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December 21, 2006

Mr. B. Michael Verne
Premerger Notification Office
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Re: Advice Received on December 19, 2006

Dear Michael:

I am writing to confirm the advice I received from you during our discussion Tuesday afternoon, December 19, 2006. I summarize below the facts and analysis that we discussed.

Facts

My client, Company W, is a regulated electric utility company that is proposing to purchase an 8% undivided interest in a coal-based generation facility, a facility in which it already owns an 84% undivided interest, from Company A. Many years ago Company A entered into a sale-leaseback arrangement involving the bulk of its 8% undivided interest in the facility. As a result, Company A now leases this portion of the facility from the "owner trustee," a trust company, and thereby derives the right to 8% of the power generated by the facility. The lease expires in 2019. Under the proposed transaction, Company W would assume the lease and be obligated to make all payments required under the lease. In addition to the lease assumption, Company W is paying Company A approximately $20 million (subject to adjustment) for leasehold improvements and related assets, at cost, that are part of the 8% undivided interest but not covered under the lease. Company W is not paying any additional consideration for the assignment.

As a condition of closing, Company W must enter into a power purchase (supply) agreement with Company M. Company M, an unrelated third party, is purchasing other electric utility assets from Company A. Historically, the power to which Company A is entitled pursuant to the 8% leasehold interest has been used to meet the needs of the business that Company M is now purchasing from Company A. The power purchase agreement that is a condition to the closing of this transaction requires that Company W sell 100% of the power to which it is entitled pursuant to the 8% leasehold interest (that is being assigned from Company A) to Company M at cost for the balance of the term of the lease. As we discussed, the lease payments Company W is assuming could be considered far below market value; however, Company W receives no benefit from this arrangement because (a) it must sell the power generated by the leasehold interest at cost-based rates to Company M under the power purchase arrangement and (b) aside from the power purchase agreement, any benefit inuring to Company W from selling that power at higher prices must be credited back to its ratepayers because it is a regulated utility. As an analogy, it is as if Company W is assuming a lease on a rent-controlled building where the lease payments are low, but because there is a restriction against sub-leasing it for higher prices, there is no ability to benefit from the low rent-controlled prices. Consequently, Company W would never have assumed the lease with higher lease payments reflecting what a party could sell the power generated by the leasehold for at market rates because of its inability to sell the power generated by the leasehold interest at above cost.

Likewise, the prices Company W is obligated to charge Company M for the power under the supply agreement could be considered far below market value. As a regulated entity, however, the prices Company W charges Company A for power under the power purchase agreement must be based on "cost-of-service". Moreover, aside from the power supply agreement, any additional revenue Company W would gain from charging higher prices must be credited back to Company W's ratepayers. Thus, Company W would never enter into a supply agreement charging higher prices in these circumstances.

Finally, for accounting purposes, Company W believes that Company A maintains the lease as an operating lease, as opposed to a capital lease, which would be considered an "asset." Company W intends to treat the lease as an operating lease for accounting purposes.

Analysis

Pursuant to the facts outlined above, you advised me that my client would not have a reporting obligation. There were two stages to the analysis. First, you agreed that the assignment of the lease should be treated as such rather than the sale of an asset. In other words, you agreed that Company A, although it is a lessee under a previous sale-leaseback transaction, does not have beneficial ownership of an asset that it is now selling to Company W. As such, Company W is not purchasing an asset when it assumes the lease from Company A.

Second, you agreed that the fair market value of the assignment is zero. As I understand it, the Premerger Notification Office takes the position that as long as there is no consideration paid to the assignor, and the lease payments are at market rates, the acquisition price for the leasehold interest is zero. *See* Premerger Notification Practice Manual (3rd ed. ABA) at Interpretations 28 and 104. As we discussed, my client considers the lease payments to be equivalent to market rates because, as a regulated utility, it cannot charge above a certain amount for its power. Should it do so, any additional revenue it derives must be credited back its ratepayers. Moreover, as discussed above, as a condition of the transaction, Company W must sell the power generated by this leasehold interest to Company M, essentially at cost. Thus, while the lease payments would be considered below market (and therefore the leasehold interest would have a positive value) for a hypothetical company that is neither regulated nor subject to a supply agreement, that is not the case for my client. You agreed that my client's fair market value determination should be conducted considering the value of the lease to it. Because my client would not make leasehold payments in amounts greater than the current obligations under the lease, given its regulated nature and obligations under the supply agreement, the acquisition price and fair market value for the leasehold interest is zero.

Because the acquisition of other assets amounts to approximately $20 million dollars, you agreed that the transaction as outlined above would not be subject to the notification and reporting obligations under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the regulations promulgated thereunder.

If I have misstated the advice you gave to me or if you believe that the analysis above is in any way incorrect, please let me know at your earliest convenience.

Very truly yours,

[redacted]

Agree -
12/21/06