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August 12, 1997

Via Federal Express

The Honorable Joel I. Klein
Assistant Attorney General
United States Department of Justice
Antitrust Division
950 Pennsylvania Avenue, N.W., Suite 3109
Washington, D.C. 20530

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ANTITRUST DIVISION

Re: Request for Business Review of Joint Purchasing Arrangement

Dear Assistant Attorney General Klein:

This letter is submitted pursuant to 28 C.F.R. Section 50.6 on behalf of our client, the California Large Electric Power Purchasing Association ("CLEPPA"), to request a business review determination regarding a proposed joint arrangement for the purchase of electric power in the deregulated California market beginning as early as January 1, 1998. The participants in the joint purchasing group include eleven large industrial electric power consumers.

The market for electric power in California is scheduled to change dramatically on January 1, 1998. The California Public Utilities Commission ("CPUC") has mandated that all customers, including industrial, commercial and residential retail customers, will have direct access to power from sources other than the local distribution monopoly, effective the first of next year. In order to take advantage of the purchasing opportunities that competition will create, it will be necessary for CLEPPA to negotiate and finalize contracts well in advance of that date. Since the proposed joint purchases will not be consummated while this request is pending, we would greatly appreciate the Department's expeditious response to this request.

Overview

CLEPPA is a proposed joint purchasing association composed of eleven large industrial customers for electric power, including eight cement manufacturers and three steel products manufacturers, located throughout California. CLEPPA's membership

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will be identical to that of the California Large Energy Consumers Association ("CLECA"), an organization that has served as an advocacy group primarily in rate proceedings before the CPUC.¹ CLEPPA is being proposed in order to optimize competitive buying opportunities presented by the emerging competition in California's electric power markets, by taking advantage of efficiencies that the group, acting as a pooled purchaser, can present to sellers in the marketplace. The joint purchasing would also offer considerable efficiencies by reducing information and transaction costs in a complex and changing market that is both new to California, and unprecedented in the United States.

CLEPPA would: (i) consolidate most internal purchasing functions for members, including the preparation of joint requests for proposals ("RFPs") for electric power and negotiation of contracts; (ii) obtain from individual members certain information needed to perform the joint purchasing function, under arrangements described below that will prevent the flow of competitively sensitive information among members; and (iii) coordinate, or contract with others to coordinate, load management by members to minimize collective electric prices.

As detailed below, the effects of the proposed joint purchasing activities would increase competition and be of benefit to an important group of California industrial power consumers, as well as to their customers in downstream markets. The venture would not restrict competition in any market. To the contrary, the proposal would reduce transaction and information costs as well as electric power rates to CLEPPA's members.

The California Electric Power Market

California's market for industrial electric power is huge. In 1983, electric power consumption in California exceeded 171 billion kilowatt hours, of which industrial use represented 44 billion kilowatt hours. By 1993, overall consumption rose to 228 billion kilowatt hours, with industrial use at nearly 51 billion kilowatt hours.² Within the state, California has a diverse mix of generation resources from more than 1300 in-state power plants.³ However, the state imports electric power from areas throughout the western United States, western Canada and northern Mexico through the Western Systems Power Pool as well as bilateral transactions, and is expected to import more in the competitive retail market beginning January 1, 1998 and through the creation of a new electricity spot market called the California Power Exchange. CLEPPA members represent a minuscule fraction (far less than 1%) of California's electric power consumption, with aggregate 1996 purchases of less than 1.85 billion kilowatt hours.

¹ CLECA includes, and CLEPPA is proposed to include, Riverside Cement Company, Mitsubishi Cement Corporation, TAMCO, California Steel Industries, Inc., Calaveras Cement Company, Kaiser Cement Corporation, SOUTHDOWN, RMC Lonestar, Schnitzer Steel Products, National Cement Company of California, Inc., and California Portland Cement Company.

² See "California Historical Energy Statistics," Publication No. P.300-95-020 of the California Energy Commission (December 1995).

³ *Id.*

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Electricity rates in California, particularly for industrial users, have far exceeded national averages. The average price of electricity nationwide as of 1995 was 5% lower than twenty years earlier, while California had experienced a 33% increase during the same period, resulting in a 40% disparity between California's rates and the lower national average.⁴

In December 1995, the CPUC issued its Policy Decision ordering the restructuring of the electric power industry in California.⁵ In the summer of 1996, the California Legislature enacted AB 1890, which laid out a more specific framework for this restructuring. A primary effect of the restructuring is the unbundling of the regulated utilities' generation, transmission and distribution functions. The restructuring contemplates a deregulated generation market open to all suppliers for both wholesale and retail sales. To help foster competitive conditions in the new generation market, integrated utilities are required to divest substantial generating assets. A Power Exchange ("PX"), or spot market for the auctioning of power, is established as a clearinghouse for unbundled power sales which are not accomplished through bilateral contracts between parties. The statewide transmission grid will be operated on a more consolidated basis by an Independent System Operator (the "ISO"), whose role will be to establish a condition of fair and open access to the grid through its daily scheduling and dispatch activities. Both the ISO and the PX are independent non-profit corporations to be regulated by the Federal Energy Regulatory Commission ("FERC") and outside the control of any sellers or buyers. Local distribution of power will continue to be within the monopoly control of public utilities. Thus, the restructuring will result in competition in the unbundled market for power, and it is in this market that this joint purchasing arrangement is proposed.

Effective January 1, 1998, all California customers will have two competitive options for purchasing electric power: (i) retaining "full" or "bundled" service from the local distribution utility, which will initially obtain the power exclusively from the PX under CPUC order; or (ii) entering into direct access contracts with third-party power suppliers, which may obtain the power from their own generation facilities, from the PX or from other generators. As with any commodities exchange, the PX will take bids and asking prices from buyers and sellers, setting a "clearing" price every hour. The rates for local distribution monopolies will continue to be set by the CPUC and indeed will be frozen for several years under state law. Thus, customers who purchase from their local distribution utility will be price takers, and will have very limited opportunity to negotiate rates for unbundled power. However, direct access customers will have an unprecedented competitive opportunity to negotiate the terms of their contracts.⁶ In the context of direct access, competitive forces will affect the prices for electricity itself, as well as such ancillary services as

⁴ *Id.*

⁵ Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation, Decision 95-12-063 (December 20, 1995), as modified by Decision No. 96-01-009.

⁶ In the new unbundled environment, customers will pay certain charges that are not negotiable. These include transmission and distribution charges and "competitive transition charges" (compensating former monopoly utilities for stranded assets).

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financial management, congestion risk management, paperless billing, and load telemetry.

Joint electric power purchasing is inevitable in the new market structure, and several joint purchasing groups have already issued RFPs. In direct access contracts, group purchasing can offer benefits to both the consumer, and to the supplier having its own generation.⁷ From the standpoint of the supplier having its own generation, a large and level demand profile that a suitable group presents may be preferable to selling into the daily auction offered by the PX, because the supplier does not know in advance whether its bid price to the PX will be sufficiently low to clear the generator's capacity. Thus, direct access contracts with a term in excess of one day offer the seller a level of certainty that the PX does not. This advantage is expected to yield price concessions for appropriately configured groups, reflective of the benefits to the generator resulting from leveled demand on its power plants.⁸ The aggregate demand and load profile of CLEPPA are expected to be more attractive than that of any single customer within the group. Since a large and level demand minimizes the generator's risks with regard to the underutilization of its generating capacity and maximizes the ability to spread fixed costs (resulting in lower rates), customers presenting such benefits can negotiate price advantages that could not be achieved by group members separately entering the marketplace to fill their individual demands.

Joint purchasing also allows the customers to share information cost burdens and risks that have been the inevitable by-products of restructuring. Under regulation, industrial customers could purchase power with a minimum of information because rates and terms were fixed by tariffs approved in advance by the CPUC. In a competitive marketplace for power, industrial purchasers must understand and negotiate such matters as load profiles, load flexibility, contract duration, delivery points, overall energy prices, pricing variability, ancillary services, imbalances between scheduled and actual loads, transmission congestion, scheduling coordination fees, metering and communications links with the ISO, and reliability. Furthermore, each user must decide whether it prefers a

⁷ Some of the same economic advantages described below should pertain for indirect purchases, because the intermediary would present the group's desirable aggregate demand profile to the ultimate source generating the power, and at least part of the advantage to that source should pass through to the group purchasers.

⁸ For most types of power plants, uneven demand necessitates either cycling generation output up and down or operating at capacity levels in excess of demand, both of which are inefficient and costly. Many thermal generating plants incur very substantial costs when they are started up, which are most efficiently recovered by being spread over an extended period of sales. During start-up periods, which may last 24 hours or more, thermal plants incur costs while unloaded without the ability to recover them through sales during the start-up period. Additionally, shutting down and starting up plants causes long-term wear and tear on the plants. Nuclear power plants cannot be cycled in response to demand fluctuations, and so must run at high capacity even through periods of lower demand. (Hydro plants do not face these same start-up and no-load costs, but still maximize economic returns operating and selling at optimum levels.) Thus, for most types of plants, leveling demand directly reduces costs, and for all plants can yield higher profits even at reduced rates.

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single supply source or more diversity, and, for multi-plant users, what geographic range of resource availability should be within a given contract. These are all matters that have long been familiar to power providers, but which power consumers have ignored due to regulation, and consequently there are limited sources of accurate information. The cost of becoming sufficiently informed about these various aspects of power purchasing are not insignificant, and this cost can be shared by CLEPPA's members through the group purchasing arrangement proposed here. CLEPPA also has access to expertise that would reduce the risk of negotiating with providers who would otherwise have superior information about the critical issues that should be addressed in contracts. Thus, although CLEPPA's primary purpose is to obtain reduced prices by aggregating an attractive demand profile, it would also create some efficiencies by reducing information costs as well as risks of negotiating from imperfect information in a market where sellers are much better informed.

The Proposed Joint Purchasing Arrangement

CLEPPA's members share critical similarities that will make joint purchasing both feasible and efficient.⁹ Each CLEPPA member is presently served on an "interruptible" tariff schedule, which permits the serving utility to call for interruption of its use of electricity at times when available power is needed to maintain service to firm service customers. This interruptible tariff option will continue in the new competitive era under state law, and the ISO will inform the utilities when tariff conditions are met requiring them to interrupt power supplies to these customers. Contracts between customers and suppliers must be drafted to incorporate this interruptibility. Aggregating interruptible buyers facilitates negotiations since the conditions for all members are similar. Additionally, all CLEPPA members can operate around the clock, which presents a particular advantage to generators since off-peak large-scale sales are at a premium in achieving levelized demand.¹⁰ Adding to this advantage, as industrial customers, they can be more flexible than other large users, such as commercial office buildings, in managing loads by adjusting plant schedules. All CLEPPA members, with one exception, are subtransmission customers, purchasing at levels of 60 kilovolts or higher directly at dedicated substations off of the ISO-controlled transmission grid. This necessitates direct communications and metering links with the ISO, which will be more efficiently arranged once by the group than eleven separate times by its members acting individually.

⁹ Certain members belong to corporate groups, and their affiliated companies within California have relatively little in common with the group. However, RFPs will seek to determine whether and in what circumstances affiliated companies could share in the benefits of their related member's participation. Because these affiliates purchase much smaller amounts of electric power, it is not anticipated that affiliate purchases through the group would result in reduced prices for them, in which event no such purchases will be made.

¹⁰ Under current tariffs, steel plants cannot operate economically during peak periods of the day, which has had the effect of preventing California steel plants from pursuing all of their operations on a 24-hour basis. This tariff penalty is expected to diminish or disappear entirely under restructuring.

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CLEPPA would operate under by-laws. The provisions of these by-laws would comport with the safeguards for joint purchasing previously articulated by the Antitrust Division and the Federal Trade Commission, and in particular would prevent the sharing of information concerning the costs or consumption of individual members (either directly or indirectly through the Purchasing Agent), permit members to purchase all or part of their power requirements outside the group, and establish an independent purchasing agent (the "Purchasing Agent") who will have sole responsibility for obtaining information from members, issuing RFPs and conducting negotiations on behalf of the group. All costs of CLEPPA's operations would be shared by members, pro rata, based upon their recorded annual power consumption. Membership in CLEPPA will be confined to similarly situated electric power consumers in order to maintain the load profile characteristics of the group, as described above. Where appropriate, qualified applicants for membership would be admitted, but it is not expected that membership will grow appreciably due to the limited number of similar consumers.

The Purchasing Agent will periodically obtain from each member sufficient information to complete RFPs on behalf of the group, and will advise the group as a whole as to the results of bidding and negotiations with potential suppliers. Each member, in turn, will advise the Purchasing Agent of the amount of its load that will be purchased through the group. Pursuant to CLEPPA's by-laws, only aggregated information will be shared with any member by the Purchasing Agent, and only to the minimum extent necessary to permit members to assess the advisability of joint purchasing. The intent is to issue requests for proposals to suppliers immediately, but without obligation on the part of CLEPPA or its members. Information provided to potential suppliers would be the subject of confidentiality agreements prohibiting disclosure to anyone, including CLEPPA members. The proposals submitted in response would be directed to the Purchasing Agent. If the Department approves, CLEPPA would then be in a position to respond to the proposals quickly, which will be necessary in order to obtain the advantages of competitive prices at the earliest possible time.¹¹ Once a joint purchasing contract has been obtained, the Purchasing Agent will centrally manage it, and will continue to serve as a point-of-contact between suppliers and CLEPPA members. The Purchasing Agent will also coordinate future RFPs and negotiations on behalf of the group.

¹¹ It is expected that the process of concluding a contract will take between four and six months from the preparation of the RFPs to the provision of service under a direct access contract. (Under the CPUC's rules, such service cannot commence until January 1, 1998, at the earliest.) CLEPPA will not enter into any contract while this request is outstanding, and the only activities that have been or will be conducted in advance of approval are meetings of CLECA with the Purchasing Agent, counsel and providers to consider the objectives and prospects of joint purchasing, the confidential submission of information to the Purchasing Agent by members, the preparation and issuance of RFPs to potential suppliers (responses to which will be shared with CLEPPA members by the Purchasing Agent when they are received), and the submission of this letter. These preliminary steps can be abandoned, if necessary in the view of the Antitrust Division. However, it is important that at least these steps be taken now, so that CLEPPA will be positioned to act promptly if the Antitrust Division agrees that the proposed joint purchasing would not transgress antitrust rules.

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The Purchasing Agent is seeking to determine from providers whether, during the course of contracts, either the power provider or the Purchasing Agent should attempt to coordinate load management by members to optimize the group's load profile. Any such coordination of plant closings and operating hours would be solely for the purpose of avoiding the sort of simultaneous closures which would deteriorate the group's overall load profile (resulting in a loss of efficiencies during affected periods, and thus higher prices) and which could also have adverse price and output effects in downstream markets. Efforts to stagger plant closures, arranged with each member separately and without direct coordination between members, is likely to have only procompetitive effects by avoiding shortages that might otherwise result from simultaneous closures. CLEPPA's by-laws and confidentiality provisions in provider contracts will prohibit members from coordinating load management directly with other members, and will restrict the flow of member-specific information to other members indirectly through the provider or the Purchasing Agent. Such efforts, furthermore, would only be undertaken if supported by demonstrated efficiencies reflected in lower prices to the group.

CLEPPA members will, in all other respects, continue to operate as fully-independent concerns. Each member will remain free to purchase all or part of its power requirements on its own, outside of the joint purchasing arrangement.¹²

Effect on Competition

CLEPPA will have several procompetitive effects, and will not be harmful to competition in any market. The aggregation of loads and coordination of load management will promote efficiency by affording predictability and stability for generators supplying the group. This will result in reduced costs of electric power supplied to CLEPPA. Increased efficiency will also attend the elimination of duplicative negotiations, and the reduction of information costs which each member, acting alone, faces in the novel context of deregulation. The managed optimization of load profiles, if this occurs, will also result in reduced prices, and would have the incidental benefit of minimizing the occurrence of simultaneous shutdowns by more than one cement plant, reducing risks of possible shortages.¹³

¹² CLEPPA members expect to continue their participation in CLECA. CLECA is an advocacy group representing the interests of large, interruptible electric power customers in California in rate proceedings at the CPUC, and sometimes also participates in proceedings before the FERC. CLECA's independent advisors obtain information from individual members, which is aggregated in presentations to regulatory officials in public filings, so that no individual member's information is shared with any other member. CLECA's existence and activities are encouraged and protected under *Eastern Railroad Presidents Conf. v. Noerr Motor Freight*, 365 U.S. 127 (1961).

¹³ CLEPPA includes all cement manufacturers located in California, but does not include manufacturers outside the state who sell or have sold into California. Cement has been imported into the state from neighboring states, as well as Mexico, Japan, Spain and other foreign sources. The three steel industry members produce different products that do not compete (shredded automobiles, rebar and other low-end construction grade steel products, and high-end steel products, respectively).

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The Department has articulated guidelines for permissible joint purchasing arrangements. Under these guidelines, it is recognized that joint purchasing can be pro-competitive, and is presumed to be so where certain conditions obtain. In the health care context, for example, an "antitrust safety zone" is recognized for joint purchasing arrangements where "the purchases account for less than 35% of the total sales of the purchased product or service in the relevant market" and where "the cost of the products and services purchased jointly accounts for less than 20% of the total revenues from all products and services sold by each competing participant in the joint purchasing arrangement." The Health Care Guidelines and consistent articulations in business review letters also anticipate that participants will not share competitively sensitive information among themselves, that purchasing negotiations will be conducted by an independent agent, and that purchases through the group generally should not be mandatory. Where these conditions have been found to apply, the Department has consistently stated that it would not challenge joint purchasing arrangements.¹⁴

The proposed joint purchasing falls within these established guidelines and precedents. Electric power is an important input for all CLEPPA members, but its cost would not exceed the guideline of 20% of revenues.¹⁵ Aggregate CLEPPA purchases would amount to far less than 35% of available generation capacity, in fact well below 1% of consumption within the State, and less than 4% of California's industrial consumption. CLEPPA has adopted the sorts of procedural safeguards favored by the Department, restricting the flow of competitive information, establishing an independent purchasing agent, and maintaining members' freedom to purchase outside the group.

Conclusion

Our client faces a great deal of uncertainty as January 1, 1998 approaches,

¹⁴ See, Department of Justice and Federal Trade Commission Statements of Enforcement Policy and Analytical Principals Relating to Health Care and Antitrust, 4 Trade Reg. Rep. [CCH] ¶ 13,152 at 20,785 (1994) ("Health Care Guidelines"). See also, Business Review Letter to Ira H. Raphaelson, Esq. re Utilities Service Alliance (July 3, 1996); Business Review Letter to Christopher B. Hockett, Esq. re Automobile Transport Fleet Affiliation (April 19, 1994); Business Review Letter to Robert D. Paul, Esq. re PRIMESOURCE (Jan. 29, 1993); Business Review Letter to the Beverage Importers' Freight Ass'n (Aug. 24, 1989); Business Review Letter to FRA Shippers' Ass'n (June 17, 1988); Business Review Letter to Columbian River Shippers' Ass'n (March 30, 1988); Business Review Letter to the North American Shippers' Ass'n (March 16, 1988); Business Review Letter to North Texas Regional Clearing House Ass'n (Sept. 23, 1987); Business Review Letter to American Furniture Manufacturers Ass'n (July 7, 1987); Business Review Letter to Independent Drug Wholesalers Group (May 18, 1987); Business Review Letter to New World Shippers Ass'n (Aug. 26, 1985); Business Review Letter to American Institute for Shippers' Associations (Feb. 12, 1985); and Business Review Letter to Transportation Brokers Conf. of America (Feb. 8, 1985).

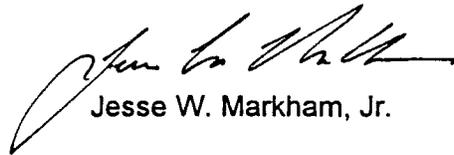
¹⁵ Aggregate revenues for the group in the most recent fiscal year of each member equaled \$1.525 billion, and aggregate electricity purchases for the same periods amounted to \$77.2 million, or 5% of revenues -- well below the 20% threshold.

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and is anxious to conclude contracts with electric power suppliers as soon as possible. Delays in implementing joint purchasing will be costly. Proposed rules by the CPUC would impose a prior notice period before industrial customers could enter into direct access contracts, which would impose an additional one-month delay once a final decision is made to proceed with joint purchasing. Also, opportunities for large blocks of power to be purchased on favorable terms are currently available but may become limited for periods of time as the marketplace adjusts, and so time is very much of the essence. We therefore would appreciate your response at the earliest possible date. We of course are available to you and your staff if you require any assistance or additional information as you evaluate this proposal.

Thank you for your consideration of our request.

Sincerely,



Jesse W. Markham, Jr.

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