UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Exelon Corporation	**)**	
	)	**Docket No. EC05-43-000**
Public Service Enterprise Group, Inc.	**)**	

Affidavit of Richard W. LeLash
on behalf of the
New Jersey Division of Ratepayer Advocate

Introduction and Summary

1. In the Joint Application made by Exelon and PSEG ("Application"), the Applicants discuss extensively electric market power and their proposed mitigation commitment plan; however, they pay little attention to the issue of combined gas capacity resources. The Application declares that "The combined company also will have a large gas distribution portfolio to complement its electric distribution business" (*Id.* at 14), but provides no direct analysis or discussion concerning the merger's impact on the Mid-Atlantic gas market. The Applicants focus on gas issues only insofar as these issues affect electric generation, stating, "The concern is that when the ownership of natural gas assets serving electric generation facilities is combined with the ownership of electric generation facilities, the potential is created for the resultant merged company to use control over the natural gas facilities to disadvantage the competing owners of the electric generation facilities." *(Id.* at 46.) The Application does not address potential horizontal market power issues that may result from the merger of PECO's and PSEG's gas capacity assets, the potential for aggregating additional power by providing asset management services for third parties, and the effect of such activities on various markets.

2. The Ratepayer Advocate has promulgated discovery questions of Applicants' witnesses William Hieronymus and Roger Frame relating to gas capacity and market issues under the jurisdiction of the FERC. The Applicants have refused to answer those discovery questions. Consequently, the Ratepayer Advocate and I, as the Advocate's gas witness in this matter, have been unable to obtain supporting data concerning the issues that have been raised in this affidavit. It is hoped that the Commission will grant the Ratepayer Advocate's request for discovery. It is only in that way that concerns and questions

regarding the Applicants' combined gas portfolios and potential concern about control of the gas market can be properly evaluated.

3. The merged company would control 35.6 % of gas transportation capacity serving the PJM East area (*Id.*, Heironymus Testimony, Exhibit J-16). In the Application, the Applicants do not fully discuss related market power in the gas supply market, merely concluding, "In short, none of the vertical concerns that the Commission focused upon in prior vertical mergers exists in this merger and the Transaction does not create or enhance vertical market power [in the gas market]." (*Id.* at 47).

4. The availability of interstate gas pipeline transportation and storage capacity is limited, particularly during peak winter periods in the Mid-Atlantic markets where pipeline operational flow orders and excessive day-ahead gas prices have become on-going concerns. With Applicants holding 35.6% of available capacity in the PJM East market area, any additional control of gas capacity resources (for example, through asset management agreements) would place the Applicants in a position where they could exert market power through various actions.

5. A full evaluation should not solely address market power issues in the upstream market as they relate to potential adverse effects in the downstream electric market. There well may be horizontal market power concerns for the gas supply market separate and apart from the vertical market power issues addressed in the Application.

6. Given the time frame for the current proceeding, the Application's emphasis on electric vs. gas market power, and the increased capacity constraints in the Mid-Atlantic gas market, it is recommended that the FERC require hearings on the Application in order to determine whether Exelon and PSEG will have undue market power within the gas market (in addition to the electric market), and whether constraints should be placed on the combined company to ensure that its market share of gas capacity does not become materially greater and that it does not use its gas capacity to negatively affect the Mid-Atlantic gas market.

Qualifications

7. My name is Richard W. LeLash and my address is 18 Seventy Acre Road, Redding, Connecticut 06896. In this matter, I am submitting this affidavit on behalf of the New Jersey Division of Ratepayer Advocate.

8. I graduated from the Wharton School of the University of Pennsylvania in 1967 with a BS Degree in Economics and from the Wharton Graduate School in 1969 with a Masters

of Business Administration Degree. I have worked in finance for Touche Ross & Co. and PepsiCo, Inc. For the past twenty-five years I have worked on matters concerning utility regulation, first with the Georgetown Consulting Group and more recently as an independent consultant.

9. During the course of my regulatory work, I have testified in approximately 270 regulatory proceedings before about 25 state and federal jurisdictions including the Federal Energy Regulatory Commission. In these proceedings my testimony was presented on behalf of state public utility commissions, attorneys general and consumer advocates.

10. Since 1980 most of my regulatory work has involved natural gas policy issues. Among other issues, my testimonies have involved gas service unbundling, physical and economic bypass, gas supply incentives, demand and capacity planning, gas contract reformation, and mergers. In addressing these issues, I have analyzed gas regulatory filings involving about 30 different local distribution companies.

The Gas Supply Market

11. Over the past few years, the wholesale natural gas market has exhibited extreme volatility with price levels reaching record highs. This pricing and volatility are related to dwindling gas supplies and steady increases in demand. As a result, there have been increases in operational flow orders on the interstate pipelines and instances of day-ahead prices reaching levels in excess of $20 per Dth. These factors have led the federal government to recognize that without the influx of foreign natural gas supplies, the economy may face serious economic consequences.

12. The mismatch between natural gas supply and demand is particularly evident in the Mid-Atlantic region where there is a question as to whether the interstate pipelines have the capacity to meet demand were there to be two or three days of design or near-design winter weather. In addition, with crude oil prices in excess of $50 per barrel, there is little prospect of natural gas demand diminution from end users with dual fuel capabilities. Despite the supply shortfalls, the Mid-Atlantic region has seen few pipeline expansion programs, and those that have become available are expensive sources of deliverability. It is therefore not surprising that the east coast has seen upgrades to its existing LNG terminal facilities with several incremental terminal projects in various stages of development.

Market Power Considerations

13. Within the Exelon/PSEG application there is only a cursory analysis of gas that addresses market power. Dr. Hieronymus has provided only summary data on pipelines flowing into

the PJM East territory and the various shares of such capacity controlled by various entities. (Application, Exhibit J-16). He provides no data on market control for individual pipelines, nor does he provide information concerning the control of storage capacity held by the entities holding the interstate transportation entitlements. Furthermore, he fails to discuss what entities are involved in asset management agreements covering pipeline capacity and what entities are market facilitators for geographic exchange transactions. Without such gas-related data, the Application is deficient. The Applicants have not provided a complete picture of all factors relevant to market power in the Mid-Atlantic gas market. This lack of factual data relating to gas market power issues prevents other parties in this matter from evaluating the Applicants' claims.

14. Different gas users have different needs, and their reliance upon pipeline transportation may differ. Depending upon the supply resources utilized, individual LDCs and their ratepayers, large commercial and industrial end users, and gas-fired electric generators may face very different market power concerns. A gas user that has only one pipeline supplier or that places high reliance on bundled peaking service is far more subject to market power issues.

15. The PSEG gas supply portfolio historically has been a significant force in the Mid-Atlantic gas market. It holds significant pipeline contracts and effectively serves as the hub for the region because of its diverse array of pipeline interconnections. As a result, many Mid-Atlantic gas users utilize, if not rely upon, PSEG's ability to facilitate the movement of gas supplies from diverse supply points. With the addition of the Exelon gas capacity, PSEG's influence in the Mid-Atlantic gas market only grows. PSEG has historically not taken advantage of its position as a pipeline hub; however, Exelon management may have a different market strategy that will negatively affect the flow of gas through the hub.

16. Yet another area of concern involves the growing trend for LDCs to utilize asset managers to operate some or all of their pipeline capacity. With the Applicants controlling 35.6% of the capacity in the PJM East area and their expertise in managing gas portfolios, it is not hard to envision the Applicants performing asset management for other entities and thereby effectively controlling an even greater percentage of the market capacity. Although gaining control of capacity by providing asset management of incremental capacity is not subject to direct Commission review or approval, it does impact upon the Commission's review of the combined companies' control of the interstate Mid-Atlantic gas market.

17. In its Long Island Lighting Company ("LILCO") Order (Docket No. EC97-19-000) the Commission noted that the existence of marketers (or third party suppliers) within the market area does not necessarily alleviate a concern that a proposed transaction may

increase the merging parties' ability to take actions that would "adversely affect the competitiveness of the upstream delivered gas market." (80 FERC par. 61035, 1997 WL 564503 at 12). Indeed, marketers have had a very limited impact on the Mid-Atlantic market despite open access in several states, and they often rely directly or indirectly on the embedded LDC's interstate gas capacity.

18. Dr. Hieronymus states, at page 71 of his testimony, that "Applicants cannot withhold [their capacity] rights to reduce supply since failure to use rights simply increases the amount of release capacity available to competitors." This statement is misleading since a capacity holder is free to nominate any level of its entitlement and is not obligated to release capacity into the market. Moreover, if the capacity holder over- nominates, even if the pipeline has the ability to provide incremental transportation capacity, it would do so only on an interruptible basis. This becomes a concern since unutilized capacity could increase cost to gas customers and potentially distort the PJM price to electric customers.

Conclusions

19. The Commission's Merger Policy Statement generally considers three factors in analyzing proposed mergers: the effect on competition, the effect on rates, and the effect on regulation. To the degree the relevant market involves multiple states, competitive issues cannot adequately be evaluated by any single state regulatory commission. Consequently, it appears that all multi-state aspects of market power for both the gas and electric markets are at issue before this Commission.

20. Parties to this proceeding have been constrained in their evaluations of the proposed merger since the Application presents only that data that the Applicants believe support the proposed merger. Other parties have not had the benefit of discovery for what can only be characterized as complex economic and operational issues. Additionally, much of the relevant data on market power parameters is not readily available to the parties for review and analysis. For example, while data on the gas capacity held by PECO and Public Service Electric & Gas is generally available, information on additional gas capacity held by Public Service Energy Resources and Trade (an unregulated entity) is not.

21. The gas market is currently experiencing major changes in its scope and structure. Factors that constitute market power in the gas industry have changed and are, in many respects, still evolving. The Commission's decision concerning gas market power and public interest merger issues will be only be made once; however, the consequences and

impact of that decision on gas consumers will only become evident over time and subject to the changing gas market.

22. Based on these considerations, and the other factors discussed above, it is recommended that the Commission require hearings and discovery on the Application, thereby affording the parties and the Commission adequate time and opportunity to fully evaluate the proposed merger. Based on information provided by the Applicants, they do not envision final approval of the merger before the second quarter of 2006. Consequently, hearings before this Commission would not adversely affect the interests of the Applicants. Such hearings would also provide a forum within which to explore possible constraints on the combined companies in order to ensure that the Applicants' assurances about their lack of market power are and remain a reality.

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Richard W. LeLash, who being duly sworn, deposes and says that the foregoing affidavit was prepared by him or under his supervision on behalf of the New Jersey Division of Ratepayer Advocate in the captioned proceeding and that the facts stated therein are true and correct to the best of his knowledge, information and belief.

Dated at Ridgefield, Connecticut, this 6th day of April, 2005.

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Richard W. LeLash

Sworn to and subscribed before me this 6th day of April, 2005

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My Commission Expires: