

Committee Counsel: Robert Smith

House Bill 1713

Public Service Companies - Mergers, Acquisitions, and Financing

SPONSORS:

Delegates D. Davis and McHale

COMMITTEE RECOMMENDATION:

FAVORABLE WITH AMENDMENTS

As amended, House Bill 1713 establishes in statute specific criteria for evaluating the acquisition of an electric company or gas company by another person. The bill updates several existing provisions on PSC approval of acquisitions and stock and debt issuances by public service companies. The bill also establishes, for a limited time, an Office of Special Counsel to review the proposed merger between Constellation Energy Group and FPL Group and make recommendations to the General Assembly.

COMMITTEE AMENDMENTS:

Amendment No. 1

adds cosponsors and makes technical changes.

Amendment No. 2

makes clarifying changes to existing law concerning stock, debt issuance, and acquisitions.

Amendment No. 3

clarifies the criteria the PSC uses to review proposed acquisitions.

Amendment No. 4

- **establishes an Office of Special Counsel to investigate the proposed merger between FPL Group and Constellation Energy Group;**
- **provides for the appointment, staffing, funding, powers, and duties of the Special Counsel;**
- **establishes required information and review criteria for the merger;**
- **reserves to the General Assembly the right to approve or disapprove the merger by enacting a law until Sine Die 2007;**
- **requires coordination between the Special Counsel and PSC proceedings for discovery and other proceedings;**
- **requires the Special Counsel to submit a final report to the General Assembly, the Governor, and the Attorney General by January 10, 2007;**
- **authorizes the Special Counsel to study and make recommendations on continuing residential electric service; and**
- **sunsets the Office of Special Counsel on June 30, 2007.**

SUMMARY OF BILL:

As amended, House Bill 1713 is an emergency bill that sets out application and PSC review requirements related to electric or gas company acquisitions and mergers involving transfer of control of the company to any person, whether a public service company or any other company. The bill provides that certain stock and obligation activities of a public service company that *operates* in the State are subject to PSC approval, which currently only applies to a company *incorporated* in the State.

The bill also establishes an Office of Special Counsel to investigate the proposed merger between FPL Group, Inc., and Constellation Energy Group, Inc.

Uncodified language provides that PSC approval of a merger between Constellation Energy Group, Inc. and FPL Group, Inc. pending as of the date the bill is effective must include specified conditions, including that the transaction may not allow the transfer of facilities between FPL or Baltimore Gas and Electric and an associate company and that any savings resulting from the merger must be applied in part to the elimination of carrying charges and the delay of increases in residential electric rates in a rate stabilization or minimization plan approved by PSC in Case No. 9052.

Acquisition of an Electric or Gas Company

Without prior PSC approval, a person may not acquire, directly or indirectly, the power to exercise substantial influence over the policies and actions of either an electric or gas company, if the person would become an affiliate of the company as a result of the acquisition. This could encompass a nonpublic service company such as an unrelated company or a holding company. An application for acquisition to PSC must include specified information, such as applicant's identity and financial ability, background of key personnel, compliance with State and federal laws, and specified documents related to the merger or acquisition.

PSC must promptly examine and investigate each application and undertake proceedings necessary or convenient to review the application. PSC must consider the following items in its review:

- the potential impact on customer rates;
- the impact on continuing investment needs for the maintenance of utility services, plant, and related infrastructure;
- the proposed capital structure that will result, including allocation of earnings;
- potential effects on employment by the public service company;
- the allocation of any projected savings among stockholders and ratepayers;
- issues of reliability, quality of service, and quality of customer service;
- the potential impact on community investment;
- affiliate and cross-subsidization issues;
- jurisdictional and choice-of-law issues; and
- any other issues PSC considers relevant in relation to public convenience, necessity, and interest.

If PSC determines that the acquisition is consistent with the public convenience, necessity, and interest, it must issue an order granting the application. The order may be conditioned on the applicant's satisfactory performance or adherence to specific requirements. If PSC determines the application is not consistent with the public convenience, necessity, and interest, it must deny the application.

Office of Special Counsel

The primary amendment to the bill adds provisions establishing an Office of Special Counsel as an independent unit of State government. The Attorney General must appoint a special counsel to investigate the proposed merger between FPL Group, Inc. and Constellation Energy Group, Inc. by May 15, 2006, and the special counsel must begin work by June 1, 2006. The special counsel

may not be a State employee or public official, and must not be or become a candidate in the State for at least 3 years.

The special counsel may employ a professional, investigative, and clerical staff, and may also retain consultants and experts. To the extent practicable, the special counsel must use the services and personnel of the Office of the Attorney General (OAG), the PSC and its technical staff, the Office of People's Counsel, and other State and local agencies. These agencies must cooperate with the special counsel.

In consultation with the Legislative Policy Committee, the Governor may transfer funds for the special counsel's investigation from other agency funds as the Governor considers appropriate. The parties to the proposed merger must reimburse the State for the costs of the investigation.

To facilitate the review by the special counsel, the parties to the merger and their affiliates must provide certain information to the special counsel. The special counsel must review the merger taking into account specific criteria, including potential impacts of the merger on a variety of consumer, service, and community related issues, and the value of certain assets previously transferred from the electric company in the State to affiliates.

The special counsel must recommend approval or disapproval of the proposed merger to the General Assembly, based on whether the merger is consistent with the public interest, convenience, and necessity, and whether the merger will provide a net benefit to consumers. A recommendation for approval may include specific conditions.

The General Assembly reserves the right to approve or disapprove the merger, through the enactment of legislation, based on the recommendation of the special counsel. Unless the General Assembly fails to act by the end of the 2007 legislative session, the PSC may not act to approve or disapprove the merger before April 10, 2007.

The special counsel may require the PSC to conduct proceedings as needed to investigate the proposed merger and provide information to the special counsel and the General Assembly. The PSC may continue its own proceedings as well in coordination with the special counsel.

The PSC must provide all information regarding the information that the special counsel requests relating to the proceedings. The special counsel is bound by the Public Information Act for the information that the special counsel receives.

The special counsel may issue subpoenas to require the appearance of a person or the production of records or documents. Subpoenas may be enforced through the circuit court.

The special counsel may provide interim reports to the presiding officers, the Governor, and the Attorney General, and must provide a final report on the merger investigation or before January 10, 2007.

In addition to the merger investigation, the special counsel may study, evaluate, and make recommendations on the provision of electricity to residential customers through standard offer service before the special counsel's office terminates on June 30, 2007.

BACKGROUND:

Current Law:

PSC's authority to oversee mergers and purchases of public service companies operating in the State is a part of its general, supervisory, and regulatory powers under the Public Utilities Article and relates strictly to companies incorporated in the State. Certain provisions explicitly require public service companies to seek permission from PSC prior to undertaking specified activities. A public service company must receive authorization from PSC prior to assigning, leasing, or transferring a franchise or right under a franchise. Without prior approval, a public service company may not purchase, acquire, take, or hold any part of the capital stock or indebtedness of another public service company incorporated in Maryland.

Background:

On December 19, 2005, FPL Group, Inc. and Constellation Energy Group, Inc. announced the signing of a definitive agreement to create the nation's largest competitive energy supplier. Constellation Energy is the parent company of Baltimore Gas & Electric (BGE) which supplies electricity to more than \$1 million residential and business customers in the State and supplies gas to over 600,000 gas customers in 10 counties and Baltimore City. On January 23, 2006, BGE submitted a petition to PSC with respect to the proposed merger resulting in PSC opening Case No. 9054. Subsequently, Constellation Energy Group has challenged PSC's jurisdiction over the matter. The Federal Energy Regulatory Commission (FERC) is also conducting a separate proceeding to consider the matter.

FERC has power under the Federal Power Act to review mergers. It must approve a merger if it finds that the consolidation will be consistent with the public interest. The analysis under its merger policy statement of whether a

consolidation is consistent with the public interest generally involves consideration of three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.

It is anticipated that energy costs are going to increase substantially this summer, the same time that the BGE rate freeze is set to expire on July 1, 2006. Based on the recent bidding process for the market priced SOS, BGE rates will increase by an average of 72% beginning in July 2006. The average bill will increase by 39% for PEPCO residential customers and by 35% for Delmarva Power and Light residential customers. As a proactive measure, on January 10, 2006, PSC initiated a proceeding to investigate and take actions it may find appropriate to deal with the anticipated price increases (Case No. 9052). PSC staff developed a mitigation plan for BGE's generation price increase which was adopted on March 6, 2006. The mitigation plan contains the following features:

- BGE Rate Stabilization Plan (the plan) begins in July 2006 and ends May 2008 for most residential customers. This two-year rate mitigation plan allows customers the option of more gradually adjusting to market rates over an extended period of time.
- Low-income customers participating in the Electric Universal Service Program will receive an option of a three-year rate mitigation plan.
- As part of the plan the initial increases will be limited to 21% and customers will receive credits to the distribution portion of their bill from July 2006 to February 2007. For the remaining period of the plan customers will receive a charge to the distribution portion of their bill to recover the credited amount. At the conclusion of the program, a final true-up will occur for program participants.
- The plan will serve as the default option for residential customers. Customers who wish to pay the full price of electricity beginning July 1, 2006 will have that opportunity.
- BGE will pay the full market price of the electric generation even though customers will only be paying the mitigated amount. PSC has determined that the appropriate interest rate for recovering this short-term deferred balance is 5.0%.
- BGE is required to work with PSC and other interested parties to develop a consumer education plan and enrollment details which must be submitted to PSC by March 31, 2006.

Prior Introductions:

None.

Cross File:

None.

QUESTIONS AND ANSWERS:

Q Is the requirement for finding a “net benefit” before approving an acquisition a change to current practice?

- A. Not really. The current standard for reviewing an acquisition is that it be in the “public interest”, which is the same as being “consistent with the public convenience and necessity”. There are two competing interpretations of that standard – either it “provides a net benefit” (as in the bill), or it “does no harm”. The most recent proceeding in which the PSC stated that it had to decide what was in the “public interest”, using either one of these standards (the failed PEPCO-BGE merger), stated that the proposed merger met both standards, so the PSC didn’t have to choose one or the other. The bill as amended makes the choice for the PSC – “provides a net benefit to consumers”.

This is consistent with the decision of the Oregon Public Utility Commission, interpreting the law on which the new language in this bill is based.

Q. What about electric cooperatives – aren’t they different? Should they be subject to the same standard as the investor-owned utilities?

- A. Coops are different in that they are owned by customers, not stockholders. However, they do have distribution assets just as investor-owned utilities do. The PSC reviews mergers and acquisitions of electric coops in the same manner, and using the same standard, as mergers and acquisitions of investor-owned utilities – determining whether the action is in the public interest. The information required by this bill, and the criteria for the PSC to use, are the same that the PSC uses now.

March 23, 2006