Exelon. PSEG

July 24, 2006

Dr. Joseph E. Bowring
PJM Interconnection, L.L.C.
Market Monitoring Unit
Valley Forge Corporate Center
955 Jefferson Avenue
Norristown, PA 19403

Re: **Potential New Jersey Settlement Competition-Improvement Measures** (NJ BPU Docket No. EM5020106, In the Matter of the Joint Petition of Public Service Electric and Gas Company and Exelon Corporation for a Change in Control of Public Service Electric and Gas Company and Related Authorizations)

Dear Dr. Bowring:

This letter invokes your advice in facilitating settlement in the proceedings before the New Jersey Board of Public Utilities ("NJBPU") regarding the Exelon-PSEG merger. Recently, we have discussed with you certain additional competition improvement mechanisms administered by the PJM Market Monitoring Unit ("MMU") that could obviate any remaining competition issues in the BPU proceedings, particularly in light of the consent decree required by the Antitrust Division of the United States Department of Justice ("DOJ"). On July 20, 2006 your office issued a report providing the results of additional sensitivity analyses performed by the MMU at the request of the Staff of the New Jersey Board of Public Utilities. Specifically, the NJBPU Staff requested the MMU to perform HHI calculations analyzing the effect of the divestitures required in the DOJ consent decree in the aggregate energy market, the locational energy market defined by transmission constraints at the PJM-East interface, and PJM capacity markets, and to do so using potential buyer scenarios and other assumptions specified by the NJBPU Staff. Based on these assumptions, the sensitivity analysis identifies certain HHI screen failures in these markets applying the screening criteria set forth in the DOJ Merger Guidelines.

However, the DOJ itself studied the merger comprehensively and concluded that at the divestitures required by the DOJ decree resolve all the competition issues potentially raised by the merger. As stated in DOJ's press release, the required divestitures will preserve competition and will ensure that consumers continue to receive the benefits of competitive markets after the merger. DOJ based this conclusion on an in depth 15 month investigation, encompassing millions of documents and reams of data and information not available to FERC, the BPU, or the MMU.

Petitioners do not believe that the results of the July 20 Sensitivity Report are indicative of the actual impact the DOJ-specified divestiture will have on competition in PJM. The DOJ's HHI thresholds are designed to serve as a beginning point to the analysis, not as the end,[1] and the exhaustive, in depth review of the merger performed by DOJ assures that the DOJ-required mitigation fully resolves any adverse impact that the merger might create on competition.

Petitioners recognize the NJBPU's desire to ensure that competition will be robust after the merger and will be untrammeled by merger-related market power. Petitioners also recognize, however, that it would serve no one's interest to engage in still further proceedings to debate the nuances of the July 20, 2006 sensitivities, which would delay realization of the merger's benefits and create a state of limbo that would adversely affect both companies and their employees.

Thus, to facilitate achievement of these NJBPU's goals and to resolve this proceeding so there is no further delay of merger benefits, Petitioners are willing to consider additional mitigation measures that would obviate and resolve any questions in each of the markets covered in the July 20, 2006 sensitivity analysis. Based on recent discussions with you, these measures consist of bid caps, administered by PJM and the MMU, which would preclude Petitioners from bidding non-competitive prices in each of these markets. Petitioners have previously discussed the possibility of such measures with you and, believe, based on those discussions, that these additional mitigation commitments would remove any potential competitive concerns raised by the merger. With these measures in place there can be no doubt that consumers will benefit from the lower prices resulting from the merger's nuclear synergies, competition will be preserved through the DOJ divestitures, and, as demonstrated below, there will be a greater level of protection against the exercise of market power than exists today.

Accordingly, Petitioners respectfully request that you or your office confirm that, with the following potential mitigation commitments, you agree that the combination of the DOJ-required divestitures, with the additional remedies discussed below, will satisfactorily mitigate any market power issues associated with the combination of Exelon's and PSEG's generating assets.

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[1] The Merger Guidelines warn that: "[h]owever, market share and concentration data provide only the starting point for analyzing the competitive impact of a merger." Department of Justice/Federal Trade Commission Horizontal Merger Guidelines at § 2.0. The DOJ remedy policy guidelines moreover state that the goal of a merger remedy should not be narrowly to remove HHI screen failures, but rather should be tailored to address the market power issue at hand. Antitrust Division Policy Guide to Merger Remedies 3-5 (Oct. 2004).

Nuclear Energy Bid Caps:

Commitment: The merged company ("Exelon Electric and Gas" or "EEG") will bid each of its nuclear generating units located in PJM East into the PJM day-ahead and daily energy markets at a price no higher than each unit's marginal cost.

Competitive Improvement: This commitment removes any concern that EEG could use Exelon's acquisition of PSEG's nuclear units in PJM East to bid up prices in the energy market. Instead, it would require each of EEG's nuclear units in PJM East to bid no higher than its costs. No such limitation applies today, so this would provide a level of market power protection that now does not exist.

PJM East Constraint Relief

Commitment: EEG will give the PJM MMU the authority to impose cost-based bid caps upon the Essex plant owned by EEG at any time that the PJM East interface is constrained.

Competitive Improvement: When the PJM East interface is constrained, PJM typically turns to peaking units in PJM East to run to relieve the constraint. Petitioners understand that this occurs in only a relatively small number of hours. Today, PJM does not have the authority to cap the bids of specific, individual units that must be run when the PJM East interface is constrained. Thus, peaking units are paid their bid price when run for this purpose, and theoretically might be able to bid above competitive prices. Petitioners believe that the DOJ divestitures make this market structurally competitive. Nonetheless, in order to achieve a settlement, Petitioners are willing to accept additional competitive enhancements that will ensure competitively priced results.

PSEG's Essex plant is not among those required to be divested by DOJ. You have informed us that the Essex plant can provide sufficient constraint relief such that if PSEG were to relinquish control over bids of the plant at times when the eastern interface binds, it would reduce the HHIs to a level that eliminates all screen failures. By giving PJM the authority to cap the bids of the Essex plant when PJM East is constrained, EEG clearly will have no ability to exercise market power at such times. Giving this control to PJM, coupled with the DOJ divestitures, would improve competitive conditions and make this market less susceptible to market power than before the merger.

PJM East Locational Capacity Market Bid Caps

Commitment: Upon implementation of the Reliability Pricing Model ("RPM") currently pending before FERC, or another locational capacity market regime, EEG will bid each of its generating units located in PJM East into the capacity market at the unit's avoidable cost as determined by the PJM MMU.[2]

Competitive Improvement: It is expected that PJM will move to locational capacity markets in the relatively near future. There has been some concern expressed that EEG could have some residual market power even after the DOJ divestitures if in such a locational regime there is a separate PJM East capacity market. This bid cap mechanism will ensure that EEG has absolutely no ability to bid up prices in any locational PJM capacity market because EEG will be strictly limited to bidding its units at their costs. Moreover, neither Exelon nor PSEG has made such a bid cap commitment absent the merger. Hence, this mechanism provides greater protection against market power in locational capacity markets than exists today.

Current Capacity Market Bid Caps

Commitment: As long as the current PJM-wide generating capacity market is in effect, EEG will bid all of its excess generating capacity (its so-called "net long capacity position") into the daily PJM capacity market at a price of zero.

Competitive Improvement: This commitment (which unlike the others described above was made to and accepted by FERC) will ensure that EEG has no ability to exercise market power in the PJM capacity market in the interim before locational capacity markets are implemented. The reason is that EEG will be compelled to accept any price the market sets in the daily market for all of the capacity that is excess to its own load needs or that it has not previously sold. EEG therefore will have no ability to impose above-competitive prices. Prospective buyers can always force it to sell any excess at the market price set by others.

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Please confirm as soon as possible that these mechanisms will mitigate any otherwise arguably unmitigated market power in the aggregate energy, PJM East, and PJM capacity markets.

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[2] EEG will also offer any of its capacity that is not selected in the locational market to PJM for reliability-must-run ("RMR") service, and will not sell any capacity it owns in PJM East outside of PJM without first obtaining prior clearance from the PJM Market Monitoring Unit to do so.

We recognize the significant time and effort that you personally and the PJM Market Monitoring Unit as an office have devoted to the analysis of this merger, and we once again express our thanks for your attention in this important matter. Should you have any questions or require any clarification of our request in this letter, please do not hesitate to contact us.

Thank you for your continued consideration.

Sincerely,

R. Edwin Selover

R. Edwin Selover
Senior Vice President and General Counsel
Public Service Enterprises Group, Inc.

Elizabeth A. Moler

Elizabeth A. Moler
Executive Vice President
Exelon Corporation