

PENDING PETITION MEMO

Date: 11/21/2007

TO : OGC
OHADR
OEG&W

FROM: CENTRAL OPERATIONS

UTILITY: CALPINE CORPORATION

SUBJECT: 07-E-1385

Petition of Calpine Corporation and LS Power Development, LLC for a Declaratory Ruling Regarding Acquisition of Common Stock, or, in the Alternative, Approval Under Section 70 and 83 of the NYSPSL.

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Via Hand Delivery

ORIGINAL

HOWARD J. READ
RICHARD C. KING
Of Counsel

November 21, 2007

Hon. Jaclyn A. Brilling
Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, NY 12223-1350

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ALBANY

Re: Case 07-E-____ In the Matter of the Petition of Calpine Corporation and LS Power Development, LLC for Declaratory Ruling Regarding Acquisition of Common Stock, or, in the Alternative, Approval Under Sections 70 and 83 of the New York State Public Service Law.

Dear Secretary Brilling:

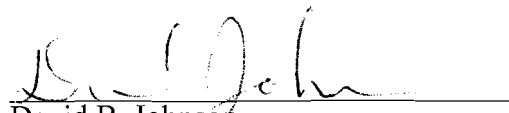
Enclosed please find an original and five copies of the *Verified Petition for Declaratory Ruling Regarding Acquisition of Common Stock* for filing in the above-referenced case. As explained in the Petition, the petitioners respectfully request the issuance of an order on an expedited basis by January 16, 2008 to facilitate Calpine Corporation's successful and efficient emergence from bankruptcy.

Please contact the undersigned with any questions concerning the Petition.

Respectfully submitted,

READ AND LANIADO, LLP
Attorneys for Calpine Corporation

By:


David B. Johnson

DBJ:tac
Enclosures

cc: Andrew Gansberg, Esq.

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of the Petition of Calpine Corporation and LS Power Development, LLC for Declaratory Ruling Regarding Acquisition of Common Stock, or, in the Alternative, Approval Under Sections 70 and 83 of the New York State Public Service Law

Case 07-E-_____

**VERIFIED PETITION FOR DECLARATORY RULING
REGARDING ACQUISITION OF COMMON STOCK**

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*Counsel for LS Power Development,
LLC.*

Dated: November 21, 2007
Albany, New York

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of the Petition of Calpine Corporation and LS Power Development, LLC for Declaratory Ruling Regarding Acquisition of Common Stock, or, in the Alternative, Approval Under Sections 70 and 83 of the New York State Public Service Law

Case 07-E-_____

**VERIFIED PETITION FOR DECLARATORY RULING
REGARDING ACQUISITION OF COMMON STOCK**

I. INTRODUCTION

Pursuant to Part 8 of the New York State Public Service Commission's ("Commission") Rules and Regulations, 16 NYCRR Part 8, Calpine Corporation ("Calpine") and LS Power Development, LLC ("LSP Development" or "Acquiror") (collectively, "Petitioners"), hereby petition the Commission for a declaratory ruling in connection with the implementation of a plan of reorganization (the "Plan") filed by Calpine and its affiliated debtors (the "Calpine Debtors") with the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court") pursuant to Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code").¹ Petitioners request that the Commission declare that it will not review, under Sections 70 and 83 of the New York State Public Service Law ("PSL"), the proposed acquisition, pursuant to the Plan, of common stock of a reorganized Calpine in amounts that would cause LSP Development to own approximately 15 percent of reorganized Calpine's common stock (the "Transaction"). Petitioners request that the Commission further declare that, to the extent the Plan provides for an initial distribution of less than 20 percent of Calpine stock ownership to LSP Development, it

¹ 11 U.S.C. §§ 101, *et seq.*

need not review the acquisition of additional Calpine stock up to 20 percent for LSP Development.

The Commission has held that there is a presumption that it will not review or regulate, under Sections 70 and 83 of the PSL, a transfer of upstream ownership interests in lightly regulated wholesale merchant generating facilities unless there is a potential for harm to the interests of captive utility ratepayers, including the exercise of market power, sufficient to override the presumption.² As discussed herein and in the affidavit of Ms. Julie R. Solomon (attached hereto as Exhibit 1), the Transaction does not raise the potential for the exercise of market power or pose any other detriment to captive New York ratepayers. The Transaction will have no adverse effect on competition. Accordingly, the presumption should prevail and the Commission should issue a declaratory ruling that it will not review or regulate the Transaction under Sections 70 and 83 of the PSL.

Petitioners respectfully request the issuance of an order on an expedited basis by **January 16, 2008** to ensure that Acquiror is able to receive its full distribution of common stock upon the Calpine Debtors' emergence from bankruptcy. In the alternative, if the Commission decides to review the Transaction pursuant to Section 70 of the PSL, Petitioners request a one-Commissioner order approving the Transaction on or before January 31, 2008. It is important that Acquiror be able to receive its full distribution of common stock in reorganized Calpine as

² See, Case 03-E-1136, *Re Sithe Energies, Inc.*, Declaratory Ruling on Review of Ownership Transactions (October 28, 2003); Case 02-E-1184, *Sithe Energies, Inc. and Apollo Energy, LLC.*, Declaratory Ruling on Review of Stock Transaction (November 26, 2002); Case 01-E-1680, *Reliant Resources et al.*, Declaratory Ruling on Review of Stock Transfer, (December 20, 2001); Case 00-E-2017, *GPU International, Inc. and MEP Investments, LLC*, Declaratory Ruling on Review of Stock Transfer (January 4, 2001); Case 00-E-1585, *Sithe Energies, Inc., Exelon (Fossil) Holdings, Inc. and PECO Energy Company*, Order on Review of Stock Transfer and Other Transactions (November 16, 2000); Case 91-E-0350, *Wallkill Generating Company, L.P.*, Petition on Regulation, Order Establishing Regulatory Regime (April 11, 1994).

soon as possible, but no later than January 31, 2008. A delay in the distribution of common stock will hamper Calpine's successful and efficient emergence from bankruptcy because, among other things, it will require Calpine to hold significant shares of common stock in reserve, thus impacting the liquidity of Calpine common stock and creating uncertainty in the marketplace with respect to these shares in reorganized Calpine.

II. BACKGROUND

A. Description of Petitioners

1. Calpine

Calpine is a Delaware corporation engaged through subsidiaries in the development, financing, acquisition, ownership, and operation of independent power production facilities and the wholesale marketing of electricity in the United States and abroad. Through various subsidiaries, Calpine owns, leases, and operates natural gas-fired, and renewable geothermal power plants in 18 states with an aggregate generating capacity in excess of 22,000 MW.

Calpine wholly owns, indirectly, three electric corporations that are subject to the lightened regulatory regime fashioned by the Commission for generators operating in a competitive environment: Bethpage Energy Center 3, LLC,³ the owner of a natural gas-fired generation facility with a summer rating of 82 MW and a winter rating of 84 MW in Oyster Bay, New York; CPN Bethpage 3rd Turbine, Inc.,⁴ the owner and operator of a natural gas-fired generation facility with a summer rating of 47 MW and a winter rating of 50 MW in Hicksville,

³ Case 04-E-0884, *Re Bethpage Energy Center 3, LLC*, Order Providing for Lightened Regulation and Approving Financing (September 23, 2004).

⁴ Case 01-E-1730, *CPN Bethpage 3rd Turbine*, Order Providing for Lightened Regulation (March 22, 2002).

New York; and TBG Cogen Partners,⁵ the owner and operator of a natural gas-fired generation facility with a summer rating of 55 MW and a winter rating of 59 MW in Bethpage, New York.

Calpine also indirectly owns two electric generating facilities that are qualifying facilities (“QFs”) under the Public Utility Regulatory Policies Act of 1978 and are exempt from the Commission’s jurisdiction under Sections 70 and 83 of the PSL: KIAC Partners, a QF that leases and operates a natural gas-fired generation facility with a summer rating of 127 MW and a winter rating of 128 MW in Jamaica, New York and sells electricity and steam to the State University of New York at Stony Brook under a long-term sales agreement and excess power to Long Island Power Authority; and Nissequogue Cogen Partners, a QF that owns and operates a natural gas-fired generation facility with a summer rating of 45 MW and a winter rating of 47 MW in Jamaica, New York and sells a portion its electricity and thermal energy to the New York Port Authority under a long-term contract, and additional output to Consolidated Edison Company of New York, Inc. (“Con Edison”), the New York Power Authority and other utility customers.

2. LSP Development

LSP Development is a Delaware limited liability company wholly owned by members of the Segal family and associated entities. The companies for which LSP Development is the general partner and their downstream affiliates are referred to herein as the “LS Power Group.” LSP Development is the principal operating company of the LS Power Group (*i.e.* the employer of most of the staff). LSP Development, in its capacity as general partner of LS Power Partners (“LS Partners”), through indirect subsidiaries, owns and operates independent power projects

⁵ Case 04-E-1710, *Re TBG Cogen Partners*, Order Providing for Lightened Regulation (March 17, 2005).

with approximately 3,259 MW of net generating capacity in various markets throughout the United States.

In 2007, LSP Development, through various wholly-owned subsidiaries, acquired approximately 40 percent of the voting power in Dynegy Inc. (“Dynegy”).⁶ Dynegy, a Delaware corporation, through various subsidiaries provides electricity to customers throughout the United States. Through its energy business, Dynegy owns or operates a diverse portfolio of energy assets, including electric generating facilities totaling approximately 19,642 MW of net generating capacity.

Dynegy wholly owns or leases, indirectly, three electric corporations, one of which is also a steam corporation, that are subject to the lightened regulatory regime fashioned by the Commission for generators operating in a competitive environment.⁷ Dynegy Danskammer, L.L.C. leases, operates and has the right to the output from a 498 MW coal-, gas- and oil-fired electric generating facility located in Newburgh, New York. Dynegy Roseton, L.L.C. leases, operates and has the right to the output from a 1,206 MW gas- and oil-fired electric generating facility located in Newburgh, New York. Sithe/Independence Power Partners, L.P. (“Sithe/Independence”) owns and operates a 982 MW electric generating facility located in Scriba, New York. Sithe/Independence also sells steam at retail to one large commercial customer located near the generating facility and is lightly regulated as a steam corporation. Other than Dynegy and certain limited indirect ownership interests, without management or

⁶ See Case 06-M-1305, *Dynegy, Inc. and LS Power Development LLC - Joint Petition for A Declaratory Ruling Regarding the Application of Public Service Law §§70 and 83, Declaratory Ruling on Review of a Merger Transaction* (Issued December 20, 2006).

⁷ See Case 00-E-1643, *Dynegy Power Corporation - Regulation*, Order Providing for Lightened Regulation (December 20, 2000); see Case 02-M-1443, *Sithe/Independence Power Partners, L.P.*, Order Providing for Lightened and Incidental Regulation and Granting a Certificate of Public Convenience and Necessity (January 23, 2003).

operational control, LSP Development does not have any other ownership interests in generation in New York.

B. The Calpine Bankruptcy

Commencing on December 20, 2005, the Calpine Debtors initiated proceedings under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court.⁸ As of December 20, 2005, Calpine's corporate structure consisted of 416 legal entities, of which 273 (including Calpine itself) filed Chapter 11 petitions.

The most recently-amended version of the Plan was filed with the Bankruptcy Court on September 27, 2007. The Plan is a "waterfall" plan of reorganization in bankruptcy under which value is to be allocated to creditors and shareholders in accordance with the priorities established by the Bankruptcy Code. Under the Plan, allowed administrative claims, priority tax claims, debtor-in-possession facility claims, first and second lien debt claims, allowed secured claims, other priority claims, and allowed unsecured convenience class claims (claims of \$50,000 or less) would generally be paid in full in cash or cash equivalents. Allowed unsecured claims would receive a *pro rata* distribution of reorganized Calpine common stock until paid in full. Any remaining value after such allowed creditors' claims have been paid in full would be distributed *pro rata* to existing holders of allowed interests (primarily holders of existing Calpine common stock) and holders of subordinated equity securities claims in the form of reorganized Calpine common stock. Among other things, the Plan also contemplates a series of so-called "roll-up" transactions through which a number of entities in the Calpine corporate structure will be eliminated on or after the Calpine Debtors' emergence from bankruptcy as part of an entity simplification process.

⁸ The voluntary petitions and other materials relating to the Chapter 11 proceedings of Calpine and certain of its affiliates are available at: <http://www.kccllc.net/calpine>.

A hearing on confirmation of the Plan is currently scheduled to be held before the Bankruptcy Court commencing on December 17, 2007. If the Plan is confirmed by the Bankruptcy Court, claims against Calpine will be resolved in accordance with the Plan, and Calpine will emerge from bankruptcy.

Calpine undertook an analysis of the current ownership of unsecured claims against the Calpine Debtors' bankruptcy estates in an effort to identify entities affiliated with electric or gas corporations in New York that could potentially take any of the common stock of a reorganized Calpine and other entities unaffiliated with electric or gas corporations that could potentially take ten percent or more of the stock resulting from the Plan. These efforts identified LSP Development.⁹

III. THE COMMISSION SHOULD DECLARE THAT IT NEED NOT REVIEW THE TRANSFER UNDER SECTIONS 70 AND 83 OF THE PSL

Section 70 of the PSL prohibits an electric or gas corporation from directly or indirectly acquiring the stock of any other corporation incorporated for, or engaged in, the same or a similar business in New York unless authorized to do so by the Commission.¹⁰ Section 70 of the PSL also prohibits any stock corporation of any description, domestic or foreign, other than a gas corporation or electric corporation, from acquiring more than ten percent of the voting capital stock issued by any gas corporation or electric corporation unless authorized to do so by the Commission. Similarly, Section 83 of the PSL prohibits a steam corporation from directly or

⁹ Calpine also identified Harbinger Capital Partners Master Funds I, Ltd., Harbinger Capital Partners Special Situations Fund, L.P., SPO Partners II, L.P. and San Francisco Partners II, L.P. (collectively, "Other Acquirors") as entities unaffiliated with electric or gas corporations that could potentially take ten percent or more of the stock resulting from the Plan. On November 16, 2007, in Case No. 07-E-1371, Calpine and these Other Acquirors filed a petition for declaratory ruling that no Commission review of the stock acquisition is required under Section 70 of the PSL.

¹⁰ New York Public Service Law § 70 (McKinney's 2000).

indirectly acquiring the stock of any other corporation incorporated for, or engaged in, the same or a similar business in New York unless authorized to do so by the Commission.¹¹

While none of the Petitioners are electric, gas or steam corporations, the Commission has determined that Sections 70 and 83 apply to transactions occurring at a holding company (*i.e.*, upstream) level. In *Wallkill Generating Company*, however, the Commission determined that it generally need not apply Section 70 oversight to the upstream transfer of ownership interests in lightly regulated wholesale electric generation facilities if there is little potential for harm to captive ratepayers:

[I]t will be presumed that Section 70 regulation does not adhere to transfer of ownership interests in entities upstream from the parents of the New York competitive electric generation subsidiary, unless there is a potential for harm to the interests of captive utility ratepayers sufficient to override the presumption.¹²

The Commission has applied the *Wallkill* presumption to a number of transactions involving the upstream transfer of interests in wholesale generation facilities.¹³ In these orders, the Commission interpreted the *Wallkill* presumption to mean that no Section 70 regulation would adhere to any upstream transfer of ownership interests unless a potential for the exercise of market power sufficient to override the presumption would arise as a result of the transfer.

¹¹ New York Public Service Law § 83 (McKinney's 2000).

¹² Case 91-E-0350, *Wallkill Generating Company, L.P.*, Petition on Regulation, Order Establishing Regulatory Regime (April 11, 1994) ("*Wallkill*").

¹³ See, e.g., Case 04-E-1364, *Sithe Energies, Inc., et al.*, Declaratory Ruling on Review of Stock Transfers (January 14, 2005); Case 03-E-1136, *Re Sithe Energies, Inc.*, Declaratory Ruling on Review of Ownership Transactions (October 28, 2003); Case 02-E-1184, *Sithe Energies, Inc. and Apollo Energy, LLC.*, Declaratory Ruling on Review of Stock Transaction (November 26, 2002); Case 01-E-1680, *Reliant Resources et al.*, Declaratory Ruling on Review of Stock Transfer (December 20, 2001); Case 00-E-1585, *Sithe Energies, Inc., Exelon (Fossil) Holdings, Inc. and PECO Energy Company*, Order on Review of Stock Transfer and Other Transactions (November 16, 2000); Case 91-E-0350, *Wallkill Generating Company, L.P.*, Petition on Regulation, Order Establishing Regulatory Regime (April 11, 1994).

The Commission ruled that the *Wallkill* presumption under Section 70 is equally applicable to upstream transfers of ownership in lightly-regulated steam plant under Section 83 of the PSL.¹⁴

The Transaction will not cause the potential for market power to be exercised. As discussed in the attached affidavit of Julie R. Solomon of CRA International, although LSP Development indirectly owns generation assets in New York as a result of its ownership of Dynegy, LSP Development's acquisition of Calpine stock will not materially increase electric market concentrations in the NYISO control area.¹⁵ Other than certain limited indirect ownership interests without management or operational control, LSP Development, through its subsidiaries, and including Dynegy, currently owns interests in 2,618 MW of generating capacity in New York, which is approximately 7 percent of the 39,000 MW of generating capacity in New York. Of this total of 2,618 MW, approximately 700 MW of the Sithe/Independence plant is committed under long-term contract (until 2014) to Con Edison for the capacity market. Calpine owns 301 MW of generating capacity in New York, which is less than one percent of the total generation in New York. After acquiring approximately 10 percent of Calpine's stock, LSP Development will indirectly, through subsidiaries, own interests in 2,919 MW of generating capacity in New York, less than 8 percent of total generating capacity in New York. Even if the relevant geographic market is considered the smaller, East of Total East portion of NYISO, the effect of the Transaction also is insignificant.

The Commission previously declared that it would not review a stock transfer involving the combination of entities that owned interests in a similar amount of total generating capacity.

¹⁴ Case 02-M-1443, *Re Sithe Independence Power Partners, L.P.*, Order Providing for Lightened and Incidental Regulation and Granting a Certificate of Public Convenience and Necessity (January 23, 2003).

¹⁵ Affidavit of Julie R. Solomon at 2.

In *Sithe Energies, Inc.*,¹⁶ the Commission ruled that it would not review under Section 70 of the PSL a transfer to Dyncgy of stock in upstream owners of Sithe Energies, Inc. At the time of the transfer, Dyncgy and Sithe owned 4 percent and 3 percent, respectively, of the 38,000 MW of generation in New York. LSP Development's acquisition of Calpine stock will result in only a marginal change in market concentrations and, as in Sithe, "well below any threshold level for concern."¹⁷

Ms. Solomon also considered the impact of the transaction on the Installed Capacity ("ICAP") or Unforced Capacity ("UCAP") market and concludes that Petitioners' market shares are too small to raise concerns.¹⁸ Based on ICAP for the NYISO, including imports (and reflecting the 700 MW capacity sale from Independence to Con Edison), the market is unconcentrated, the Applicants' shares are 4.4 percent for LS Power and 0.7 percent for Calpine, and the Herfindahl-Hirschman Index ("HHI") change is only 6 points.¹⁹ With respect to the Long Island and New York City locational ICAP markets, Ms. Solomon concludes that LS Power's affiliated generation is too remote to exercise market power in these locations.²⁰ Ms.

¹⁶ Case 04-E-1364, *Sithe Energies, Inc., et al.*, Declaratory Ruling on Review of Stock Transfers (January 14, 2005).

¹⁷ *Id.* at 5.

¹⁸ *Id.* at 3.

¹⁹ As explained in Ms. Solomon's affidavit, markets with post-merger HHIs of 1000 to 1800 are considered "moderately concentrated." In those markets, mergers that result in an HHI change of 100 points or less are considered unlikely to have anti-competitive effects. Solomon aff. at note 5.

²⁰ *Id.* at 7.

Solomon also demonstrates that the combined company would not be able to benefit from withholding in the ICAP market.²¹

Finally, the Transaction raises no vertical market power concerns because neither Calpine nor LSP Development, nor any of their affiliates, owns or controls any electric transmission or distribution facilities in the control area of the NYISO, other than facilities required to interconnect generation to the transmission system. Additionally, none of the Petitioners nor any of their respective affiliates owns or controls any gas facilities, or any other inputs to power generation within the NYISO control area.

With respect to Sithe/Independence's retail steam customer, the Transaction cannot cause any harm to this customer because no upstream ownership interests in Sithe/Independence are being transferred, and the operation of Sithe/Independence's facility will not change as a result of the Transaction. Therefore, the Commission should rule that the Transaction need not be reviewed under Sections 70 and 83 of the PSL. The Commission should further rule that, to the extent the Plan provides less than 20 percent distribution of Calpine stock to LSP Development, it need not review the acquisition of additional Calpine stock up to 20 percent for LSP Development.

IV. IF THE COMMISSION DETERMINES THAT REVIEW UNDER PSL SECTIONS 70 AND 83 IS REQUIRED, IT SHOULD APPROVE THE TRANSACTION

In the alternative, if the Commission finds that Sections 70 and 83 review is required, Petitioners request that the Commission approve the proposed Transaction pursuant to Section 70 and 83. The proposed Transaction satisfies the public interest requirement in Section 70 of the PSL. As discussed above, the Transaction does not pose the potential for harm to captive

²¹ *Id.* at 8.

ratepayers and will allow Calpine to achieve its reorganization and emergence from bankruptcy. Accordingly, the Transaction and the acquisition of any additional stock up to 20 percent for LSP Development is in the public interest and should be approved.

V. CONCLUSION

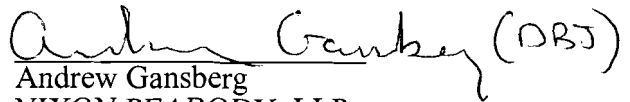
Based on the foregoing, Petitioners respectfully requests that the Commission issue a ruling declaring that it will not review the Transaction under Sections 70 and 83 of the PSL. Petitioners further request that the Commission act as soon as possible, but in any event, no later than *January 16, 2008*. In the alternative, if the Commission decides to review the Transaction pursuant to Section 70 of the PSL, Petitioners request a one-Commissioner order approving the Transaction on or before January 31, 2008.

Respectfully submitted,



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*Counsel for LS Power Development,
LLC.*

Dated: November 21, 2007
Albany, New York

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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In the Matter of the Petition of Calpine Corporation and
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Case 07-E-_____

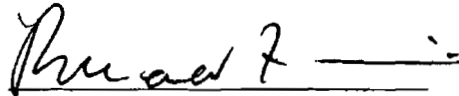
STATE OF NEW YORK)
)ss.:
COUNTY OF NEW YORK)

VERIFICATION

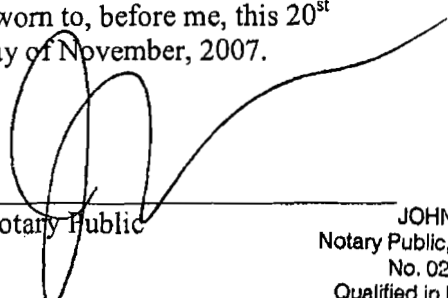
Ronald Fischer being duly sworn, deposed and says:

I am a Senior Vice President of LS Power Development, LLC, and I am fully familiar with the facts presented in the above-captioned petition.

I have read the foregoing petition and know the contents thereof. All of the facts asserted in the above-referenced petition are true and accurate to the best of my knowledge.



Sworn to, before me, this 20st
day of November, 2007.



Notary Public

JOHN STAIKOS
Notary Public, State of New York
No. 02ST6138639
Qualified in New York County
Commission Expires December 27, 2009

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Case 07-E-_____

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)ss.:

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VERIFICATION

Gregory L. Dooly being duly sworn, deposed and says:

I am the VP, General Counsel of Calpine Corporation, and I am fully familiar

I have read the foregoing petition and know the contents thereof. All of the facts asserted in the above-referenced petition are true and accurate to the best of my knowledge.

488

Sworn to, before me, this 20st
day of November, 2007.

Notary Public

ANN R. JOHNSON
Notary Public, State of New York
No. 01JO6077809
Qualified in Bronx County
Commission Expires July 18, 2006
2019

NEW YORK STATE PUBLIC SERVICE COMMISSION

**In the Matter of the Petition of Calpine
Corporation and LS Power Development, LLC
for Declaratory Ruling Regarding the Acquisition
of Common Stock, or, in the Alternative, Approval
Under Sections 70 and 83 of the New York State
Public Service Law.**

Case 07-E-

AFFIDAVIT OF JULIE R. SOLOMON

I. INTRODUCTION

My name is Julie R. Solomon. I am a Vice President at CRA International, Inc. ("CRA"), formerly known as Charles River Associates Incorporated. My business address is 1201 F Street, N.W., Suite 700, Washington, DC 20004-1204. A large portion of my consulting activities involves electric utility industry restructuring and the transition from regulation to competition. I have been involved extensively in consulting on market power issues concerning mergers, other asset transactions and market-based rate applications. I have filed a number of affidavits or testimony before the Federal Energy Regulatory Commission ("FERC") in connection with electric utility mergers, the purchase and sale of jurisdictional assets, applications for market-based rates, and triennial updates. I also have some experience involving mergers and acquisitions concerning assets in New York, but have not filed testimony before the New York State Public Service Commission ("Commission" or "NYPSC") with respect to those transactions. My resume is attached as Exhibit 1 to this affidavit.

Calpine Corporation ("Calpine") and LS Power Development, LLC ("LS Power") (together, the "Petitioners") seek a Commission ruling declaring that a transaction (the "Transaction") under which Calpine emerges from bankruptcy and LS Power obtains shares in the reorganized company ("New Calpine") need not be reviewed under Section 70 of the Public Service Law because the Transaction does not raise potential market power concerns. LS Power owns, through affiliates, interests in three New York generating facilities (Independence, Roseton and Danskammer) and Calpine owns five generating facilities (Bethpage, TBG Cogen Partners,

Bethpage Energy Center 3 (I refer to these collectively as “Bethpage”); Nissequogue Cogen Partners (“Stony Brook”); and KIAC).

I have been asked by counsel for Petitioners to provide an evaluation of the potential competitive impact of the Transaction on the relevant electricity markets in accordance with procedures used by the Commission. My analysis demonstrates that the post-Transaction share of Petitioners’ generation potentially competing in New York Independent System Operator, Inc.’s (“NYISO”) administered markets is less than approximately 8 percent, and the increase in market share resulting from the transaction is *de minimis*.¹ I also include an additional analysis of New York capacity markets that may be of interest to the Commission in its consideration of the competitive implications of the Transaction.

II. SUMMARY OF CONCLUSIONS

The Transaction will not have an adverse impact on competition in the relevant markets. The acquisition of Calpine’s New York generation will not cause a significant increase in the market concentration in the relevant product markets in New York. To the extent there are any horizontal issues, they relate to the combination of LS Power-affiliated generation and Calpine generation located in NYISO.² The relevant geographic market in New York is large and generally unconcentrated. NYISO has within its control area some 39,000 MW of generation,³ of

¹ The Commission’s horizontal market power guidelines track the Appendix A Competitive Analysis Screen used by the FERC to assess the competitive effect of a merger. See Case 94-E-0098 et al, Niagara Mohawk Power Corporation, Order Authorizing Process for the Auctioning of Generation Facilities, Appendix A (May 6, 1998). My demonstration that the extent of Petitioners’ business transactions in the NYISO market is *de minimis* is consistent with FERC Order No. 592 (FERC Stats and Regs. ¶ 31,044 (1996), and FERC Order No. 642 (Final Rule in Docket No. RM98-4-000, 18 CFR Part 33, 93 FERC ¶ 61,164 (2000).

² LS Power also is affiliated with about 4,000 MW of generation in the PJM Interconnection, LLC (“PJM”) region, primarily located in the western portion of PJM, and about 1,000 MW of generation in ISO-New England Inc. (“ISO-NE”). Calpine is affiliated with about 75 MW of generation in PJM and about 400 MW in ISO-NE. Given Petitioners’ ownership in PJM and ISO-NE and the relative size of these markets (160,000 MW and 30,000 MW of installed generation, respectively), I determined there was no need to analyze the impact of this generation on the NYISO energy markets. I do, however, discuss below the potential relevance of this generation to the New York capacity markets.

³ Unless otherwise indicated, generation data refer to summer ratings reported in the NYISO’s 2007 *Load and Capacity Data*. In some cases, these ratings do not match the ratings reported in the Petition. The ratings in the Petition are the same as those in the Joint Application for Approval Under Section 203 of the Federal Power Act by Calpine *et al.*, in Docket No. EC08-15 (filed November 16, 2007) and Calpine’s EIA filings.

which LS Power is affiliated with about 7 percent⁴ of installed generation in the NYISO through its 40 percent indirect ownership interest in Dynegy Inc. (“Dynegy”) and Calpine owns less than one percent. Calpine’s market share clearly is *de minimis*. As a result, the combination of these two market shares would result in a change in market concentration of only about 10 points,⁵ well below any possible threshold of concern.

The location of LS Power’s and Calpine’s affiliated generation further confirms the lack of competitive concerns. LS Power’s affiliated generation is located in zones G (Roseton, 1,197 MW and Danskammer, 482 MW) and C (Independence, 939 MW)), the former inside of the Total East interface and the latter west of the Total East interface. Calpine’s generation is all located on Long Island (the three Bethpage units and Stony Brook, 184 MW) or in New York City (KIAC, 117 MW). Calpine’s share of installed generation on Long Island and in New York City is only 3.5 and 1.2 percent, respectively. Even in the East of Total East market, the combination of LS Power’s 6.8 percent share of installed generation and Calpine’s 1.2 percent share of installed generation is too small to trigger any competitive concerns.

I also considered the impact of the transaction on the Installed Capacity (“ICAP”) or Unforced Capacity (“UCAP”) market and conclude that Petitioners’ market shares again are too small to raise concerns.

There also is no opportunity for Petitioners to exercise vertical market power as a result of the Transaction. None of the Petitioners own transmission assets in New York, other than those

⁴ A portion of the Independence plant (approximately 700 MW) is sold as capacity under long-term contract with Consolidated Edison Company of New York (“ConEd”). LS Power or its affiliates also hold certain limited indirect ownership interests, without management or operational control, in publicly-traded companies that own interests in New York generation, which are not included in my analysis.

⁵ To determine whether a proposed merger requires further investigation because of a potential for a significant anti-competitive impact, the Department of Justice (“DOJ”) and Federal Trade Commission (“FTC”) consider the level of the Herfindahl-Hirschman Index (“HHI”) after the merger (the post-merger HHI) and the change in the HHI that results from the combination of the market shares of the merging entities. Markets with a post-merger HHI of less than 1000 are considered “unconcentrated.” The DOJ and FTC generally consider mergers in such markets to have no anti-competitive impact. Markets with post-merger HHIs of 1000 to 1800 are considered “moderately concentrated.” In those markets, mergers that result in an HHI change of 100 points or less are considered unlikely to have anti-competitive effects. Finally, post-merger HHIs of more than 1800 are considered to indicate “highly concentrated” markets. The *Guidelines* suggest that in these markets, mergers that increase the HHI by 50 points or less are unlikely to have a significant anti-competitive impact, while mergers that increase the HHI by more than 100 points are considered likely to reduce market competitiveness. (See U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (April 2, 1992), *amended* 1997.)

necessary to connect their generation to the grid. Any potential concerns about the creation of barriers to entry resulting from control over scarce resources or inputs into generation in the relevant markets (e.g., fuels delivery systems or generation sites) are not relevant to the Transaction.

I conclude, therefore, that there are no material market power issues arising from the Transaction, and recommend that the Commission conclude that the Transaction will not have an adverse effect on competition in relevant markets.

III. DESCRIPTION OF RELEVANT ASSETS

As noted earlier, LS Power, through its affiliation with Dynegy, owns the Roseton (1,197 MW) and Danskammer (482 MW) plants in New York zone G, and the Independence plant (939 MW) in zone C. Of this total 2,618 MW, approximately 700 MW of the capacity of Independence plant is committed under long-term contract (until 2014) to ConEd.

Calpine has approximately 301 MW of generating capacity in NYISO, consisting of the three Bethpage units (178 MW) and Stony Brook (7 MW),⁶ located on Long Island, and KIAC (117 MW) located in New York City. Electricity and steam from Stony Brook are sold to the State University of New York at Stony Brook under a long-term sales agreement, and excess power is sold to Long Island Power Authority (“LIPA”). A portion of the electricity output and thermal energy generated by KIAC is sold to the New York Port Authority under a long-term contract, and additional output is sold to ConEd, the New York Power Authority (“NYPA”) and other utility customers.

IV. ANALYSIS

Petitioners’ combined share of installed generation in NYISO, as shown in Table 1 below, is less than 8 percent, and the HHI change is only 10 points, well below any level that would raise competitive concerns. This overstates the combined share, and the HHI change, in energy markets

⁶ NYISO reports only a 7 MW summer rating for Stony Brook. This rating possibly excludes the portion of the output of the facility sold to State University of New York at Stony Brook.

because some of the output of the Calpine-affiliated generating facilities is sold to third-parties under contracts.

Table 1: Effect of Transaction in NYISO

	MW	Share
LS Power	2,618	6.69%
Calpine	301	0.77%
Other	36,189	92.54%
Total	39,108	100.00%
HHI Change: 10		

Even if the relevant geographic market is considered the smaller, East of Total East portion of NYISO, the effect of the Transaction also is small, as shown in Table 2 below.

Table 2: Effect of Transaction in East of Total East

	MW	Share
LS Power	1,679	6.84%
Calpine	301	1.23%
Other	22,581	91.94%
Total	24,561	100.00%
HHI Change: 17		

Both of these analyses are conservative since they are without consideration of imports.

The impact of this Transaction on relevant NYISO capacity markets also is small. Based on ICAP for the whole of the NYISO (the NYCA capacity market), including imports (and reflecting the 700 MW capacity sale from Dynegy to ConEd), the market is unconcentrated, the Petitioners' shares are 4.4 percent for LS Power and 0.7 percent for Calpine, and the HHI change is only 6 points, as shown in Table 3 below.

Table 3: Effect of Transaction on NYCA Capacity Market

	MW	Share
LS Power	1,918	4.40%
Calpine	301	0.69%
New York Power Authority	6,585	15.10%
KeySpan Generation, LLC	4,199	9.63%
NRG Power, Inc.	4,099	9.40%
Entergy Nuclear	2,910	6.67%
Constellation Power Source	2,396	5.49%
KeySpan Ravenswood, Inc.	2,305	5.28%
Astoria Generating Company L.P.	2,148	4.92%
Consolidated Edison Co. of NY, Inc.	2,400	5.50%
Other Local Generation	9,845	22.57%
Imports, etc	4,512	10.34%
Total*	43,620	100.00%
Pre-Transaction HHI: 623		
HHI Change: 6		
* Total market based on 2008/2009 <i>Final NYISO ICAP Demand Curve Recommendations - Capability Years 2008-2011</i> http://www.nyiso.com/public/products/icap/demandcurve.jsp The market HHI ignores the contribution of imports to the HHI.		

The other capacity markets of potential relevance here are the Long Island and New York City markets, but only one of the Petitioners, Calpine, owns or controls any generation within these markets. Further, the amount of generation it controls (184 MW in the Long Island market and 117 MW in the New York City market) is small in both absolute terms and relative to the size of the markets and other market participants. Generation qualifying for the markets in 2008/2009 is 6,410 MW for Long Island and 10,431 MW for New York City, with Calpine's share 2.9 and 1.1 percent, respectively.⁷

Each of the locational markets also has a minimum installed capacity requirement – 80 percent of forecast peak load for New York City and 99 percent of forecast peak load for Long Island,⁸ and a demand curve for capacity that specifies the price of capacity given different levels

⁷ 2008/2009 *Final NYISO ICAP Demand Curve Recommendations - Capability Years 2008-2011*. This includes potential supply from imports. <http://www.nyiso.com/public/products/icap/demandcurve.jsp>

⁸ http://www.nyiso.com/public/webdocs/products/icap/icap_manual/app_a_attach_icapmnl.pdf

of supply relative to the 16.5 percent installed reserve margin (going to a zero capacity price at 118 percent of this requirement for New York City and Long Island, and at 112 percent for NYCA).

With a summer peak load forecast of 5,485 MW for Long Island in the capability year 2008/2009,⁹ and installed capacity in zone K of 5,282 MW, all of the generation on Long Island will be required to meet the zone K requirements, and Long Island will be partially reliant on imports. The source of import capability that qualifies to meet the locational ICAP requirement for Long Island consists of the Cross Sound Cable (330 MW from ISO-NE) and the Neptune Cable (660 MW from PJM).¹⁰ While Calpine owns generation on Long Island, LS Power does not, and if it should seek to participate in the Long Island capacity market, it would require Unforced Capacity Deliverability Rights (“UDRs”) over these links either from ISO-NE or PJM. LS Power does not own generation in New York City, and hence none of its capacity can qualify to meet the New York City locational capacity requirement.

However, of LS Power’s 4,200 MW of affiliated generation in PJM, 3,600 MW is located in Ohio, Illinois or Wisconsin,¹¹ of which 500 MW is in the process of being sold, leaving only about 560 MW of generation located in the eastern portions of PJM. Even LS Power’s Eastern PJM generation is relatively remote from the interconnection with the Neptune Cable, and, in any event, LIPA has reserved all of the transmission capability on the Neptune Cable. A hypothetical sale by LS Power to LIPA would require de-listing of that capacity from the PJM capacity market. Of LS Power’s approximately 950 MW of affiliated generation in ISO-NE, 500 MW is located in Maine, a generation pocket that is remote from the Connecticut end of the Cross Sound Cable. LS Power’s 450 MW of generation in Connecticut is located in Southwest Connecticut, itself a constrained area, and, ultimately a potentially separate local capacity market. ISO-NE also would require de-listing of this generation for it to participate in New York

⁹ This represents the non-coincident peak load forecast for summer 2008. The forecast peak coincident with the NYISO peak is 5,384 MW. *2007 Load and Capacity Data*.

¹⁰ In addition to installed generation and imports, there is 138.4 MW of “special case resources” (e.g., interruptible load and distributed generation) reported as available on Long Island. *2008/2009 Final NYISO ICAP Demand Curve Recommendations - Capability Years 2008-2011*. <http://www.nyiso.com/public/products/icap/demandcurve.jsp>.

¹¹ This consists of the Rocky Road, Riverside/Foothills, Rolling Hills, and Kendall generating facilities. Some of the output of these facilities is committed under long-term contract to third-parties.

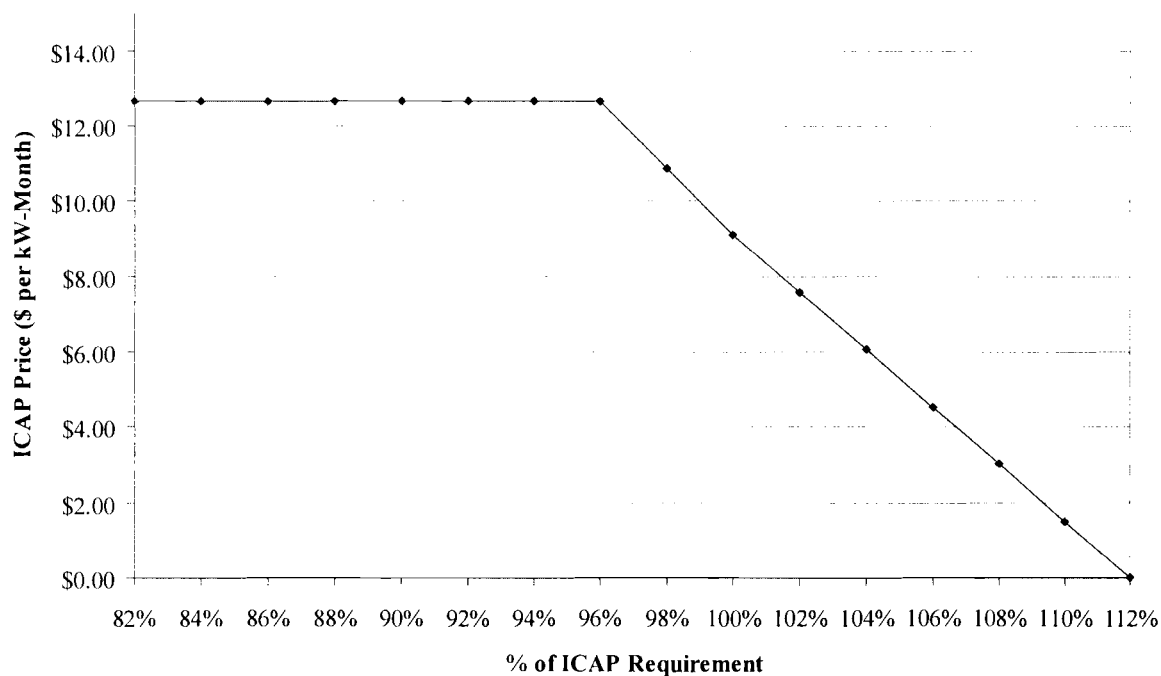
capacity markets. The theory that a new affiliation between this remote LS Power-affiliated generation and Calpine generation on Long Island and New York City would create market power concerns is not plausible given the institutional rules and market realities that affect how external supply can compete in NYISO capacity markets.

At the Commission Staff's request, I also evaluated whether the combined company has the theoretical ability to benefit from withholding in the ICAP market. In order to conduct this inquiry, I relied on a model that my colleague, Dr. William Hieronymus, developed in connection with the merger of Dynegy and Sithe. I used the forecasted data for the 2008/2009 capability year for the NYCA capacity market,¹² the market in which both LS Power and Calpine each have affiliated generation.¹³ The NYCA summer 2008 demand curve is shown below in Figure 1, which shows a price of \$9.09/kW-month at 100 percent of the ICAP requirement. At 112 percent of the ICAP requirement, the price is zero, and at 96 percent of the requirement, the price flattens out at \$12.68/kW-month.

¹² 2008/2009 *Final NYISO ICAP Demand Curve Recommendations - Capability Years 2008-2011*.
<http://www.nyiso.com/public/products/icap/demandcurve.jsp>.

¹³ The Long Island and New York City markets have exhibited market clearing prices higher than the NYCA market. As discussed above, LS Power's ability to participate in the Long Island and New York City capacity markets is very limited. By the same logic, the Calpine generation is likely to participate in the locational capacity markets (or in bilateral markets) rather than the NYCA capacity market.

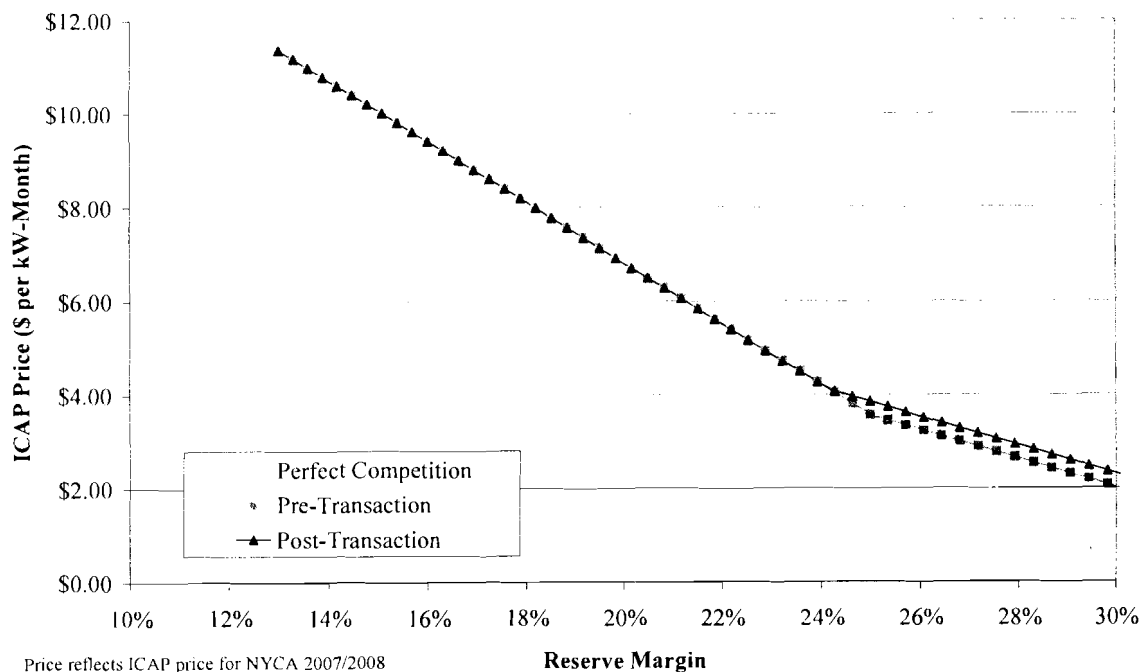
Figure 1: NYCA Demand Curve, 2008/2009



I translated this supply curve into an ICAP price at various reserve margins and found that at relatively high levels of reserves (that is, well below the horizontal portion of the price curve), all sellers may benefit from (or not be harmed by) withholding capacity. The price effect of reducing the amount of capacity available in the ICAP auction is linear, such that a large supplier withholding a given amount of capacity will have more remaining capacity that receives the higher price. The larger the supplier, the greater the incentive to withhold relative to that of a smaller supplier. Further, the price level at which withholding becomes unattractive is lower for small suppliers than for large suppliers. For these reasons, as a matter of mechanics, there will be a region of the ICAP demand curve at high reserve levels in which the combined company will theoretically have an incentive to withhold more after the Transaction than before it.

I simulated the profit maximizing amount of supply offered for LS Power/Dynegy and Calpine separately and for the combined firm.¹⁴ I varied demand up and down.¹⁵ The results are shown in Figure 2 below.

Figure 2: NYCA ICAP Price, 2008/2009



At reserve margins in excess of about 24 percent, a supplier the size of a pre-Transaction LS Power operating alone would find it economic to withhold some small amount of supply if unconstrained by market rules if no other supplier was also withholding.¹⁶ This result suggests that, absent some non-structural requirement to bid (i.e., NYISO rules against withholding and/or operation of the anti-market manipulation clause in sellers' market-based rate tariff), prices at the

¹⁴ I also assumed that each of the Petitioners knew the amount that the other was bidding into the market and that all other suppliers bid all of their capacity. Formally, this is a two-person Cournot game with all other players treated as fringe players. Exports are assumed to be zero.

¹⁵ This is equivalent to holding demand constant and varying non-petitioners' supply up and down, except that 100 MW of demand change is equivalent to 116.5 MW of supply change.

¹⁶ Of course, this assumption is unlikely to hold true because other similarly-sized generators would have similar incentives.

lowest part of the demand curve would not occur because a generator (or generators) would withhold capacity before prices could fall to that level.

In this lower part of the demand curve, the additional withholding made economic by the acquisition raises the theoretical price by small amounts, about 29 cents or less. Since this occurs only at reserve margins that are well above the 16.5 percent installed reserve margin, a more important question is whether the transaction causes a generator such as LS Power to profit from withholding at significantly lower reserve margins than before the transaction. The answer is that it does not. The point at which a generator such as LS Power ceases to profit at all from withholding is at NYISO peak demand levels only about 200 MW higher than before the transaction.

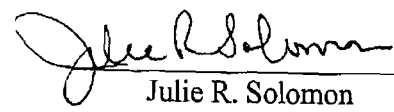
In the real world, the effect of the Transaction would be much smaller than these calculations show, if indeed there would be any effect at all. First, contrary to the assumption in my analysis, suppliers do not have unfettered ability to withhold capacity from the ICAP market. Second, even the theoretical effect is small, at most \$0.29 per kW-month, and even this effect occurs only if reserve margins are quite high. The reserve margin at which withholding is profitable substantially exceeds the target reserve level at which entry becomes profitable.

Third, the analysis that I have performed ignores the potential effects of withholding by sellers other than Petitioners. My analysis assumes, counter-factually, that there is no regulatory constraint on withholding. Under such circumstances, other sellers would have an incentive to increase prices; this would reduce any theoretical incentive for a generator such as LS Power to withhold, with or without the Transaction.

Finally, I note that in the long term, withholding, even if not disciplined by market rules, would not affect the price of ICAP in New York, as the ICAP price adapts to ensure new entry, adjusted for energy margins.

V. CONCLUSION

On the basis of the analyses discussed herein, I conclude that the Transaction does not raise potential market power concerns.


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