

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Oklahoma Gas and Electric Company
NRG McClain LLC

Docket No. EC03-131-000

ORDER SETTING DISPOSITION AND ACQUISITION OF FACILITIES
APPLICATION FOR HEARING

(Issued December 18, 2003)

1. On August 26, 2003, Oklahoma Gas and Electric Company (OG&E) and NRG McClain LLC (NRG McClain) filed a joint application pursuant to Section 203 of the Federal Power Act (FPA)¹ requesting Commission authorization for the sale of certain jurisdictional facilities by NRG McClain to OG&E (Transaction). The Commission has reviewed the application pursuant to the Merger Policy Statement² and finds that the Transaction, unless adequately mitigated, will undermine competition and thus not be consistent with the public interest. We will, therefore, set the application for hearing to determine remedies we could impose as a condition of any approval for the Transaction, as discussed below.

2. This order benefits customers by ensuring that the Transaction will not adversely affect competition in the marketplace.

¹ 16 U.S.C. § 824b (2000).

² Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592, 61 Fed. Reg. 68,595 (1996), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,044 (1996), reconsideration denied, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement); see also Revised Filing Requirements Under Part 33 of the Commission's Regulations, Order No. 642, 65 Fed. Reg. 70,983 (2000), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,111 (2000), order on reh'g, Order No. 642-A, 66 Fed. Reg. 16,121 (2001), 94 FERC ¶ 61,289 (2001).

Background

3. NRG McClain is a wholly-owned public utility subsidiary of NRG Energy, Inc. (NRG Energy), which in turn is wholly owned by Xcel Energy Inc. (Xcel Energy). NRG McClain filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code on August 19, 2003. NRG McClain owns a 77 percent undivided interest in the McClain Facility, a 520 MW gas-fired combined-cycle electric plant located in Oklahoma. Oklahoma Municipal Power Authority (OMPA), a wholesale customer of OG&E, owns the remaining 23 percent undivided interest. NRG McClain currently operates the McClain Facility.

4. OG&E provides bundled retail electric service within the State of Oklahoma. To date, OG&E has relied on its own generating plants, purchase power agreements with qualifying facilities (QFs) under the Public Utility Regulatory Policies Act of 1978 (PURPA), a purchase power agreement with Southwestern Public Service Company, and firm power purchases from third parties to meet customers' demands for energy service. As discussed below, some of these agreements are expiring. OG&E is purchasing the McClain Facility to provide additional generation to serve its customers.

5. On August 18, 2003, OG&E and NRG McClain executed an asset purchase agreement (Purchase Agreement) under which OG&E will acquire NRG McClain's interest in the McClain Facility, including associated jurisdictional transmission facilities.³ The Transaction enables OG&E to satisfy its native load service obligation and to fulfill its commitment under an Oklahoma Corporation Commission (OCC) Settlement Order dated November 22, 2002 (OCC Settlement Order). Upon closing of the Transaction, OG&E will assume operating responsibility pursuant to operating agreements that address the operations and dispatch of the McClain Facility. Applicants state that the Transaction will enable OG&E to pass through fuel cost savings to customers taking service under retail and wholesale tariffs and rate schedules.

6. OG&E requests the Commission to issue an order authorizing the Transaction in order to enable it to meet its obligation under the OCC Settlement Order to acquire electric generating capacity of not less than 400 MW to be integrated into the OG&E generation system. Under the OCC Settlement Order, if OG&E is unable to acquire not

³ OMPA will continue to own the remaining 23 percent interest. OG&E and OMPA executed a Transmission Operation and Maintenance Agreement (O&M Agreement), dated August 25, 2003. Under the O&M Agreement, OG&E will maintain the transmission facilities included in the ownership of the McClain Facility, and OMPA will continue to have the right to dispatch its share of the McClain Facility and have input on the scheduling of outages in accordance with the generation operating agreement between OG&E and OMPA.

less than 400 MW of generation by December 31, 2003, OG&E must credit \$25 million annually (at a rate of 1/12 of \$25 million per month for each month that the facility is not in place) to its Oklahoma retail customers from January 1, 2004 through December 31, 2006. OG&E plans to close the Transaction no later than December 1, 2003, in order to ensure that the McClain Facility will be available for OG&E's customers by January 1, 2004.

Notice and Interventions

7. The Application was noticed on August 27, 2003, 68 Fed. Reg. 52,760 (2003), with comments, protests or interventions due on or before September 16, 2003. OMPA, Oklahoma Industrial Energy Consumers, InterGen Services Inc. and Redbud Energy LP (InterGen), and PowerSmith Cogeneration Project LP (PowerSmith) filed timely motions to intervene and protests. Southwest Power Pool (SPP) filed an untimely motion to intervene on October 1, 2003, and OCC filed an untimely motion to intervene on October 10, 2003.

8. OG&E filed an answer to the Intervenors' protests on October 1, 2003. InterGen filed a reply to OG&E's answer on October 16, 2003, and PowerSmith filed a reply to OG&E's answer on October 29, 2003. OG&E filed an answer opposing PowerSmith's reply on October 31, 2003. PowerSmith filed a reply to OG&E's October 31, 2003 answer.

9. Finally, OMPA and OG&E both filed comments on November 19, 2003 and November 20, 2003, respectively, urging prompt Commission action on this application. InterGen and PowerSmith filed responses to those requests on November 25, 2003.

Discussion

A. Procedural Matters

10. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,⁴ the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. The Commission will grant the motions to intervene out of time filed by SPP and OCC given their interest in this proceeding, the early stage of the proceeding and the absence of any undue prejudice or delay.

⁴ 18 C.F.R. § 385.214 (2003).

11. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure⁵ prohibits an answer to a protest or answer unless otherwise permitted by the decisional authority. We will accept the answers and replies filed by OG&E, PowerSmith, and InterGen because they provided information that assisted us in our decision-making process.

B. Section 203 Analysis

12. Section 203(a) of the FPA provides that:

No public utility shall sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of the Commission, or any part thereof of a value in excess of \$50,000, or by any means whatsoever, directly or indirectly, merge or consolidate such facilities or any part thereof with those of any other person, or purchase, acquire, or take any security of any other public utility, without first having secured an order of the Commission authorizing it to do so.⁶

13. In 1996, the Commission issued the Merger Policy Statement setting forth procedures, criteria and policies applicable to public utility mergers and other dispositions of jurisdictional facilities. The Merger Policy Statement and Order No. 642, which sets forth the Commission's filing requirements for Section 203 applications, provide that the Commission will take account of three factors in its Section 203 analysis: (a) the effect on competition; (b) the effect on rates; and (c) the effect on regulation.

C. Effect on Competition

Applicants' Analysis of Horizontal Competitive Issues

14. Applicants' witness, Dr. William Hieronymus, examined the effect of the Transaction on competition in two relevant geographic markets: (1) the southern sub-region of SPP (SPP South); and (2) the OG&E control area. Dr. Hieronymus estimated the change in market concentration for both Economic Capacity (EC) and Available Economic Capacity (AEC) for Winter, Summer and Shoulder Periods under the Commission's Appendix A competitive analysis screen. He analyzed the net effect of the Transaction and the expiration of two long-term power purchase contracts. The net increase in capacity is 90 MW – the addition of 400 MW from the McClain Facility along with the expiration of 310 MW from two long-term contracts. The two long-term

⁵ 18 C.F.R. § 385.213(a)(2) (2003).

⁶ 16 U.S.C. § 824b(a) (2000).

contracts are a 200 MW purchase from SPS and a 110 MW purchase from PowerSmith Cogeneration, a QF under PURPA.

15. The Transaction passes the screen for the SPP South region in all seasons and load conditions for both EC and AEC.

16. In the OG&E market, the Transaction fails the screen for six of the ten time periods for EC. During those periods the market concentration ranges from 3222 Hirschman- Herfindahl Index (HHI), a standard measure of market concentration, to 4810 HHI, with increases ranging from 93 to 109 HHI. Applicants argue that because Oklahoma does not have retail choice, and OG&E retains a native load obligation, AEC is the relevant measure in evaluating the effect of the Transaction on concentration. The Transaction passes the screen in all time periods for AEC.

17. Applicants propose transmission upgrades that will increase transmission import capacity from the Entergy control area by 105 MW in the summer and 305 MW in the winter in order to mitigate the effect on competition. Applicants state the proposed mitigation would eliminate all of the screen failures and make the market less concentrated than it would be without the Transaction.

Applicants' Analysis of Vertical Competitive Issues

18. Applicants argue that the combination of OG&E's transmission facilities with the NRG McClain Facility will not create any competitive concerns regarding vertical market power. They state that OG&E operates under the SPP OATT and that they are committed to join a Regional Transmission Organization through the membership in SPP.

19. Applicants also argue that the combination of OG&E's natural gas interests and the addition of the McClain Facility will not create any competitive concerns regarding vertical market power. Applicants explain that OG&E's pipeline affiliate, Enogex, only serves the AEP West control area, so it could not use any influence it has in the upstream natural gas market to affect prices in the relevant downstream electricity markets (SPP South and OG&E).

Comments and Protests

20. InterGen first questions Dr. Hieronymus' assertion that the net increase due to the Transaction is only 90 MW rather than the entire 400 MW OG&E is acquiring from NRG McClain. InterGen states that one of the long-term contracts is a QF contract and that there is no indication that the ability of a QF to sell its output at avoided cost to OG&E will disappear. Moreover, it argues that because generators inside the OG&E territory cannot sell out of that territory, OG&E will be obliged to buy the QF's output; thus, OG&E would retain effective control of the unit. InterGen argues that OG&E has

foreclosed access into and out of its service territory by failing to upgrade transmission facilities.

21. Second, InterGen argues that Applicants' analysis is flawed because it failed to account for transmission exports. InterGen argues that for an eight month period, before the QF contract expires, OG&E will control more generation than it needs to meet its native load. That is, OG&E will be "long" on generation and will be looking to sell outside its territory. Therefore, OG&E will have an incentive to favor its own generation over rival generation. InterGen argues that OG&E will have the ability and incentive to foreclose competitors' access to transmission for export out of the OG&E control area. InterGen cites the Commission finding in AEP:

A successful foreclosure strategy does not require that the merged company control more generation than it did before the merger. Instead, it requires that the merged company be able to frustrate competitors' access to an input necessary for selling in downstream electricity markets, thereby narrowing the scope of relevant markets and increasing the concern that, in highly concentrated markets, prices will rise after the merger.⁷

22. Third, InterGen argues that Applicants did not analyze the proper geographic market. InterGen questions the assertion by Dr. Hieronymus that the SPP South region has no significant internal transmission constraints. It states that SPP was the region with the second most transmission loading relief orders (TLRs) in the month of August 2003. InterGen concludes that SPP is internally constrained and not the relevant geographic market.

23. InterGen does not suggest that the Commission reject the Transaction. If the Commission approves the Transaction, it should be conditioned as follows: (1) OG&E should be required to establish a program to include merchant generators in its economic dispatch process; (2) OG&E should be required to engage an independent entity to calculate its Available Transmission Capacity (ATC) and do its transmission planning studies until SPP is a truly independent ISO; (3) OG&E should be required to post redispatch alternative and costs for bottlenecks that impede transmission out of its control area; and (4) OG&E should be required to engage an independent market monitor, subject to this Commission's and OCC's oversight.

24. PowerSmith argues that the increased concentration of generation resources in Oklahoma in the hands of OG&E will harm competition. It notes that the Commission

⁷ InterGen at 15, citing American Electric Power, 90 FERC ¶ 61,242 at 61,786 (2000) (AEP).

has expressed concern about the attempted acquisition by franchised utilities of generation facilities that were initially developed as merchant generation. PowerSmith cites the Commission's concern in Cinergy regarding "the possible implication of affiliate transactions [of this type] for the competitive process in general and for the region's wholesale competition."⁸ In this case OG&E is seeking to completely displace existing sources of wholesale supply by contract termination.

25. PowerSmith further asserts that the Transaction could exacerbate existing transmission constraints into, out of, and within the OG&E control area. PowerSmith questions whether Applicants' proposal to increase transmission import capabilities to mitigate market power is viable, given the difficulties with certification and siting requirements.

26. Regarding the combination of OG&E's generation and transmission facilities with the McClain generation capacity, InterGen argues that OG&E has vertical market power and the incentive to use it: (1) the SPP OATT does not mitigate the vertical market power or the potential for undue discrimination; (2) an SPP RTO that may be fully functioning in the future will not mitigate the market power that it asserts will exist as a result of the Transaction; and (3) the future SPP RTO may not be independent.

Applicants' and Intervenors' Responses

27. Applicants reply that, contrary to InterGen's argument, the SPP South control area is a relevant geographic market. First, the high number of Transmission Loading Relief occurrences (TLRs) on SPP flowgates does not indicate that SPP South is not a relevant market. They state that most of the TLRs cited by InterGen were Level 3 curtailments of non-firm power occurring in the summer, which are not significant events. Moreover, Applicants argue that Dr. Hieronymus did analyze the effect of the Transaction on the smallest relevant geographic market; the OG&E control area.

28. Applicants assert that Dr. Hieronymus's use of the net increase in capacity is reasonable and consistent with Order No. 642 and Appendix A of the Merger Policy Statement. They state that since the long-term power purchase contracts will no longer be in place in 2004, OG&E will not control the output of those facilities, even if it buys non-firm power from PowerSmith. Therefore, the analysis reflects all generation controlled by OG&E, as required under Appendix A.

29. SPP refutes InterGen's protest regarding the SPP OATT and the future independence of the SPP RTO, asserting that it operates in a non-discriminatory manner and is capable of calculating ATC. SPP cites to the Commission's finding in AEP that

⁸ Cinergy Services Inc., et al., 102 FERC ¶ 62,128 at 61,345 (2003) (Cinergy).

SPP is qualified to be an independent administrator for the calculation and posting of ATC and total transmission capacity, and to independently perform the OASIS function of processing transmission service requests for AEP.⁹

Commission Determination

30. As discussed below, we find that the acquisition of the McClain Facility, without further mitigation, will harm competition in the OG&E market, and therefore, we will set the issue of appropriate mitigation for hearing. The harm comes from increases in OG&E's horizontal and vertical market power. The increase in horizontal market power is indicated by the horizontal screen failures in the analysis of the effect of the Transaction on concentration in relevant wholesale markets. The increase in vertical market power comes from the fact that OG&E, a vertically integrated utility, would be adding 400 MW of generation capacity to its existing transmission and generation facilities, thus increasing its incentive (it already has the ability) to use its control of transmission facilities to disadvantage its competitors in wholesale power markets.

Horizontal Market Power

31. We do not agree with InterGen's argument that Applicants did not define the geographic scope of the market appropriately. Applicants analyzed the smallest relevant market, in this case the OG&E territory. We note that Applicants concede that the Transaction fails the horizontal competitive screen analysis for EC in the OG&E service territory. To address this failure, therefore, Applicants propose mitigation that would reduce market concentration by expanding the geographic scope of the market. Applicants propose to increase the import capacity of the OG&E transmission system. The proposed upgrade is an installation of a 500 - 161 kV transformer and a 500 kV circuit breaker at OG&E's Ft. Smith substation, which is part of OG&E's interface with Entergy in Arkansas. Applicants' witness, Melvin Perkins, estimates that it will take approximately 18 months to complete the enhancement.

32. In Order No. 642, we stated that we intend to consider current and reasonably foreseeable regional developments as part of our merger analysis. In the Merger Policy Statement, we adopted the U.S. Department of Justice / Federal Trade Commission Horizontal Merger Guidelines (the DOJ/FTC Guidelines) as the analytical framework for analyzing the effect on competition."¹⁰ The DOJ/FTC Guidelines address the issue of changing market conditions by stating that "[t]he Agency will consider reasonably predictable effects of recent or ongoing changes in market conditions in interpreting

⁹ SPP Intervention and Response at 4.

¹⁰ Merger Policy Statement at 30,111.

market concentration and market share data.”¹¹ There is no evidence in the record showing whether or not the upgrade was a foreseeable and reasonably certain change in the market. If it was, then it must be included in both the pre- and post-merger scenarios for analyzing the Transaction’s effect on market concentration, and OG&E may not count it as mitigation. If it was not, then OG&E may count the proposed upgrade as mitigation. Accordingly, we direct Applicants to demonstrate whether or not the proposed upgrade was foreseeable and reasonably certain.

33. In addition, we find that Applicants’ treatment of the expiring long-term contracts is not consistent with the Commission’s Merger Policy because the contracts will expire irrespective of the acquisition. Assigning control of the contracts to OG&E in the pre-transaction scenario, but not in the post-transaction scenario, improperly confuses the effect of changing market conditions with the effect of the Transaction in the analysis of market concentration. As a result, Applicants’ treatment of the contracts understates the change in market concentration resulting from the acquisition. We direct Applicants to present a revised horizontal competitive analysis that does not assign control of the long-term contracts to OG&E in pre-transaction scenario (that is, assign control to the sellers of the expiring contracts) during the hearing. This may result in a need for different mitigation.

34. Section 203 of the FPA requires that dispositions of jurisdictional facilities be consistent with the public interest. As we stated in AEP, mitigation for an identified market power problem must be in place at the time of consummation of the Transaction.¹² While Applicants’ proposal to enhance the geographic scope of the market by transmission expansion appears to be an appropriate structural remedy to the horizontal market power problem, this mitigation may take up to a year and a half to complete. Therefore, interim mitigation is necessary to ensure a competitive outcome for that time period.¹³

Vertical Market Power

35. We also are concerned about the vertical implications of the Transaction. The vertical market power issue is whether the Transaction would create or enhance the

¹¹ The DOJ/FTC Guidelines §1.521.

¹² See AEP at 61,789; see also Merger Policy Statement at p.30,121..

¹³ See Ameren Services Company on behalf of Ameren’s Public Utility Company Subsidiaries, 101 FERC ¶ 61,202 (2002) (imposing interim mitigation because the proposed transmission upgrades would not be in place for approximately 18 months after the transaction).

ability and incentive for OG&E to use its transmission system to raise electricity prices or to frustrate entry in relevant wholesale electricity markets. Both the ability and incentive to raise prices by restricting access are necessary for a vertical market power problem to exist. In this case, we find that OG&E has the ability, and the acquisition of 400 MW of generation will increase OG&E's incentive, to use its transmission system to frustrate competition in wholesale markets by denying rival suppliers access to the market. As we stated in AEP, "[a successful foreclosure strategy] requires that the merged company be able to frustrate competitors' access to an input necessary for selling in downstream electricity markets, thereby narrowing the scope of relevant markets and increasing the concern that, in highly concentrated markets, prices will rise after the merger."¹⁴

Applicants' analysis shows highly concentrated relevant markets. While OG&E and SPP argue that their Open Access Transmission Tariff (OATT) ensures that all generators will have non-discriminatory transmission access, we are not convinced that the OATT will fully mitigate the increase in OG&E's vertical market power. As we stated in Order No. 2000:

With respect to continuing opportunity for undue discrimination, the NOPR observed that, when utilities control monopoly transmission facilities and also have power marketing interests, they have poor incentive to provide equal quality transmission service to their power marketing competitors.¹⁵

In this case, the acquisition of 400 MW of generation increases OG&E's incentive to use its transmission facilities to harm competition. Therefore, consistent with Order No. 642 and AEP, mitigation is needed to ensure that the Transaction does not harm competition.

Mitigation

36. Our objective is to impose mitigation, both interim and permanent, as a condition of any approval of the Transaction that eliminates the harm to competition resulting from the Transaction without being unduly burdensome on OG&E or in any way harming the reliability of the OG&E system. Interveners have proposed a number of specific mitigations.¹⁶ Interveners' proposals, as well as alternatives from Applicants and

¹⁴ AEP at 61,787.

¹⁵ Order No. 2000, 65 Fed. Reg. 809 (Jan. 6, 2000); FERC Stats. & Regs. Regulations Preambles July 1996-December 2000 ¶ 31,089 at 31,004 (Dec. 20, 1999).

¹⁶ These proposals include that: (1) OG&E should be required to establish a program to include merchant generators in its economic dispatch process; (2) OG&E should be required to engage an independent entity to calculate its Available Transmission Capacity (ATC) and do its transmission planning studies until SPP is a truly independent ISO; (3) OG&E should be required to post redispatch alternative and

Commission Staff, need to be more fully considered. Therefore, we will set the issue of appropriate mitigation for hearing.

37. Based on all of the above considerations, the Commission finds it necessary to set this matter for hearing to address the mitigation measures that should be put in place to alleviate the market power effects of this acquisition. The Transaction, without the appropriate mitigation measures, will harm competition in the OG&E market. The harm comes from increases in OG&E's horizontal and vertical market power. There is insufficient evidence in the record for the Commission to determine what mitigation measures should be implemented if, and when, we authorize this disposition.

D. Effect on Rates

Applicants' Analysis

38. Applicants state that OG&E serves ten wholesale requirements customers, with six customers served under market-based rates, three served under cost-based rates, and one under a mix of the two. They state that OG&E expects savings to its customers will be derived from: (1) the avoidance of power purchase contracts otherwise needed; (2) the replacement of an above-market cogeneration contract when it can be terminated at the end of August 2004; and (3) fuel saving associated with the operating efficiencies of the McClain Facility. They state that all of these customers are protected from adverse effects of the Transaction on rates because their contracts contain fixed demand charges. Moreover, Applicants argue that the fuel cost adjustment clauses in the tariffs and rate schedules will enable customers to benefit from the McClain Facility's efficient operations which will lower OG&E's average fuel costs.

Comments and Protests

39. PowerSmith challenges OG&E's assertion that the PowerSmith contract is an "above market" rate. PowerSmith states that the rate was negotiated in 1987 based on OG&E's estimate of its future avoided costs, as required by PURPA. PowerSmith states that the contract will be renegotiated at current avoided costs and that it has offered to sell power at a reduced rate for the capacity offered because the debt on the plant will be retired as of September 2004.

40. InterGen argues that OG&E failed to procure power for its customers in a transparent, competitive way. InterGen argues further that OG&E made no showing as to

costs for bottlenecks that impede transmission out of its control area; and (4) OG&E should be required to engage an independent market monitor, subject to this Commission's and OCC's oversight.

the level of ratepayer savings from the Transaction relative to the alternative (non-acquisition) power purchase or tolling arrangements to secure needed capacity and energy.

Applicants' Response

41. Applicants argue that InterGen's assertion that OG&E did not hold a competitive procurement process is irrelevant to the section 203 proceeding because OG&E is not seeking to raise any wholesale customer's rates. Applicants assert that InterGen's real concern is the fact that OG&E decided to purchase the McClain Facility rather than purchasing capacity and energy from InterGen. Applicants also argue that InterGen's concerns about the prudence of the Transaction are not relevant to a section 203 proceeding before the Commission.

Commission Determination

42. We find that the Transaction, if properly conditioned, will not harm wholesale electricity rates. We note that none of OG&E's wholesale customers protested the Transaction. We accept Applicants' assertion that OG&E's wholesale customers are protected because their contracts contain fixed demand charges, and that the fuel cost adjustment clauses in the tariffs and rate schedules will enable customers to benefit from any efficiencies in the McClain Facility's operations, which may lower OG&E's average fuel costs.

43. While InterGen expresses concern with the prudence of the purchase, Applicants have shown that the purchase will not adversely affect wholesale rates. As to retail rates, we note that the OCC will review the prudence of the purchase. We note, further, that InterGen's concern regarding the competitive procurement process would be addressed by the proposed economic dispatch plan mitigation requirement.

E. Effect on Regulation

44. Applicants state that the Transaction will not affect federal or state regulation. They note that OG&E is subject to state regulation in Oklahoma and Arkansas. They state that the Transaction will not create a registered public utility holding company. They further state that OG&E will remain subject to regulation by the Commission and the relevant state commissions.

45. Applicants have shown that the Transaction will not affect state or federal regulation. The Transaction does not impair the OCC's ability to regulate OG&E. We note that OCC requested that the Commission grant an out-of-time filing of intervention and comments. We will grant that request. We note that we did not rely on Applicants'

claim that the lack of timely intervention by the OCC showed a lack of concern by the OCC.

F. Applicants' Request for Expedited Action

46. OG&E alleges that if it is unable to acquire the McClain Facility by December 31, 2003, under the terms of the OCC Settlement Order, it will be compelled to credit \$25 million annually (at a rate of 1/12 of the \$25 million per month for each month that the Facility is not in place) to its retail customers beginning January 1, 2004.¹⁷ OG&E contends that this "penalty," combined with the financial consequences of failing to close on the McClain Facility will affect OG&E's capital expenditures, including the ability to fund reliability upgrades to OG&E's transmission system.¹⁸ OG&E, therefore, requests expedited action on this Section 203 application.

47. OMPA also asserts that Commission delay in issuing an order in this case will threaten the power supply for its customers.¹⁹ It says that such a Commission delay might require OMPA to renegotiate a number of contracts with OG&E and others, and undermine OMPA's ability to supply power to its member municipalities at a reasonable cost.²⁰

48. In response, InterGen urges that, in light of the competitive issues surrounding the acquisition that deserve a thorough Commission review, the Commission not to rush to judgment on the proposed acquisition.²¹ InterGen points out that OG&E may enter into a short-term power purchase agreement in the interim until the Commission's decision on the merits of the acquisition.²² In order to facilitate this proposal, InterGen states that it submitted a short-term power sales offer to OG&E commencing January 1, 2004, and renewable until the Commission acts on the acquisition in this proceeding.²³ According

¹⁷ See Applicants' Joint Application at 4-5; see also OG&E's letter to Chairman Pat Wood, III, dated November 20, 2003.

¹⁸ Id.

¹⁹ See OMPA Motion to Intervene at 3; see also OMPA's letter to Chairman Pat Wood, III, dated November 19, 2003.

²⁰ OMPA's November 19, 2003 letter at 1-2.

²¹ InterGen's Letter to Chairman Pat Wood, III, dated November 24, 2003.

²² Id. at 1.

²³ Id. at 2 and Short-term Power Sales Term Sheet addressed to OG&E dated November 24, 2003, attached thereto.

to InterGen, acceptance of InterGen's offer, or a similar offer with another power supplier, by OG&E would mitigate any financial consequences of regulatory delay, remove any problem with OG&E financing reliability upgrades on its transmission system, and provide the Commission the time to consider the issues raised in this proceeding.²⁴

49. PowerSmith also challenges OG&E's assertions regarding the consequences of the Commission's failure to act expeditiously on the acquisition, and suggests as an alternative that OG&E renew an existing contract with PowerSmith for 110 MW of capacity.²⁵ PowerSmith also points to a "major and fast-moving" proceeding pending before the OCC that it alleges will affect the Commission's evaluation of the proposed acquisition.²⁶ PowerSmith, therefore, urges the Commission not to take precipitous action, but to await the outcome of the pending OCC proceeding.²⁷

50. Finally, OCC, while not taking a position on the merits of the Applicants' filings or the Intervenor's protests, raises state regulatory authority concerns with respect to this proceeding.²⁸ OCC points out that OG&E's agreement to purchase 400 MW of electric generating facilities is conditioned on a prudency review by OCC that will include a review of the appropriateness of OG&E's purchase as compared to other alternatives that may have been available, and a state regulatory rate review within twelve months of the date of acquisition and initial operations of the new generation.²⁹

51. As discussed above, we find there are issues regarding the mitigation measures that require the development of a more complete evidentiary record before the Commission can make a determination as to whether to authorize the disposition of the McClain Facility in this proceeding and on what conditions. We must set this application for hearing in order to address these issues and to develop a more complete record on which to make a decision on the Transaction. We request that, if OG&E is unable to

²⁴ Id. at 2.

²⁵ PowerSmith's Letter to Chairman Pat Wood, III, dated November 24, 2003.

²⁶ Id. The OCC proceeding will address the appropriate avoided cost rate for the capacity that PowerSmith is offering to, and allegedly has the legal right to, provide OG&E over the next five years.

²⁷ Id. at 2.

²⁸ OCC's Motion to Intervene Out-of-Time, at 4-6.

²⁹ Id.; see also Joint Stipulation and Settlement Agreement attached thereto.

secure interim supply while we develop the record, OCC consider the effect of this Commission order when deciding whether to penalize OG&E.

The Commission orders:

(A) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by Section 402(a) of the Department of Energy Organization Act and the Federal Power Act, particularly Section 203 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R. Chapter I), a public hearing shall be held to address the appropriate mitigation for Applicants' proposed disposition of facilities.

(B) A Presiding Administrative Law Judge, to be designated by the Chief Administrative Law Judge, shall convene a prehearing conference in the proceeding, to be held within approximately 15 days of the designation of the presiding judge in a hearing room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates and to rule on all motions (except motions to dismiss), as provided in the Commission's Rules of Practice and Procedure.

By the Commission. Commissioner Brownell concurring with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Oklahoma Gas and Electric Company

Docket No. EC03-131-000

(Issued December 18, 2003)

BROWNELL, Commissioner, concurring:

1. I do not question that Oklahoma Gas and Electric Company's (OG&E) acquisition of NRG McClain creates both horizontal and vertical market power problems. The interveners propose a number of specific mitigation measures. We set the issue of what mitigation measures, both interim and permanent, should be imposed to eliminate the harm to competition without unduly burdening OG&E or in any way harming the reliability of the OG&E system. Our stated objective for the hearing is to more fully consider the interveners' mitigation proposals, as well as alternatives from OG&E and NRG McClain and Commission Staff. I concur. However, I do have some thoughts about this process.

2. With regard to the horizontal market problem, I believe structural measures are the best way of eliminating market power and ensuring competitive market outcomes. OG&E is proposing just such a solution: an increase in transmission import capacity from the Entergy control area by 105 MW in the summer and 305 MW in the winter. Once transmission import capacity is increased, the horizontal market problem will be eliminated. It is estimated, however, that the transmission enhancement will take 18 months to complete. Therefore, the task here is to design a proportionate interim mitigation measure. In a similar situation, we imposed an interim mitigation measure that required the buyer to offer excess capacity to market until the transmission upgrades were completed. See, Ameren Services Company on Behalf of Ameren's Public Utility Company Subsidiaries, 100 FERC ¶ 61,202 (2002). The parties and Commission Staff should develop a record on whether this condition would effectively mitigate horizontal market power in this case.

3. Addressing the vertical market power problem is a more difficult and complex question. OG&E proposes to acquire NRG McClain to serve its native load in order to meet its obligation under a settlement agreement with the Oklahoma Corporation Commission. OG&E has approximately 5,700 MW of generation and 5,600 MW of peak native load. Given these facts, I struggle with what would be an appropriate vertical mitigation measure in this case. Further, mitigation of vertical market power raises industry-wide issues. One generic issue is how any mitigation measures we may impose

to eliminate vertical market power are compatible with regional decision-making on resource adequacy. Another generic issue is the range of mitigation tools we should consider. The optimal solution to vertical market power is membership in an RTO. Lacking that, what is the appropriate mitigation? Should any vertically integrated utility that seeks to acquire any additional generation be subject to the same mitigation, or should the mitigation vary based on the circumstances? Are there mitigation measures other than those proposed by interveners that we should consider, for example, would a requirement for regional planning be appropriate? I think we would benefit from an industry-wide debate to define the problem, gather the viewpoints from all segments of the industry, and explore whether a generic approach is appropriate.

4. For these reasons, I concur with today's order.

Nora Mead Brownell
Commissioner