually, and the Commission should review these projections expeditiously. Second, if native load growth surpasses expectations, the merged company must add capacity; it should not interrupt firm wheeling contracts reached under the Commission's conditions. Firm wheeling entitlements should not be treated on a "last-in, first-out" basis.

Third, native load should not include load attributable to territories newly acquired by the merged company. In the past, UP&L could control the options of southern buyers by monopolizing the bulk power markets in the north. The Commission's conditions seek to prevent the merged company from exercising that control. But the merged company still could block other sellers from serving southern buyers by simply acquiring the southern buyers, deeming them "native load," and serving them over transmission capacity set aside for that purpose. The conditions should prohibit that tactic. Fourth, the Commission should establish an affiliate rule so that transmission capacity allocated to an affiliate of the merged company is treated as allocated directly to the merged company.

Fifth, the Commission apparently would assign to the merged company capacity to serve firm contracts which, while entered

into prior to the merger application, still may have been entered into in anticipation of the merger. Mr. Russell testified (Ex. 20 at 25): "There may be contracts which PP&L or UP&L entered into before the date the merger was agreed to, where PP&L's or UP&L's ability to fulfill the contractual obligations was based in part on the benefits offered by the proposed merger." Mr. Russell's Condition #2 therefore did not preserve for the merged companies capacity they desired to serve contractual obligations "entered into in anticipation of the merger." Ex. 20 at 9. As Mr. Russell explained (Ex. 20 at 26):

> A possible example of this problem would be the proposed 140 MW sale from UP&L to Nevada Power. While I am not directly familiar with the facts, it is my understanding that certain parties have alleged that UP&L had assembled a set of nonaffiliated entities to supply the Nevada Power contract, but then discarded these entities in favor of PP&L. [[1]] ... If the Commission were to determine that PP&L had gained a special advantage over its competitors with respect to UP&L's sale to Nevada Power by means of the proposed merger, then the sale should not be treated as a preexisting condition.

The determination whether a sales contract was entered into "in anticipation of the merger" and, therefore, whether it reflected merger-related market power, is of necessity a fact-based inquiry. The Commission should not preclude that inquiry. [2]

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[1] See, e.g., Intervention of Idaho Power and Montana Power.

[2] According to Mr. Topham, the merging companies intend to treat the sale to Nevada Power as a "firm contract entered into prior to the merger application." Transcript of Proceedings Before the Utah Public Service Commission, Case No. 87-035-27 at 81 [hereinafter cited as "UPSC Transcript"]. Case No. 87-035-27 is the UPSC proceeding concerning the proposed merger. The UPSC

If the Commission does choose to replace a factual inquiry with a date certain, that date should not be the "merger application" date. Participants in the western bulk power market became aware of the merger when it was announced, if not before. That date likely preceded the filing of the FERC application. And even if the "merger application" date is the relevant date, it would be the date of the application filed at the first state commission, not the application filed at FERC.

Should the Commission nevertheless afford native load treatment to the Nevada Power contract or any other contract, any extension of the contract, in term or amount, should be treated as a new contract subject to the allocation scheme. See Mr. Russell's Condition #3(a), Ex. 20 at 9-10, 27.

ii. The definition of "Transmission Dependent Utilities" (Order at 40 n.165) should not restrict Tier 1 membership to existing municipal or cooperative systems. Officials of the merging companies view this Commission as intending to limit municipal and cooperative organizations to their existing membership. [3] The Commission should correct them. Transmission Dependent Utilities require transmission access for their existence. In this respect, a to-be-formed municipal system is

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transcripts cited in this brief cover November 8-9, 1988. On those days, the UPSC began an inquiry into the effects on Utah of the conditions imposed by FERC in Docket No. EC88-2-000. The cited UPSC transcript pages are attached as Appendix A hereto. The UPSC will continue that inquiry in hearings beginning November 28, 1988.

[3] See UPSC Transcript at 53-55 (UP&L President Davis).

no different from an existing one. Barring future municipals from Tier 1 would relegate them to Tier 3, with no clear guarantee of a transmission link between load and resource. Absent that guarantee, a future municipal could not obtain the financing to municipalize. Consequently, barring future municipal systems from Tier 1 effectively chokes off future municipalization. That result is inconsistent with antitrust principles. Cf. Otter Tail Power Co. v. United States, 410 U.S. 366 (1973). It also is inconsistent with this Commission's consumer protection duties, since the threat of municipalization disciplines utility monopolies. [4]

iii. Under the Commission's "proration-by-tier" plan, utilities needing capacity for survival could receive less favorable treatment than utilities desiring capacity for profitability. Assume that total Tier 1 demand exceeds Tier 1 capacity; while Tier 2 demand equals Tier 2 capacity. Tier 1 utilities ill be prorated, Order at 41; Tier 2 utilities will be satisfied fully. While proration is a reasonable means for allocating scarce capacity, [5] this example demonstrates that proration-by-tier can produce results not "consistent with the public interest." We see at least three ways to mitigate this problem.

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[4] Thus in the UPSC hearings UP&L's President Davis agreed with counsel that he viewed "the risk of municipalization as an incentive to the company to lower rates and extend excellent service to ... existing retail customers." UPSC Transcript at 55.

[5] Mr. Russell proposed proration in his Condition #3(c). Ex. 20 at 9-10.

1. To the extent Tier 1 is oversubscribed, shift capacity from Tier 2 and Tier 3 into Tier 1.

2. To the extent capacity in Tier 2 or Tier 3 remains unused after the 90-day period, shift that capacity into Tier 1 to the extent Tier 1 is oversubscribed.

3. To the extent Tier 1 is oversubscribed, permit Tier 1 members to shift their "excess" demand to Tier 2 for allocation under the Tier 2 rules.

iv. <u>The Commission's treatment of undersubscribed capacity in Tiers 1 and 2 presents problems of timing and discrimination.</u> Where Tier 1 or Tier 2 remains undersubscribed after 90 days, "subsequent wholesale transmission requests in such tier will be honored on a first-come, first-served basis." Order at 41. And where Tier 1 or Tier 2 remains undersubscribed after 1 year, "any unused capacity shall revert to the merged company for use in Tier 3." Id. We discuss separately below problems with two categories of transactions: (1) transactions in which interest exists at the time Remaining Existing Capacity is announced; and (2) transactions in which interest develops some time after the announcement, but during the initial 5-year period. [6]

With respect to transactions in which interest exists at the time Remaining Existing Capacity is announced: The Commission's 90-day period is not sufficient for all buyers and sellers to identify their alternatives, respond to and compare bids, and negotiate and close deals. Mr. Russell proposed a 1-year period.

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[6] As a technical matter, the Commission should make clear whether the 1 year period runs from the beginning or the end of the 90-day period.

Ex. 20 at 10 (Condition #3(b)). As he explained (Ex. 20 at 29): "Parties require considerable time to negotiate long-term firm contracts. A year can be a relatively brief period for this type of negotiation." The 1-year period is the only period supported by the record, and we urge the Commission to adopt it.

With respect to transactions in which interest develops some time after the announcement, but during the initial 5-year period: The "reversion-to-Tier 3" rule for Tiers 1 and 2 gives the merged company control of capacity in an essential facility during the transition period, even when competing demands for that capacity surface. [7] That result is inconsistent with the Commission's duty, and stated goal, to eliminate the market power produced by the merger. Instead, the Commission should provide for annual or semiannual resubscriptions, using the proration rule suggested by Mr. Russell and adopted by the Commission for the first 90 days. At the very least, the Commission should allow the first-come, first-served rule to run through the first five years, with the merged company standing on equal terms with other potential users. Either of these approaches ensures a nondiscriminatory approach to transmission access in theory.

In practice, however, a first-come, first-served rule could favor the merged company. The merged company will have unique

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7 We are assuming, without agreeing, that the Commission intends to permit the merged company to use the reverted capacity for its own purposes, including renting to others on terms it sees fit, unrestricted even by the Trial Staff's revised wheeling policy. If our assumption is incorrect, we request clarification of this matter.

access to information on who is considering contracts with whom; negotiating partners would be contacting the merged company to determine (1) the amount and location of available capacity and (2) the embedded costs associated with that capacity. Therefore, any implementation of a first-come, first-served rule requires guidelines to prevent the merged company from abusing its unique access to such information.

v. The Commission's treatment of undersubscribed capacity in Tier 3 would permit discrimination by the merged company. The Order provides that to the extent Tier 3 capacity is unsubscribed after 90 days, the merged company would allocate it on a case-by-case basis according to Part IV.A, D and E of the Trial Staff's revised wheeling policy. Order at 41-42 (as clarified by subsequent order). That policy is impossibly vague and discriminatory.

The Trial Staff policy is based on, and differs little from, the Applicants' wheeling policy. The Commission expressly condemned Applicants' policy as

> not likely to result in meaningful access to the merged company's transmission system. Moreover, nothing contained in [Applicants'] wheeling policy ... would prevent them from unduly preferring their own higher-cost generation over competitors' cheaper alternatives....Finally, the case-by-case approach ... will likely result in numerous Commission proceedings under section 206 of the FPA to determine whether wheeling was improperly denied.

Order at 38-39. The same evaluation applies to the Staff policy. The merged company could cite any one of 11 "factors" in determining whether to grant or deny a wheeling request. Many of

these factors defy predictability; they invite arbitrary application. For example:

> <u>Factor #1: "The duration of the requested service"</u>: Does this factor disfavor long durations, because they are more likely to compete for capacity with native service? Or does the factor disfavor short durations, because long transactions can be more profitable and therefore are more beneficial to native customers?
>
> <u>Factor #2: "Whether new facilities would have to be constructed in order to provide the requested service over the Company's facilities"</u>: Does this factor favor wholesale transmission service not requiring new facilities, because pricing the transmission at rates which roll in the costs of the new and old facilities (as opposed to specifically assigning the new facilities to the wheeling customer) risks underrecovery where the retail jurisdiction continues to set rates based on the old facilities? Or does this factor favor service requiring new facilities, on the grounds that the merged company thereby can spread across more customers the costs of an addition needed to serve growing native load?
>
> <u>Factor #6: "The degree of firmness of the requested service"</u>: In a competitive market without transmission scarcity, buyers can obtain any mix of firmness and non-firmness they wish. To permit the merged company to discriminate based on firmness of the service requested is to authorize abuse of monopoly power. Only if rates are skewed to favor one type of service over another is there an incentive to discriminate. This problem underscores the need to ensure that pricing is "cost-based."

In short, the merged company could cite any of these factors to justify any response to a wheeling request. The factors afford the merged company unbridled discretion to grant or deny access. That result is inconsistent with antitrust principles.

The Commission may have presumed that where there is unsubscribed capacity, there is no scarcity problem, no "bottleneck" and no risk of discrimination. We would disagree. Circumstances could change during the five-year transition

period, creating demand for transmission access that did not exist in the first 90 days. A nearby utility could suffer a plant outage, and require access to off-system sources. Or a new generator could seek entry into the market. In short, an essential facility does not cease being an essential facility merely because demand for it has not yet developed.

Even if the staff proposal were not fundamentally flawed, its adoption here violates intervenors' right to a hearing. As we explained in our Brief on Exceptions (at 67-69), neither the Trial Staff's policy, nor the Applicants' virtually identical proposal appeared until the briefing stage of this proceeding. Intervenors' witnesses could not comment on the proposal. Due process does not permit the Commission to adopt as law the product of private negotiations between lawyers for the Trial Staff and lawyers for the Applicants, without the benefit of public hearing.

The ramifications of a rule permitting on-the-stand "evolution" of proposals fundamental to a proceeding are deeply troubling. In the past, intervenors with limited expert budgets could review the Company's direct testimony, estimate the cost of pre-filed testimony and cross-examination assistance, and budget accordingly. Now, these intervenors will have no idea how much resources to devote to pre-hearing preparation and how much to save for hearing surprises. Similarly, deadlines for filing testimony would be meaningless. Companies would feel no obligation to present their entire case on in pre-filed

testimony. Moreover, the new privilege of presenting only part of a position, leaving the rest until it is too late for opposing witnesses to respond, is likely to advantage the entities required to present their cases first. For the most part, those entities are the regulated utilities, not the customers.

vi. <u>When a north-to-south transaction is offset by a south-to-north transaction, the resulting capacity should be returned to Remaining Existing Capacity for reallocation</u>. However, the extra capacity created by such offsetting transactions should be contingent on the initial transactions actually being scheduled from hour to hour. In other words, the merged company should total the amount of capacity remaining in each direction after the initial capacities are allocated, and then offer contingent capacity. This procedure can be done on a daily or hourly basis.

vii. <u>A buy-sell commitment should be the admission ticket to any capacity on the merged company's transmission system</u>. The Commission states that for "each respective tier, each entity announcing an executed contract shall be designated a 'Qualifying Entity' for purposes of the allocation process." Order at 41. This passage appears in a paragraph dealing with only the initial allocations made after the first 90-day period. The Commission should make clear that the contract requirement applies to all transmission allocations, whether during the first 90 days or subsequently. Transmission capacity should be allocated by free market forces, not by a requestor's financial ability to tie up existing capacity.

viii. The Commission should require wheeling reciprocity in all situations. The Order requires reciprocity when Part IV.D of the Trial Staff's revised wheeling policy applies, that is, to Tier 3 capacity unsubscribed after 90 days. Order at 41-42. The Commission also would require reciprocity with respect to participation in additional capacity during the transition period. Order at 43. Reciprocity should apply to all wheeling requests from those who own transmission, not just in these two situations. Mr. Russell's Condition #6 (Ex. 20 at 14) furnishes one possible approach:

> 6. Limitation on PP&L/UP&L's Obligation to Wheel for Nonaffiliated Entities: PP&L/UP&L shall be obligated to wheel only for (i) those nonaffiliated entities seeking wheeling that have in place rate schedules for wheeling services, and for (ii) nonaffiliated entities who have no transmission facilities. Such rate schedules must offer wheeling on a basis at least as favorable as that on which PP&L/UP&L renders wheeling services to nonaffiliated entities. In other words, PP&L/UP&L has no obligation to wheel for entities with transmission facilities that do not offer to wheel for PP&L/UP&L and others.
>
> For the purposes of this paragraph, if a nonaffiliated entity without transmission facilities is affiliated with an entity owning transmission, the first entity shall be deemed to own the transmission facilities of the second entity.

Under this Condition, transmission owners desiring wheeling service from the merged company must file with the Commission, and have accepted for filing, rate schedules generally offering wheeling services on terms at least as favorable as the terms offered by the merged company. Such entities need not make a specific offer to wheel for the merged company, or actually be wheeling for the merged company.

The phrase "at least as favorable" in the condition refers to the criteria which the wheeling entity would determine whether transmission service is available. The term does not refer to price, which would be set in future Commission proceedings designed to ensure that wheeling services offered under these Conditions carry "just and reasonable" rates under the Federal Power Act. Because the relationship of load to capacity may differ among entities, actual availability may differ among entities. What matters, in determining if a tariff offers terms which are "at least as favorable" as those offered by the merged company, is the criteria by which availability is to be determined.

If a prospective wheeling customer has no transmission facilities, but is affiliated with an entity who does, the first entity should be deemed to own the transmission facilities of the first. Without this requirement, wheeling customers could evade their wheeling obligations to the merged company by spinning off their transmission facilities to a subsidiary.

In the FERC hearing, Mr. Topham asserted that entities with little or no transmission should not receive wheeling service on the same par as, say, and Idaho Power. As he put it, the parties "must bring roughly the same thing to the table." Tr. 581. Deseret, as an example, would have "very little system to offer." Tr. 676. Mr. Topham's insistence that the merged company need not provide service to a nontransmission-owning system because the merged company gets nothing in return ignores logic and

precedent. In Gainesville Utilities Dept. v. Florida Power Corp., 40 F.P.C. 1227 (1968), Gainesville sought an interconnection with the Florida Power system. Florida Power insisted that Gainesville, in addition to bearing the full cost of the new interconnection, also pay a special fee for "backup service." Florida Power reasoned that the charge was justified because the benefits from the interconnection would not be reciprocal; only Gainesville would realize benefits. The Commission rejected the proposed backup fee (40 F.P.C. at 1237), and the Supreme Court ultimately affirmed. Gainesville Utilities Dept. v. Florida Power Corp., 402 U.S. 515, 523 (1971) ("the appropriate analysis should focus not upon the respective gains to be realized by the parties from the interconnection but upon the sharing of responsibilities by the interconnected operations").[8]

ix. The Commission should define the phrase "total transfer capacity." See Order at 40. We suggest the following definition:

> The sum of the power that can be scheduled at all points of delivery in any given hour as that maximum schedulable amount of power may change from time to time as a result of changes in the level of power which Qualifying Entities in combination seek to schedule, native load, circulating loop flow, system deratings, revised designs, changes in system configurations and other objectively determined engineering and operating

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8 Accord, Mid-Continent Area Power Pool (MAPPOOL) Agreement, 58 F.P.C. 2622, 2635 (1977) (small utilities lacking transmission entitled to pool membership if they "provide compensation for the true value of this transmission service, whether in kind or money") (emphasis added), aff'd sub nom. Central Iowa Power Cooperative v. FERC, 606 F.2d 1156 (D.C. Cir. 1979).

constraints.

Seasonal maximum ratings for seasonal load conditions and for each system contingency (such as, but not limited to, outages of generating units, outages of transmission facilities, schedules on the Pacific Intertie) shall be established in advance by use of load flow and transient stability studies conducted in accordance with Western Systems Coordinating Council ("WSSC") standards. The seasonal maximum ratings shall be published regularly in advance of each season. Hourly deratings shall be disseminated as promptly as possible to all Qualifying Entities with entitlements. Applicant shall make contemporaneous records of hourly deratings and the reasons therefore and shall make such records available as requested to any WSCC member utility, independent power producer and PURPA Qualifying Facility.

x. Double dipping should be precluded: The Northwest, Eastern and transmission dependent utilities ("TDU's") have rights to capacity with which they would sell power to other utilities entitled to the other 50% of remaining existing capacity. Therefore, an "other" utility, such as Southern California Edison, could buy under the 30% rights of a Northwest seller, buy under the 20% rights of a TDU and then obtain another entitlement from the 50% reserved for "other" utilities. This type of double and triple dip should be precluded in the allocation process.

b. Participation in New Facilities

i. "Participation" in the construction of facilities 345 kV or higher should include ownership. See Order at 43. As Mr. Russell testified (Ex. 20 at 32-33), there are at least four reasons for requiring the ownership option: First, an ownership share is what PP&L is acquiring from UP&L. Competitors should be allowed to obtain the same preferred access. Second, wheeling

contracts always have a finite term whereas ownership is for perpetuity. Upon expiration of a wheeling contract, the merged company would obtain certain privileges and would have an incentive to raise the rate or not to negotiate a contract extension. Ownership prevents a competitor from being subjected to such pressures. Third, there is considerable synergism in transmission systems in that parallelling or reinforcing an existing line creates new capacity at a lower cost and with a higher reliability than does constructing an independent line. This benefit typically goes to the owners of a line and not to the wheeling customers. Fourth, transmission rights-of-way are a scarce and valuable resource. If a competitor does not obtain ownership, he may be frozen out of the benefits of owning transmission rights-of-way.

Any dispute over construction participation should be resolved by the Commission expeditiously.

ii. The Commission should clarify the criteria which prospective participants in 345 kV-or-higher facilities must satisfy. See Order at 43. We emphasize here six points. First, the Commission says that a requestor must have a "legitimate interest or service-related purpose." In order to preserve a competitive bulk power market, that purpose should include shopping or marketing off-system. Second, the Commission would bar "participation [that] will ... render [the transmission expansion] impractical for the merged company as a matter of economics...." Id. at 43. An expansion which raises the average

cost of the transmission facility should not be deemed to render the expansion "impractical ... as a matter of economics."

Third, when the Commission requires the "potential participants ... to equitably share in the costs and benefits of the project," we assume the Commission means "costs" as used in footnote 163. In other words, we assume the Commission is deferring to a Section 205 proceeding the determination whether the project price should be based on incremental cost or rolled-in cost. Fourth, the Commission would require consideration of "the value of the merged company's existing investment in related facilities." Explanation is needed. Specifically, "value" in this context cannot mean the value to the monopolist of its essential facility. Crediting "value" in this manner would be indistinct from the opportunity cost pricing already condemned by the Commission. Fifth, where the requestor benefits from both the new facility and existing facilities, his rate should reflect the rolled-in costs of both; in this manner "the value of the merged company's existing investment" will be considered. Sixth, the Commission requires consideration of "the benefits to be derived by each party." We assume the Commission does not intend to price the new facility based on its value to the buyer, for that is monopoly pricing:

> It is certainly true that the same service or commodity may be more valuable to some customers than to others, in terms of the price they are willing to pay for it. An airplane seat may bring greater profit to a passenger flying to California to close a million-dollar business deal than to one flying west for a vacation; as a consequence, the former might be willing to pay more for his seat than the latter. But

> focus on the willingness or ability of the purchaser to pay for a service is the concern of the monopolist, not of a governmental agency charged both with assuring the industry a fair return and with assuring the public reliable and efficient service, at a reasonable price."

Gainesville Utilities Department v. Florida Power Corp., 402 U.S. 515, 528 (1971) (emphasis added). If on the other hand the Commission means that to the extent the merged company benefits from a capacity addition, that benefit should reduce the price it charges for the addition, we agree.

iii. The merged company's construction obligation should not be limited to lines 345 kV or higher. In setting this limitation, Order at 43, the Commission may have assumed that a sub-345 kV is always "economically duplicable"; and that therefore, an entity requiring such a facility could not be dependent on the merged company's monopoly power. There is no record basis for that assumption; and we believe a factual inquiry could demonstrate otherwise. Therefore, we urge the Commission to eliminate the 345 kV threshold. The merged company's construction obligation should apply simply to any facility not economically duplicable.

The origin of the criteria for transition period participation in new facilities is the "Trial Staff's revised conditions." That document, we remind the Commission, surfaced after the hearing. It emerged, as we explained above, largely from private negotiations between the merging companies and the Trial Staff; it never was subjected to the rigors of expert review or cross examination. Its centerpiece consisted of

arbitrary access criteria and opportunity cost pricing; in short, confirmation of the merged company's monopoly power. Use of that policy in any context threatens to blur the Commission's otherwise clear intent to curb monopoly power.

2. Post-Transition Access

The Commission states: "'Firm' [transmission] can include off-peak service, as well as service that has some degree of interruptibility." Order at 44 n.171. Clarification is necessary. If the Commission means only that a wheeling customer who requests "less-than-firm" service has the same right to service as a customer requesting traditionally firm service, then we have no objection. [9] If, on the other hand, the Commission means that the merged company can decline to provide fully firm service even if that is what the customer wants, we urge the Commission to reconsider. The merged company should not be permitted to pick and choose the types of service it will provide based on the perceived profitability of the service. [10]

Finally, the Commission should adopt a reciprocity rule with respect to participation in additional capacity in the long term, to parallel the one it imposed with respect to additional

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[9] We discuss the issue of non-firm access and pricing more fully in Part I.B, infra.

[10] By mandating that all types of transmission service are "cost-based," the Commission will eliminate any incentive in the merged company to discriminate against certain types of service requests. Thus we argue in Part I.B.3, infra that the Commission's three-way sharing methodology for pricing non-firm transmission service must be replaced, in the context of an essential facility, by "cost-based" pricing.

capacity in the transition period. See Order at 43.

3. Pricing Conditions Generally

a. "Cost-Based" Pricing Should Assign to Wheeling Customers Alone the Incremental Cost of Transmission Facilities Benefiting All Customers

The Commission states: "Where additional capacity is needed to meet a request, rates may be designed to specifically assign the cost of that capacity addition to the party requesting service. We do not preclude the possibility that such costs will subsequently be allocated to other beneficiaries of the additional capacity." Order at 39 n.163. Because the Commission refers to "cost-based" pricing or "cost" in a variety of settings, we request clarification.

We assume this statement contains no implication that the Commission will deviate from its historical insistence on rolled-in pricing. Rather, the statement leaves open the issue whether a particular facility added to serve a requestor (a) provides benefits to that requestor only, and therefore could be allocated directly to that requestor; or (b) provides benefits generally to all customers of the merged company, and therefore should be "rolled-in" with all facilities. [11]

For example, the Commission states that the merged company may reject a request for participation in new facilities if the requestor is unwilling to pay the "cost." Order at 43.

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[11] In this regard, we support the Commission's statement (Order at 55) reiterating its "general policy of requiring rolled-in pricing" and its opposition to "assigning specific generation or transmission resources to specific customers."

Similarly, the Commission states that a complainant who was denied long-term service must show that "it was willing to pay the full cost of the service." Id. at 45. We assume the Commission uses the term "cost" here in the same sense as in footnote 163; that is, that the Commission is deferring the issue whether the requestor must pay the cost of the new facility alone or a rolled-in cost, depending on the nature of the facility.

Lack of clarity on this point could make business planning for prospective wheeling customers extraordinarily difficult, leading to competitive harm. After five years, the Commission will consider for Tiers 1 and 2 ratemaking methods other than embedded cost. Order at 42. Wheeling customers planning future transactions must have some assurance that their wheeling costs will be predictable. Increases in rolled-in embedded costs, due to facilities additions necessitated by demand increases on the merged company's system during the life of the contract, are predictable. Increases in incremental costs, where the wheeling customer suddenly finds itself "blamed" for an increase in native load and obligated to pay the full cost of the new facility required to meet that load, are much less predictable. Prospective wheeling customers facing the latter uncertainty may be unable to secure financing for their transactions. In contrast, the merged company knows that its own wheeling costs will be the rolled-in embedded cost. Under these circumstances, uncertainty becomes the bottleneck's accomplice, and helps to entrench the merged entity's monopoly power. Accordingly, the

Commission should make clear now that it will ensure equivalent rate treatment of all competitors; i.e., it will not deviate from its rolled-in philosophy.

b. Divisional Pricing Should Not Become "Pancaked Pricing"

The Commission envisions divisional pricing on a temporary basis. Order at 53-55. The Commission should make clear that the merged company may not use divisional pricing to impose "double" or "pancaked" rates on a wheeling customer who takes service over the transmission systems of both divisions. Our concern is based on cross-examination of UP&L witness Topham. He testified that where both divisions of the merged company furnish transmission service in a particular transaction, the customer would need a contract from both divisions. Tr. 270. "Either two rates would be applied or a different rate [i.e., different from the rate applied were only one division involved] would be applied...." Tr. 264.

Pancaked rates in this context would be improper, for two reasons. First, Applicants plan to operate as a single coordinated system. Pancaked rates under these circumstances violate the Federal Power Act's ban on discriminatory rates. Fort Pierce Utilities Authority v. FERC, 730 F.2d 778, 784 (D.C. Cir. 1984) ("If coordination between FP&L and FPC had become so extensive that the two systems operated as an integrated whole, then each utility's customers would in fact use both transmission systems; in that case, the individual rates approved by FERC would arguably force customers paying "double rates" to subsidize

the remaining customers by paying twice for a functionally identical transaction.").

Second, assuming arguendo the legitimacy of double rates in this context, discrimination opportunities abound. How will the merged company determine whether both systems were used, and how much of each system was used? In an interconnected system, any transaction can arguably affect both systems, even where if the origin and destination points of the transaction lie within one division's system. With the option of pancaked rates available, the merged company will have an incentive to cast every transaction as a two-system transaction. See also Southern Company Services, Inc., 37 F.E.R.C. para. 61,190 at p. 61,451 (1986) (questioning Southern's premise that Commission would approve a pancaked transmission rate, rather than a joint rate, for service across two of Southern's subsidiaries).

The proper solution, which the Commission should mandate now, is a single "joint rate" reflecting the costs of the two divisions.

4. Environmental Implications

Significant differences between the Commission's conditions and Bonneville Power Administration's Long-Term Intertie Access Policy ("LTIAP") (May 17, 1988) have implications for environmental protection. These implications require careful investigation.

The LTIAP contains important environmental protection provisions. For example, Section 4(a)(4) bars from the Pacific

Intertie power produced by hydroelectric projects constructed in designated "protected areas." Thus northwest hydropower developers seeking Intertie access to serve southwestern markets must build in less sensitive areas. And under Section 7, northwest utilities seeking access to the Intertie to export under long-term contracts must waive their contractual right to BPA replacement power. Thus northwest utilities who commit to make long-term sales, but then become unable to sustain those sales over the full contract term, cannot force the federal power system to finance replacement generation.

The Commission's transmission conditions in this case contain no comparable provisions. At the same time, the Commission's conditions make a non-BPA path to the southwestern markets more feasible than previously. As a result, northwest developers may be able to evade the thrust of the LTIAP's provisions by using the merged company's transmission system. We unambiguously support the Commission's goal of preventing the merged company from monopolizing Western bulk power markets. But we also seek assurance that the Commission does not encourage inadvertently the evasion of another agency's environmental protection regulations.

The LTIAP was promulgated after the record closed in the instant case; its implications were not explored at hearing. We therefore ask the Commission to initiate an inquiry into the environmental impact of development, sales or other activities that may take place in response to the Commission's transmission

conditions, as well as possible mitigation strategies.

B. <u>The Commission's Non-firm Wheeling Conditions Permit the Merged Company to Exploit Its Monopoly Power</u>

1. <u>Introduction</u>

The Commission imposed the following condition for non-firm wheeling: "To the extent that the merged company negotiates non-firm wheeling transactions with other utilities, rates for such service shall be based on an equal three-way sharing of the benefits in accordance with trial staff's revised wheeling policy." Order at 46. This non-firm condition permits the merged company to exploit its monopoly power, and should be revised.

Unless a customer is a 100% load factor transmission user, even firm contracts leave non-firm capacity available. Thus the industry recognizes two types of transmission capacity: (a) firm-firm" capacity, is available even after the single contingency which most reduces transfer capability; and (b) "firm scheduling rights (or interruptible transmission), which is the capacity in excess of firm-firm on which economy energy can be prescheduled; such capacity is withdrawable in the event of outages, loop flow, and other unexpected events. This second type of capacity is a valuable commodity that is used for importing nonfirm energy. The distinction is important because the second type of capacity is frequently available. If the Commission does not specify that both types of transmission capacity are to be shared, the merged company could seize this valuable right for itself.

Thus the Commission's non-firm condition, as currently written, clashes with the Commission's factual findings, as well as its firm wheeling conditions. The Commission found that the merger, unconditioned, will harm competition to sell "bulk power" markets. The Commission never drew a distinction between bulk power and non-firm power, and there is none; the former is a component of the latter. The Commission also identified one relevant geographic market the "transmission paths ... through which the relatively low-cost power generated in the Northwest ... may be delivered to markets in the Southwest." Id. Nonfirm power travels over these paths. Consequently, the Commission's conclusion about the merger's anticompetitive risk must apply to both non-firm and firm transmission.

To render the proposed merger consistent with the public interest, the Commission must require the merged company to offer non-firm wheeling on a nondiscriminatory basis at cost-based rates. We address below two aspects of the issue: (1) access and (2) price.

2. The Merged Company Remains Free to Refuse Non-Firm Access to an Essential Facility

The Commission was appropriately skeptical of "the merged company's assurances that it will not deny access to competitors in the future." Order at 37. Yet the Commission imposed no obligation to provide non-firm transmission service. The merged company remains free to grant or deny non-firm access at will, or to continue its monopolistic brokering practices, which the

Commission expressly condemned. Order at 34.[12]

To prevent such practices, the Commission must require the merged company to offer non-firm wheeling on a nondiscriminatory basis. A methodology is necessary to assign scarce transmission capacity during the transition five-year period, where there may be constraints; and in the post-transition period, when the merged company is obligated to add capacity to serve firm wheeling requests.

Mr. Russell solved this problem with a minimum of complexity. His Condition #5 (Ex. 20 at 12-13) states as follows:

> 5. Nonfirm Wheeling for Nonaffiliated Entities: With respect to sales of nonfirm energy, PP&L/UP&L shall allocate the use of its network in the following manner:
>
> a. Condition of No Surplus: In the absence of a declaration of surplus by BPA, the Northwest competitor (including PP&L/UP&L) with the lowest priced nonfirm energy shall have access to the PP&L/UP&L network to the extent of the competitor's available generating capacity. The Northwest competitor with the next lowest priced nonfirm energy shall have access to the PP&L/UP&L network to the extent of its available generating capacity, and so on. Any access granted by the preceding two sentences shall be reduced by the amount of access which the Northwest competitor has to Southwest markets through the Pacific Intertie or other alternative facilities.
>
> b. Condition of Surplus: PP&L/UP&L shall allocate the use of its network according to the principles underlying the Exportable Agreement [Agreement Executed by the United States of America

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12 The Order merely prescribes a pricing rule (itself monopolistic -- see Part I.B.3, infra) "[t]o the extent the merged company negotiates non-firm wheeling contracts." Order at 46 (emphasis added).

> Department of the Interior by and through the Bonneville Power Administrator and Utilities in the Pacific Northwest (BPA Contract No. 14-03-73155, January 13, 1969)]. See Dept. of Water and Power of the City of Los Angeles v. Bonneville Power Administration, 759 F.2d 684, 687 (9th Cir. 1985). Specifically, all Northwest sellers that can meet a price set by BPA shall receive a pro rata allocation of capacity in the PP&L/UP&L system based on their declared capacity. Any access so received shall be reduced by the amount of access which the Northwest competitor has to Southwest markets through the Pacific Intertie or other alternative facilities.

PP&L/UP&L shall be permitted to recover through nonfirm transmission rates the cost of maintaining equipment and staff to perform the allocations.

The rationale for this condition is as follows: As Mr. Russell testified, for "non-firm sales, short-term price is the primary determinative factor. Therefore, it makes sense to grant access to a transmission bottleneck on the basis of price." Ex. 20 at 28, 1.6-8. The access rule would depend on whether or not Bonneville had declared a surplus. In the Northwest, during surplus times there is a floor price; there is little or no competition below that floor. During nonsurplus periods, there is competition. For that reason, Condition #5 uses different allocation rules for periods of surplus and nonsurplus.

Note that under Condition #5, access to which a seller is otherwise entitled under this Condition #5 would be reduced by the amount of access the seller had over the Pacific Intertie. The purpose of the Condition is to ensure that the merged company's transmission bottleneck does not defeat competition. To the extent a competitor has access to the Intertie, he is not faced with a bottleneck, and does not need the assistance of this

condition.

Mr. Russell's method allocates access on the basis of seller efficiency, and ensures that consumers receive the least cost power at any point in time. Those are the results mandated by the Federal Power Act.

3. "Three-Way Sharing," In the Context of an Essential Facility, is Monopoly Pricing

There is no dispute that three-way sharing deviates from cost-based pricing. See, e.g., Tr. 336 (Mr. Topham describing his non-firm pricing goal as obtaining "at least adequate benefits that we think compensate for the use of the system on some basis other than embedded cost rates"). Three-way sharing is closely related to brokering as historically practiced by UP&L, where the wheeling entity buys on a split savings basis and then sells on a split savings basis. See Ex. 205, Sch. 3 (Rebuttal Testimony of Mr. Walton). And brokering by the owner of an essential facility is indistinct from extraction of monopoly prices. As the Commission found (at 34-36; footnotes omitted):

> 'The traditional starting point for determining the existence of monopoly power is to compare prices with incremental cost.' By refusing to wheel power and instead engaging in buy/sell transactions, UP&L is able to charge a price that reflects more than the cost of the transmission service it provides.....UP&L's sales of power at a price that is maintained at a level far exceeding its costs, coupled with its ownership and control over essential transmission facilities, demonstrates its market power to extract monopoly profits.

Indeed, it appears to be Applicants' present view that this Commission's non-firm pricing condition has enhanced UP&L's

ability to exploit its strategic transmission facility in the context of non-firm sales:

> In one respect, the FERC order on non-firm may be better than the [UP&L] past practice. The FERC order requires the parties to reveal their true cost instead of merely offering a buy or sell price.

Fourth Supplemental Testimony and Exhibits of Verl R. Topham, UPSC Case No. 87-035-27.

Absent explicit justification, deviation from cost-based pricing violates the Federal Power Act. <u>See</u> <u>Atlantic Refining Co. v. Public Service Commission</u>, 360 U.S. 378, 388 (1959) (Commission is obligated to set the "lowest possible rate consistent with maintenance of adequate service in the public interest"); <u>City of Detroit v. FPC</u>, 230 F.2d 810, 818 (D.C. Cir. 1956) (any departure from embedded cost-based rates is suspect and must be justified). Mere assertion of "market forces" cannot save so-called market-based rates:

> In setting extraordinarily high price ceilings as a substitute for close regulation, FERC assumed that, with the wide exposed zone between the ceiling and the "true" market rate, existing competition would ensure that the actual price is just and reasonable. Without any empirical proof that it would, this regulatory scheme, however, runs counter to the basic assumption of statutory regulation, that "Congress rejected the identity between the 'true' and the 'actual' market price." <u>FPC v. Texaco</u>, 417 U.S. [380] at 399 [(1974)]. In fact, FERC's "'regulation' by such novel 'standards' is worse than an exemption <u>simpliciter</u>. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." <u>Texaco v. FPC</u>, 474 F.2d [416] at 422.

The rationale for the non-firm pricing condition cannot be competitive market forces, since the Commission found the merger

would reduce competition. Indeed, UP&L witness Walton admitted that if market forces did exist, in the form of alternative transmission paths, the wheeling price would fall to the marginal cost of the wheeling party, and the more efficient wheeler would win the load. Tr. 1915-16. Under the logic of Farmers Union, supra, three-way sharing is impermissible.

The Commission offered no other justification for its deviation from cost-based rates, and none appears in the record. No party or witness has suggested that three-way sharing is necessary for efficiency. Indeed, Mr. Walton admitted that efficiency can be achieved simply by setting the wheeling price at incremental wheeling cost. Tr. 1869. He agreed that efficiency in the typical nonfirm transaction does not depend on the percentage of savings retained by the wheeling entity. Tr. 1950. Mr. Walton also agreed that "the middle utility receiving a portion of the trading value, in excess of his own marginal transmission costs, has a chilling effect on the incentives for the buyer and seller to trade." Tr. 1877-78. If the wheeling entity extracts too large a share, he agreed, a prospective seller might decide not to sell. Tr. 1950. [13]

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13 Mr. Walton asserted that the market in which the merged company would operate would contain multiple transactions; and since these transactions could be used to establish prices for particular increments of production, the chilling effect would not necessarily harm efficiency. Tr. 1878. But he offered no examples of the multiple transactions. Moreover, he agreed that time and transaction costs could impede a trader's ability to use multiple transactions. Tr. 1880. Lack of knowledge on the part of the trader as to actual marginal costs could make the problem worse, he added. Tr. 1881.

Staff has argued that three-way sharing will provide proper price signals to investors in new generation capacity. But the only signal prospective generation investors would receive is this: whenever they make an efficiency breakthrough, they must forfeit a third of it to a monopolist who contributed nothing to the breakthrough. That result will not "provide proper price signals to investors in new generation capacity."

If there were competing wheeling paths, the wheeling price would be driven to the marginal cost of the wheeling party, and the more efficient wheeler would win the load. Tr. 1915-1916. The only reason to award the merged company a higher rate is because the merged company will refuse to wheel without it, and there are no alternative paths. The Commission may not premise its pricing decisions on monopoly power.

The Western Systems Power Pool Experiment, referenced by the Trial Staff's revised policy, furnishes no basis for adopting three-way sharing here. See Pacific Gas & Electric Co., 38 F.E.R.C. para. 61,242 (1987). The key question the Commission must answer is whether the proposal will prevent the merged company from using abusing its market power. The Commission's WSPP decision sheds no light on that issue.

The WSPP Experiment is just that: an experiment. To use it as precedent supporting Applicants' three-way sharing would be to approve and extend the Experiment without analyzing it. That is not what the Commission had in mind. For example, Pacific Gas & Electric told the Commission that the Experiment, in the

Commission's words, "should not provide any precedential value." 38 F.E.R.C. at p. 61,785. The Commission agreed. Id. at p. 61,796. Similarly, Southern California Edison told the Commission, in the Commission's words, that "any change in Commission policy will not result from acceptance of this filing, but from the data collected during the Experiment and analyzed by the Commission, and the conclusions ultimately derived from the Experiment." 38 F.E.R.C. at p. 61,785. As the Commission stated: "The market must actually be tested and the information which will become available during the Experiment must provide a basis for identifying any potential monopoly...." 38 F.E.R.C. at p. 61,796.

The Commission expressed concern that transmission owners with pricing flexibility could "raise transmission prices far above their out-of-pocket costs even when transmission capacity is not fully loaded .... The high prices would discourage valuable use of the unused capacity and result in monopoly profits to the transmission owners." 38 F.E.R.C. at p. 61,797. For a bulk power market to be considered competitive, the Commission stated, "no utility, whether it is a buyer or a seller, can find itself in a position to influence appreciably the price at which transactions take place." 38 F.E.R.C. at p. 61,791. [14]

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[14] Even the proponents of the WSPP Experiment did not even represent that the Experiment will guarantee a competitive market. They described the Experiment merely as a "good faith proposal to increase competition and opportunities for power transactions...." 38 F.E.R.C. at p. 61,786.

Because the proposal was only an experiment, however, the Commission dismissed claims of monopoly abuse without a hearing. See 38 F.E.R.C. at p. 61,793, 61,800. But the merger proposed here is not an experiment (unless Applicants want to make it one), and we have had a hearing. The evidence is that the merged company will be in a position to abuse pricing flexibility. If the Commission does not choose outright rejection, it must withhold approval until the WSPP Experiment has been fully analyzed. [15]

C. The Commission May Not Leave PURPA Qualifying Facilities Exposed to the Merged Company's Monopoly Power

The Commission imposes "an absolute obligation on the merged company to provide firm wholesale transmission service at cost-based rates any utility that requests such service." Id. at 38 (emphasis added; footnote omitted). The Commission then excludes from "utilities" all Qualifying Facilities ("QFs") as defined in the Commission's PURPA regulations. Id. at 38 n.158. Because QFs are as vulnerable to the merged company's market power as is any other seller, we request rehearing on this portion of the Commission's Order. [16]

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[15] The staff policy, Part IV, states: "The following principles accomplish an equitable sharing of benefits acceptable to the Company." This is not a settlement; it is a merger condition. The standard under Section 203 is not "acceptable to the Company," but "consistent with the public interest."

[16] As captive residential customers seeking the benefits of vigorous price competition, UMWA, et al. asserted in its Intervention in this proceeding that the merger could enable the merged company to compete unfairly against small power producers, including QFs. See Intervention at 13-14. Thus we are entitled

It may be that the Commission intends with this language merely not to order "retail wheeling" at this time. Specifically, the Commission may have chosen not to address whether QFs who are retail industrial customers of the merged company should be entitled to use the new wheeling conditions to import power from non-merged company sources for consumption at the industrial customers' plants. If that is the only reason for the exclusion, we have no objection provided the Commission says so clearly.

We fear that the Commission's Order can be interpreted more broadly: to bar QFs-as-sellers from the transmission access conditions completely. That result would leave QFs-as-sellers exposed to the same merger-created anticompetitive harm from which the Commission has protected all other sellers. Such anticompetitive harm would cause the merger to fail the "consistent with the public interest" test of Section 203.

Exclusion of QFs has no basis in the record, and in fact conflicts with the Commission's analysis of that record. The Commission found that "bulk power" was a relevant product market. Order at 27-28. The Commission then found that the transmission pathways linking Northwest sellers with Southwest buyers constituted another relevant product market. Order at 29-34. Based on these market definitions, the Commission concluded that the merger "would enhance the merged company's ability to foreclose competition for sales of bulk power." Order at 34

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to seek rehearing on this issue.

(footnote omitted). A QF's output is no less "bulk power" than a non-QF's output; therefore, the QF is vulnerable to the merged company's market power.

The exclusion violates antitrust principles, Sections 203 and 205 of the Federal Power Act, and PURPA. Citing the exclusion, the merged company could deny transmission access to a QF-as-seller while granting access to a utility seller. That power to discriminate is rooted in the merged company's monopoly power. To permit the exercise of that power is to violate the same antitrust principles undergirding the Commission's protective conditions are based. See Order at 26-27. That anticompetitive result would not be "consistent with the public interest" under Section 203 of the Federal Power Act. Moreover, the merged company's discriminatory denials certainly would violate the nondiscrimination requirement of Section 205(b) of the Federal Power Act. The litigation produced by such denials would prevent the timely and orderly assignment of transmission access to all Northwest sellers. Finally, by disadvantaging QFs in the marketplace relative to their utility competitors, the exclusion would undermine the Congressional policies underlying PURPA.

It appears that a utility buying from a QF remains free to obtain wheeling service from the merged company under the Commission's conditions. This fact does not eliminate the problem of discrimination. Utilities-as-buyers commonly expect competing sellers to present them with full sales packages,

including wheeling costs, for comparison. The QF would be unable to compete in those situations were it unable to request wheeling service from the merged company.

For these reasons, we urge the Commission to eliminate footnote 158. The Commission should state clearly that all sellers, including QFs, will have the right to nondiscriminatory, cost-based transmission under the Commission's conditions.

D. The Commission's Enforcement Procedure Should Provide for Damages

Under the Commission's complaint procedure, a successful complainant would obtain an order requiring only prospective obedience to the Commission's conditions. Order at 45-46. The merged company thus has an incentive to breach the conditions and reap monopoly profits until the complaint litigation ends. To eliminate that incentive, the complaint procedure must provide for damages. If the complaining entity forfeits transactional benefits to the merged company during the complaint litigation, the merged company must disgorge its ill-gotten gains.

Whether this Commission has the statutory authority to award damages in the non-merger context is beside the point. To permit the merged company to exploit its monopoly power even temporarily is not "consistent with the public interest." The damages condition is necessary to prevent that behavior.

E. The Commission's Authority to Impose Wheeling Conditions Requires Clarification

In defending its authority to require nondiscriminatory wheeling as a condition of merger approval, the Commission

distinguishes its wheeling conditions here from, among other things, its wheeling order overturned in Richmond Power & Light v. FERC, 574 F.2d 610 (D.C. Cir. 1978). See Order at 21-23. The Commission explains that unlike the Richmond order, the instant conditions are necessary to ameliorate the merger's anticompetitive effects and therefore "would not serve to make the merged company a common-carrier." Order at 22. Without conceding that Richmond was correctly decided, we think the Commission's use of the phrase "common carrier" detracts from the clarity of the Order because it blurs the key distinction between Richmond and the instant case.

The distinction is simply this: In the instant case wheeling is voluntary; in Richmond it was not. Here the Commission has determined that the merger, absent wheeling conditions, is inconsistent with the public interest due to anticompetitive harm. The wheeling conditions are, in the Commission's view, the "minimum necessary" to render the merger consistent with the public interest from the standpoint of competition. Order at 38. The choice of merging and wheeling, or not merging and not wheeling, remains entirely with the merging companies.

II. MERGER BENEFIT ISSUES

A. The Commission Erred in Attributing to the Merger (1) "Pecuniary" Benefits and (2) Savings Attainable Through Coordination Contracts

Under Section 203, the merging companies must show, at the very least, that merger costs do not exceed merger benefits. The

Commission concluded that the "probable merger benefits nonetheless add up to substantially more than the costs of the merger." The reason, the Commission apparently concluded, was that "the power supply benefits alone would likely be greater than the costs of the merger." Order at 53. [17] There are two major problems with this reasoning.

First, certain power supply benefits were "pecuniary" benefits that came at the expense of other utilities. A merger "benefit" that disadvantages another entity does not serve the public interest. At best, it leaves the public interest unchanged. This is the case with one of the major benefits assumed in Mr. Steinberg's model: the acquisition and resale of low-cost power. Tr. 3103. Mr. Steinberg assumed that without the merger, UP&L and PP&L, operating separately, would not be able to take advantage of these low-cost power supplies. Tr. 3103-3104. Mr. Steinberg did agree that in the Northwest, there "are probably a couple" of utilities that have the capability to integrate these same low-cost power supplies into their systems, although they may need to build some transmission facilities to do so. Tr. 3104. Such integration could occur on both a long-term and a short-term basis. Tr. 3104. The ALJ found that certain of the claimed benefits met this description, 43 F.E.R.C. para. 63,030 at 65,335 (1988). The Commission must make clear

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17 The Commission concluded that certain claimed benefits "have not been substantiated." Order at 52. For the purposes of argument, we will assume that the "probable" power benefits were "substantiated." Certainly benefits must be substantiated before they are probable.

that "pecuniary" benefits do not enhance the public interest and therefore cannot offset merger costs for the purposes of the Section 203 analysis.

Second, the Commission apparently included in "power supply benefits" benefits achievable through contract coordination. The Commission held that "[t]he possibility of achieving a particular benefit through a contractual arrangement does not diminish the cost savings associated with that benefit." Order at 52. We respectfully disagree. Attributing these benefits to a merger will lead, in Mr. Russell's view, to "[m]ore consolidations and acquisitions of utilities ..., with the loss of diversity in ownership and competitive pressure on prices." Ex. 20 at 43-44. The Commission's policy in fact would discourage coordination. For example, a utility contemplating acquisition of its neighbor would be disinclined to coordinate with that neighbor, for fear of dissipating merger "benefits." Where the first utility has special access to regional resources, and the neighbor does not, the first utility's refusal to coordinate can weaken the neighbor competitively and financially, rendering it more vulnerable to takeover.

Contractual coordination promises real benefits. As Mr. Russell testified, "there has been extensive and successful national experience achieving by contract precisely those coordination benefits PP&L/UP&L claims cannot be achieved by contract." Ex. 20 at 42-43. The merged company's witnesses did not disagree. Mr. Steinberg conceded that some portion of his

benefit projections could be obtained through a UPL-PPL contract. Tr. 3101-3102.

Under the cost-benefit comparison of Section 203, we must compare two worlds: (1) a world in which the utilities have ignored their obligation to realize natural coordination efficiencies, and (2) a world in which they realize those efficiencies through concentration. The Commission has declared the world better off because efficiencies have resulted. We take a different view: the merger has structural diversity and reduced incentives to coordinate, while bringing benefits which have yet to be substantiated.

The Commission is obligated to encourage coordination. See Section 203(b) (Commission has authority to condition merger approval on terms and conditions "necessary or appropriate to secure the maintenance of adequate service and the coordination in the public interest of facilities" subject to its jurisdiction)); Section 202 (Commission must encourage the voluntary interconnection and coordination of facilities). The Commission here has done the contrary. It has rewarded with merger approval utilities who eschew coordination.

It may be that the Commission wishes not to discourage mergers promising true efficiencies. A policy of excluding from merger "benefits" efficiencies which prudent management is obligated to achieve will not have that effect. On the contrary, the policy will force hearing participants to focus on those efficiencies and costs truly produced by consolidation.

Conversely, if the Commission wants to encourage utilities to realize full coordination potential, it need not invite mergers. Under Section 206, the Commission may challenge the rates and practices of those who fail to coordinate.

In short, Applicants cannot meet the test of Section 203. They have not proven that the merger costs do not exceed merger benefits, because they have not proven there are actual merger benefits.

B. To Eliminate the Merged Company's Incentive to Withhold Merger Benefits, the Commission Should Continue Refund Protection Past 15 Months

The Commission properly concluded that where "a merger generates significant cost savings, there is very little incentive for the new utility to come forward with new rates that fully reflect those savings." Order at 57. The Commission accordingly seeks to prevent a merger that "could result in the collection of substantial excess revenues without according any refund protection to the affected wholesale customers." Order at 58. As the Commission notes, the Regulatory Fairness Act, Pub. L. No. 100-473 (1988), "provides some refund protection where rates are found to be unjust and unreasonable." Id. n.213. Reliance on the Regulatory Fairness Act alone will not create the necessary incentive in the merged company to "come forward with new rates," however, because the Act has a 15-month refund period restriction. Given the unusual incentives in merging companies to avoid or delay rate decreases, the Commission should make

clear that the 15-month restriction will not apply.[18]

CONCLUSION

Representatives of the merged company apparently will seek to resolve ambiguities in the Commission's order through compliance filings, not rehearing. See Letter from PacifiCorp Chairman Don C. Frisbee to Commission Chairman Martha O. Hesse (Nov. 16, 1988). We disagree with that approach. While reserving our rights to contest any compliance filing not consistent with the Commission's order, we urge the Commission to resolve the ambiguities on rehearing. The Commission viewed its conditions as the "minimum necessary" to render the merger "consistent with the public interest." Id. at 38. If the conditions are unclear, then the Commission has not assured this consistency. Accordingly, ambiguities in the Commission's original order must be resolved in the rehearing order, where the public can watch and where the parties can preserve their rights for appeal.

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18 This condition would not "amend" the Regulatory Fairness Act, of course, any more than the Commission's wheeling requirements "amend" the Federal Power Act. The condition prevents the collection of excess revenues, and therefore ensures that the merger is "consistent with the public interest" under Section 203.

WHEREFORE, for the foregoing reasons, we respectfully request this Commission to grant rehearing on the issues set forth above, and to decide these issues in the manner requested.

Respectfully submitted,

Scott Hempling

Environmental Action Foundation
1525 New Hampshire Ave. NW
Washington, DC 20036

Attorney for
UMWA, *et al.*

November 25, 1988

APPENDIX A

PUBLIC SERVICE COMMISSION
COPY

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

--oOo--

In the Matter of the Application of Utah Power & Light Company, and PC/UP&L Merging Corp. (To be Renamed PacifiCorp) for an Order Authorizing the Merger of Utah Power & Light Company and PacifiCorp into PC/UP&L Merging Corp. and Authorizing the Issuance of Securities, Adoption of Tariffs and Transfer of Certificates of Public Convenience and Necessity and Authorities in Connection Therewith.	Case No. 87-035-27 REPORTER'S TRANSCRIPT OF PROCEEDINGS COPY 15 17 20

Salt Lake City, Utah

Tuesday, November 8, 1988

10:05 a.m.

BEFORE:

BRIAN T. (TED) STEWART, Chairman, Public Service Commission of Utah;

BRENT H. CAMERON, Commissioner, Public Service Commission;

JAMES M. BYRNE, Commissioner, Public Service Commission of Utah.

APPEARANCES:

AS HERETOFORE NOTED IN THE RECORD AND AS FOLLOWS:

SCOTT HEMPLING, Attorney at Law, 1525 New Hampshire Avenue, NW, Washington, DC 20036, for and on behalf of UMW District 22.

BRUCE PLENK, Attorney at Law, Utah Legal Services, 124 South 400 East, Salt Lake City, UT 84111, for and on behalf of the Salt Lake Community Action Program and the Salt Lake Citizens Congress.

1 A Maybe I better leave that for Mr.
2 Steinberg.
3 COM. CAMERON: On remaining existing
4 capacity, what's the status of the Nevada sale,
5 what's in and what's out or --
6 THE WITNESS: In our view, the status of
7 the Nevada sale is that that was a sale contracted
8 prior to the filing of the FERC application and that
9 that is indeed the recognition in the change in the
10 FERC order from the draft order, which required some
11 -- that calculation to be made at a date prior to
12 the Nevada contract, but I think certainly you have
13 to recognize that if there isn't a Nevada sale, then
14 there isn't a Nevada line, either, so, you know,
15 it's a Catch-22 situation.
16 COM. BYRNE: The Nevada two sale was
17 dependent on the 500 kV AC?
18 THE WITNESS: Yes.
19 COM. BYRNE: And therefore not a concern.
20 THE WITNESS: The Nevada II sale, I think
21 there could be a question as to the Nevada II sale
22 but that sale was contemplated over a line to be
23 built by Nevada Power or someone else.
24 COM. BYRNE: Well, is Utah Power -- is
25 the merged entity talking with other utilities in

PUBLIC SERVICE COMMISSION
COPY

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

--oOo--

In the Matter of the Application of Utah Power & Light Company, and PC/UP&L Merging Corp. (To Be Renamed PacifiCorp) For An Order Authorizing The Merger of UP&L Co. and PacifiCorp into PC/UP&L Merging Corp. and Authorizing the Issuance of Securities, Adoption of Tariffs, and Transfer of Certificates of Public Convenience and Necessity Authorities in Connection Therewith.	Case No. 87-035-27 REPORTER'S TRANSCRIPT OF PROCEEDINGS

COPY

Salt Lake City, Utah

Wednesday, November 9, 1988

10:06 a.m.

BEFORE:

BRIAN T. (TED) STEWART, Chairman, Public Service Commission of Utah;

BRENT H. CAMERON, Commissioner, Public Service Commission;

JAMES M. BYRNE, Commissioner, Public Service Commission of Utah.

WENDY K. RANDALL, CSR, RPR
(801) 328-1188

1 A Because over the past year, more of the
2 benefits have been quantified. We know more about
3 it now than we did. Secondly, I recognize the risk
4 of not going forward with the merger more now than I
5 did then. I'm simply convinced that even with this
6 FERC order, the balance of benefits are so great
7 that we simply would not be a good steward to our
8 constituencies if we did not go forward.
9 Q Then your view is consistent with that of
10 Mr. Topham and Mr. Steinberg, the benefits which
11 have been projected by the applicants, you feel more
12 confident now that they will actually occur?
13 A Yes.
14 MR. MOOY: I have no further questions.
15 COM. STEWART: Mr. Hempling.
16 CROSS-EXAMINATION
17 BY MR. HEMPLING:
18 Q Good morning, Mr. Davis. We haven't met
19 before. Would you turn to page 3 of your testimony,
20 please, lines 19 through 23.
21 A Yes.
22 Q Would you take a moment to review that?
23 A Yes, I know what it is.
24 Q You are interpretating the phrase,
25 "transmission dependent utilities" to be limited to

1 existing municipals?

2 A That is correct.

3 Q So is it your interpretation that a newly
4 formed municipal which requires access to UP&L
5 transmission system in order to connect its load
6 with its resources would be placed in tier 3? Is
7 that your understanding or your interpretation of
8 the FERC order?

9 A Yes. Yes, I think FERC intended to limit
10 existing organizations like DG&T and UAMPS to their
11 existing membership.

12 Q Then based on what you just said, is it
13 fair to interpret your sentence beginning on line 19
14 as saying there is reason to believe that FERC
15 intended to discourage future municipal power
16 expansion? Would that be a fair paraphrasing of
17 what you just said?

18 MR. FORSGREN: I object. That's
19 argumentative.

20 MR. HEMPLING: I don't mean to be. I'm
21 just looking to get some clarification.

22 THE WITNESS: What I said there --

23 MR. FORSGREN: Let the Commissioner rule
24 on the objection.

25 COM. STEWART: I will overrule the

1 objection. I think he should answer the question.
2 THE WITNESS: What I'm saying there is I
3 do not think it was the intent by that limitation to
4 encourage further municipal utilities.
5 Q (By Mr. Hempling) I understand that.
6 That's what your written testimony says. Are you
7 also saying that it is your interpretation that the
8 intent was to limit the membership to existing
9 municipals?
10 A Yes, for those transmission dependent
11 utilities.
12 Q Now, looking to the bottom of page 3 and
13 over to the top of page 4 of the sentence beginning
14 on line 25 of page 3, you state that the only course
15 to avoid formation of new municipals is to lower
16 your rates and extend excellent service to your
17 customers. Again, I'm not intending to be
18 argumentative, but is it a fair paraphrasing to say
19 that you view the risk of municipalization as an
20 incentive to the company to lower rates and extend
21 excellent service to your existing retail customers?
22 A Yes.
23 Q Now, on a different issue, did you
24 participate in the board of directors deliberations
25 after the FERC order to the impact of that FERC

Before the
PUBLIC SERVICE COMMISSION
of Utah

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

HE MATTER OF THE APPLICATION	)	
TAH POWER & LIGHT COMPANY,	)	
PC/UP&L MERGING CORP. (TO BE	)	FOURTH
MED PACIFICORP) FOR AN ORDER	)	SUPPLEMENTAL TESTIMONY
ORIZING THE MERGER OF UTAH	)	AND EXHIBITS
R & LIGHT COMPANY AND	)	
FICORP INTO PC/UP&L MERGING	)	
AND AUTHORIZING THE ISSUANCE	)	
CURITIES, ADOPTION OF TARIFFS	)	

UTAH POWER & LIGHT COMPANY

TESTIMONY AND EXHIBITS

1 FERC order deal primarily with firm contracts. Mr.
2 Steinberg's analysis shows that the revenue received from
3 having transmission capacity committed to firm wheeling
4 will be approximately equal to the anticipated margin on
5 the surplus sales it displaces through the five-year
6 merger benefit period. Second, the FERC order's
7 treatment of non-firm is very positive.
8 QUESTION
9 Please explain why the order is positive with regard
10 to non-firm sales.
11 ANSWER
12 The FERC order provides that, for non-firm sales,
13 the Merged Company would receive a one-third split of the
14 savings between the buyer's decremental cost and the
15 seller's incremental cost. This amount would not be
16 limited by embedded cost and would provide a fair
recognition of the transmission contribution to the
overall savings between the supplier and the buyer. In
one respect, the FERC order on non-firm may be better
than the past practice. The FERC order requires the
parties to reveal their true cost instead of merely
offering a buy or sell price. This one-third split was
contained in the Company's proposed wheeling policy
presented at FERC for non-firm transactions, therefore we
received exactly what we asked for on non-firm sales.
The vast majority of the historical off-system

CERTIFICATE OF SERVICE

I hereby certify that on November 25, 1988, I served a copy of the foregoing document on those persons listed on the official service list in this proceeding, by depositing a copy thereof in the United States mail, postage prepaid, or by equivalent method of service.

Scott Hempling