



DEPARTMENT OF JUSTICE

Antitrust Division

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Gary L. Kaplan, Esq.
Reed Smith Shaw & McClay, LLP
435 Sixth Avenue
Pittsburg, Pennsylvania 15219-1886

Dear Mr. Kaplan:

This letter responds to your request on behalf of the electric power utilities that jointly own the Keystone and Conemaugh electric power plants in western Pennsylvania for the issuance of a business review letter pursuant to the Department of Justice's business review procedure, 28 C.F.R. § 50.6. You have requested a statement of the Department's current enforcement intentions regarding proposed changes in the manner that the joint ventures' electric power is sold in a newly-deregulated market environment. Based on the information and assurances that you have provided, the Department has no current intention to challenge the joint ventures' proposal to sell their electric power on a bid price, rather than regulated cost, basis.

In the 1960's eleven electric power utilities located in Pennsylvania, New Jersey, Maryland and Delaware formed two joint ventures to finance, construct and operate four coal-fired steam electric generation units at the Keystone and Conemaugh plants in western Pennsylvania. Two generation units were built at each plant. To date, the owners have invested over a billion dollars for construction of, and additional capital improvements in, the four units. The four generating units have a future life of 25 years, with proper maintenance and capital investment. Their total capacity of 3,400 megawatts constitutes less than six percent of capacity and less than ten percent of the weekly peak load of the generating capacity located in the four state region.

The owners of the joint ventures are all members of the Pennsylvania-New Jersey-Maryland Interconnection Association ("PJM"), which operates as a regional economic dispatch center with its dispatchers selecting, on an hourly basis, the cheapest (based on regulatory "cost" concepts) source of energy available from any Pool member or other Pool participant to serve the next increment of demand for electricity. When electricity produced by a generating unit owned by one Pool participant is dispatched by PJM to supply the customers of another participant,

those participants are said to have sold and purchased energy in "Pool interchange." PJM members, however, retain the right to designate the output of generating units they own for the benefit of their own customers. Pool interchange thus functions as a residual market, under which energy needs that Pool participants have not arranged to satisfy from their own generating resources or from contract energy purchases are met through the most economic uncommitted generating resources of any PJM participant. PJM administers a settlement and billing process to collect and distribute payment for Pool interchange after the fact.

You have represented that at present, PJM determines which generating unit constitutes the least expensive resource available to meet energy needs of the Pool on the basis of the variable costs of the generating units. Until recently, Pool interchange was priced on the basis of "split savings." That is, PJM members whose generating units provided energy to the Pool for dispatch received a portion of the difference between their variable cost of producing that energy and the amount it would have cost the PJM member whose customers consumed the energy to produce the energy using its own resources. PJM members purchasing Pool interchange paid a portion of that difference. As a result, sellers and purchasers of energy through Pool interchange split the savings resulting from Pool interchange.

According to your application, FERC, in 1996, changed the way in which power pools like PJM must operate in the future. Accordingly, you indicate that PJM is in the process of restructuring itself, under FERC supervision, to develop an Independent System Operator ("ISO") to conduct PJM energy purchase, sale and dispatch functions. Under this new structure, the ISO will begin receiving proposals to buy and sell wholesale energy from all utility and non-utility market participants, including power marketers, independent power producers and other utilities outside the PJM region. This restructured market will be open for bids from participants submitted one day in advance to supply energy to meet PJM's projected demand for the next day.

You inform us that under a FERC-approved revision of the PJM Agreement that took effect April 1, 1997, the pricing of Pool interchange has been modified. Now, Pool interchange is priced on the basis of hourly "market clearing" prices. The market clearing price is the reported variable cost of the most expensive resource that the ISO calls on in an hour to satisfy demand for Pool interchange in that hour. Any PJM Pool participant whose generating units supply Pool interchange in a given hour receives the market clearing price for that hour, and any PJM Pool participant whose customers consumed Pool interchange in the hour pays that same market clearing price, regardless of their actual bid amount.

On July 14, 1997, PJM members proposed a further modification of pricing for Pool interchange to permit each PJM Pool participant to bid to supply energy to PJM at any price that Pool participant deems appropriate, rather than at cost. PJM's current dispatch method -- the use of member bids to determine order of dispatch and a market clearing price -- would then apply to

such discretionary bids. You indicate that such a change would require a determination by FERC that the Pool members either lack market power over the sale of electric energy in Pool interchange or have adequately mitigated any market power they may possess. The proposed changes in PJM would allow the joint ventures to bid their output based on the price they are willing to accept rather than their regulatory costs. Since the joint ventures' price bids to the ISO will compete with those of their individual owners, the parties seek a business review letter.

To avoid the risk that the joint ventures might be used as conduits for collusion between or among their owner/rivals, they and their owners will observe information flow limitations designed to avoid anticompetitive information exchanges. The joint ventures' bids to PJM or the ISO will be prepared solely by an independent internal Project Office, i.e., with no participation by any owner in the bidding strategy of the joint venture. No owner will communicate any information to the joint ventures about any bid that the owner intends to submit to PMJ. Conversely, the Project Office will not provide any owner any information about bids that the joint ventures submitted to PMJ until after the deadline for submission of competing bids. In addition, all owners of the joint ventures have pledged to adhere to a Code of Conduct that expressly enjoins them from discussing with each other their independent prices, marketing plans, costs and other competitively significant information. An outside law firm has been retained to assist the joint ventures and their owners in complying with the antitrust laws.

On the basis of the information and assurance that you have provided to the Department, it does not appear that the joint ventures' proposal to bid their electric power output on a price, rather than regulated cost, basis will have any anticompetitive effect. Since the joint ventures' capacity would not be sufficient to supply even ten percent of the market, it is unlikely that they could determine market prices by themselves. Moreover, the proposed restrictions on information flows between the joint ventures and their owners and between the owners inter se, should, if effective, prevent the owners from using the joint ventures as conduits for anti-competitors information exchanges.

This letter expresses the Department's current enforcement intentions, and is predicated on the accuracy of the information and assertions that you have presented to us. In accordance with its normal practice, the Department reserves the right to bring an enforcement action in the future if the actual operation of the joint ventures prove to be anticompetitive in any purpose or effect.

This statement is made in accordance with the Department's business review procedure, 28 C.F.R. § 50.6. Pursuant to its terms, your business review request and this letter will be made

publicly available immediately, and any supporting data will be made publicly available within thirty days of the date of this letter, unless you request that any part of the material be withheld in accordance with Paragraph 10(c) of the business review procedure.

Sincerely,

Joel I. Klein
Assistant Attorney General