BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of Union Electric Company for an Order Authorizing (1) Certain Merger Transactions Involving Union Electric Company; (2) the Transfer of Certain Assets, Real Estate, Leased Property, Easements and Contractual Agreements to Central Illinois Public Service Company; and (3) in Connection Therewith, Certain Other Related Transactions.	))))))))	Case No. EM-96-149

CONCURRING OPINION

Zobrist, Chairman:

This case stands as an example of the difficult issues facing state commissions considering mergers and consolidations at a time when Congress and state legislatures debate the merits of restructuring the electric industry.

On the important issue of market power, I found it puzzling that the parties apparently avoided discussion of this topic in their efforts to arrive at the Stipulation and Agreement. If such discussions occurred, the record initially contained very little hint of it. While there exists no universally accepted method to analyze post-merger market power under the current system of monopoly franchises, all parties must engage in a comprehensive effort to develop the analytical tools to study this issue. While economies of scale through consolidation and merger may bring the benefits of lower prices, better service and more choices to customers, the market power of such new entities cannot be allowed to manipulate prices to generate excessive profits.

The study which the Commission ordered should use those tools which can best measure the ability of Ameren to achieve benefits for its customers. I encourage the Commission's Staff

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and the Office of the Public Counsel to work constructively with the company to produce an analysis which is meaningful and practical. The parties should consider the use of computer models, such as those which are a part of the record in the proposed merger of Northern States Power Company and Wisconsin Electric Power Company into Primergy Corporation. See In re Wisconsin Elec. Power Co., et al., Docket No. EC95-16-000 (F.E.R.C., Aug. 29, 1996)(presiding administrative law judge's initial decision). Although these kinds of tools may be works in progress, like the Hatfield Model and other proxy cost models being developed in the telecommunications arena, they should be explored and used if they offer hope of advancing the analysis.

I am not certain that the Federal Energy Regulatory Commission's adoption of the Department of Justice/Federal Trade Commission Merger Guidelines, which include the Herfindal-Hirschman Index (HHI), gives us the best tool to analyze market power in the electricity industry. See In re Commission's Merger Policy under the Federal Power Act: Policy Statement, Order No. 592, Docket No. RM96-6-000 (F.E.R.C., Dec. 18, 1996). It may be that the Guidelines are a first and necessary step in a long series of steps to better market analysis. I expect that more sophisticated tools will develop as the electricity industry changes.

Any future merger case brought before this Commission should contain a careful analysis of market power issues, in addition to the traditional means used to measure the alleged merger benefits for ratepayers. All parties, including Staff, should be careful in their selection of expert witnesses. Staff's position endorsing the Stipulation and Agreement in this case was weakened by its retention of an expert who opposed Staff's recommendations. While he offered certain helpful observations on market power, his argument for divestiture under the facts of this case was not at all persuasive.

Finally, I believe that the Commission wisely approved this merger upon the condition that Union Electric Company and its holding company Ameren join an independent system operator (ISO). The concept of an ISO which offers non-discriminatory access to the integrated transmission system over a broad region is the last, best hope for those who wish to avoid mitigating market power at the local level through the divestiture of generation assets. Many knowledgeable individuals have expressed the belief that an ISO cannot function as a truly independent operator because the transmission owners will refuse to grant the necessary authority to the ISO governors. While such skepticism may be justified, I believe that governing principles can be developed which grant sufficient powers to the "trustees" of the transmission system to make the ISO truly independent. See "Declaration of Independence" (signed by 18 state commissioners) (Oct. 22, 1996). This Declaration, which follows my opinion, expresses the belief that an ISO can function properly only if its independence is guaranteed. While the owners of the transmission system are entitled to retain a voice in the operation, maintenance and planning of the system, they must absolutely relinquish any ability to control or unduly influence the ISO. Otherwise, they have proven the case that divestiture is the only solution.

Karl Zobrist

Karl Zobrist, Chair

March 10 1997

A DECLARATION OF INDEPENDENCE

Why Transmission and System Operation Must Be Truly Independent from the Ownership of Generation

Efforts to restructure the electric power industry are based on the conviction that open competition in power supply will advance consumer interests better than traditional economic regulation. The objective of restructuring must be to create conditions that will allow genuine competition to thrive. The ultimate measure of success is whether competition delivers benefits to consumers, not just to those in the electricity business, either competitive electricity suppliers or providers of monopoly wire services.

To succeed, the restructuring process must address the inherent market power problems caused by ownership or control of the monopoly transmission system that connects competitive generators with their customers. The divergent interests of suppliers and customers are clear:

* In competitive electricity markets, all generators will benefit from high prices while customers benefit from low prices;

* In competitive markets, higher prices achieved through any action, including control of the transmission system, by any generator or group of generators, will benefit all generators;

* Decisions regarding transmission pricing, dispatch rules, and new investment in the transmission system can add value to generation. An unnecessarily constrained transmission system will lead to overpriced electricity and excess profits for suppliers;

* Many techniques for leveraging transmission and system operation to add value to generation assets are complex, subtle, and difficult to control through regulatory oversight.

This means that steps taken to deregulate supply could harm rather than advance consumer interests, if not paired with measures to sever suppliers' control over transmission services.

To ensure that the transmission system is operated and expanded to suit the needs of society at large rather than the narrower interest of generators, most nations implementing competition in generation have chosen to completely separate the ownership of power plants from ownership or control of transmission lines. Such separation provides a clear, workable and effective means of protection against the potential for many types of abuse.

However, many US utilities oppose divestiture of either generation or transmission assets. They offer instead to separate ownership from control, by placing control of the transmission system in an "Independent System Operator" or ISO. Unfortunately, most ISO proposals put forth to date have been seriously deficient in one or both of two key areas: (1) the scope of functions entrusted to the ISO is too limited, so it does not effectively control transmission pricing and system operation, and (2) the ISO is not truly independent.

Each ISO should have a mandate to manage and expand the portion of the nation's grid under its control so as to ensure reliability while minimizing costs. The management of the transmission system involves the exercise of hundreds of small and large decisions, many of them subjective judgment calls, involving such matters as the pricing of transmission service, construction of new lines, and operation and maintenance of the existing system. All of these decisions should be made by the ISO, subject to regulatory oversight. The transmission system should be operated and expanded so as to encourage rather than limit competitive challenges among suppliers.

Most ISO proposals fall short by giving suppliers substantial, or in some cases, majority control of the system. Independence is not achieved by simply sharing control of the transmission system among different types of suppliers. To achieve independence, ISOs should be responsible to boards that are completely independent of suppliers. In the absence of a clear structural solution such as divestiture, we must create solutions equivalent to a non-voting "transmission trust": generating companies must cede all control of their transmission lines to the ISO; they will be entitled to fair compensation on their investment, but afforded no opportunity to influence the use of those lines.

The ISO should, in turn, be subject to appropriate regulatory oversight. This regulatory framework should strive to harmonize the interests of the ISO with those of the public: reliability and stability, low generation and transmission prices, and minimum environmental impact. Such regulation must reflect both federal and state interests, ensuring the development of regional markets while recognizing states' interests in siting, and in shaping regulatory reform to suit local concerns.

Effective regulation of regional markets and transmission systems may require creation of new regional governance mechanisms, such as regional joint boards or councils under existing or new enabling legislation. However this is accomplished, FERC, the States, and Congress must insist upon creation of ISOs that have authority to operate and improve regional transmission systems, and that are truly independent from the owners of generation resources. Only when transmission constraints cannot be used to leverage above-market value from generation assets will the public's interests in genuine competition be well served.

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