

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Modifications to Commission Requirements for
Review of Transactions under Section 203 of the
Federal Power Act and Market-Based Rate
Applications under Section 205 of the Federal
Power Act

Docket No. RM16-21-000

**COMMENTS OF THE
AMERICAN ANTITRUST INSTITUTE**

The Federal Energy Regulatory Commission ("FERC" or "the Commission") seeks comment on revising its current approach to identifying and assessing market power in its Notice of Inquiry (NOI) in Docket RM16-21-000: *Modifications to Commission Requirements for Review of Transactions under Section 203 of the Federal Power Act and Market-Based Rate Applications under Section 205 of the Federal Power Act*.¹ The Commission's questions arise in the context of transactions subject to (1) section 203 of the Federal Power Act (FPA) and (2) applications for market-based rate (MBR) authority for electric energy, capacity and ancillary services under section 205 of the FPA.

I. Interest of the American Antitrust Institute

The American Antitrust Institute (AAI) appreciates the opportunity to respond to the Commission's NOI. The AAI applauds the Commission's efforts to periodically reassess its policy and technical approaches to implementing its important review of competition matters involving mergers and grants of MBR authority. The AAI is an independent,

¹ Modifications to Commission Requirements for Review of Transactions Under Section 203 of the Federal Power Act and Market-Based Rate Applications Under Section 205 of the Federal Power Act, 81 Fed. Reg. 66,649 (Sept. 28, 2016), 156 FERC ¶ 21,214 (2016).

nonprofit organization devoted to promoting competition that protects consumers, businesses, and society. We serve the public through education, research, and advocacy on the benefits of competition and the use of antitrust enforcement as a vital component of national and international competition policy.²

The AAI has provided legal and economic analysis on mergers, market conduct issues, and competition policy involving the energy industries since its founding in 1998. AAI has long been involved in competition policy and regulatory issues in the electric power industry, including sponsoring an annual Energy Roundtable for experts in government, academia, and the private sector.

II. Communications

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III. Questions Raised by the Commission's Notice of Inquiry

The NOI poses a number of questions and issues relating to the Commission's approach to performing competitive analysis in Section 203 and Section 205 MBR applications. The NOI asks whether the Commission should make additions or modifications to its 203 analysis. These potential changes involve important issues. One is the type of analysis that would aid the Commission in determining if a merger or grant of MBR authority raises competitive concerns or would enhance the ability and/or incentive of

² For more information, please see www.antitrustinstitute.org.

an applicant to exercise market power unilaterally or in coordination with rivals. The analyses generally under consideration in the NOI include HHI, supply curve, 2ab, market share, and pivotal supplier tests. The NOI addresses the appropriateness of capacity calculations for market shares that are the basis for the foregoing tests. The Commission also asks whether applicants should be required to provide additional documents with their filings, particularly those that support their analyses in antitrust reviews at the U.S. Department of Justice (DOJ) and Federal Trade Commission (FTC). Finally, the NOI asks about safe harbors for transactions that are unlikely to raise market power concerns, as well as revisiting blanket authorizations.

IV. Growing Concerns Over Competition in the Economy and Energy Industries

The Commission's NOI comes at an important time. Concerns over growing concentration in key U.S. industries are very much on the public interest and political agenda. For example, the White House expressed concern about declining competition in an April 2016 Executive Order: *Steps to Increase Competition and Better Inform Consumers and Workers to Support Continued Growth of the American Economy*.³ In the Executive Order, the President highlighted the harmful effects of declining competition on economic growth, opportunities for labor, and national priorities in healthcare, energy, and telecommunications. A Council of Economic Advisors report that accompanied the Executive Order identifies three indicators of declining competition: increasing concentration, increasing rents accruing to few firms, and lower levels of firm entry and labor market mobility.⁴

Moreover, there are growing examples of the damaging effects on consumers of the

³ Exec. Order No. 13725, 81 Fed. Reg. 23,417 (Apr. 15, 2016).

⁴ Council of Economic Advisors, *Benefits of Competition and Indicators of Market Power*, THE WHITE HOUSE at 4 (Apr. 2016), https://www.whitehouse.gov/sites/default/files/page/files/20160414_cea_competition_issue_brief.pdf.

exercise of market power in wholesale electricity markets.⁵ In the last two years, concerns have arisen over strategic withholding in capacity markets in Regional Transmission Organizations. For example, in a July 2014 letter to the DOJ and the FTC, the AAI stressed the importance of using both antitrust and regulatory tools for addressing market power concerns in wholesale electricity markets:

Organized wholesale electricity markets handle much of the nation's wholesale electricity supply and affect millions of U.S. consumers. These markets can deliver the benefits of competition to consumers, but only if they are properly structured and managed. This is in large part because wholesale electricity markets are conducive to the exercise of market power by market participants – acting alone or in coordination with others. Over the past several months, there have been two alleged incidents of strategic capacity withholding for the purpose of driving up wholesale electricity prices. One involved the private equity firm Energy Capital Partners (ECP) in ISO New England (ISO-NE) and the other involved Exelon Corporation in the PJM Interconnection (PJM). Such conduct can be particularly damaging to buyers of wholesale electricity and ultimately retail consumers, who pay supra-competitive prices for an essential service.⁶

In the following comments, the AAI will address the broader implications of the queries set forth in the NOI. Namely, the NOI is an important opportunity for the Commission to "debalkanize" and conform competitive analysis across two critical areas of jurisdiction (mergers and MBRs) that have important implications for competition in electric wholesale power markets. Such changes would provide more full and complete information for the Commission's determination of competitive effects, reduce the risk that certain types of competitive concerns will be underestimated or overlooked entirely, and provide a clear

⁵ See, e.g., Paul L. Joskow & Edward Kahn, *A Quantitative Analysis of Pricing Behavior in California's Wholesale Electricity Market During Summer 2000*, ENERGY J. (No. 4, 2002); Frank A. Wolak, *Measuring Unilateral Market Power in Wholesale Electricity Markets: The California Market, 1998-2000*, 84 AM. ECON. REV.: PAPERS AND PROC. OF THE ONE HUNDRED FIFTEENTH ANN. MEETING OF THE AM. ECON. ASS'N. 425 (2003); John Kwoka & Vladlena Sabodash, *Price Spikes in Energy Markets: "Business by Usual Methods" or Strategic Withholding?* 38 REV. IND. ORGAN. 285 (2011). For further discussion and a summary of the economic literature on withholding, see Diana L. Moss, *Electricity and Market Power: Current Issues for Restructuring Markets (A Survey)*, 1 ENVTL. & ENERGY L. & POL'Y J. 11 (2006).

⁶ Letter from AAI to Assistant Attorney General William Baer and Chairwoman Edith Ramirez re: Antitrust Tools for Challenging Capacity Withholding in Wholesale Electricity Markets (July 22, 2014), available at http://antitrustinstitute.org/sites/default/files/AAI%20on%20Capacity%20Withholding_final.pdf.

approach for applicants seeking a determination from the Commission.

V. Section 203 and Section 205 MBR Applications Raise the Same Competitive Issues and Should Therefore Utilize the Same Analysis

The Commission's analyses of competitive issues in Section 203 and 205 MBR applications have evolved along very different historical paths. As a result, the Commission's approaches to evaluating competitive concerns in these contexts have diverged somewhat. However, the concerns regarding the potential for a merger or grant of MBR authority to adversely affect competition and consumers (i.e., ratepayers) are fundamentally the same. Competition analysis focuses on two types of concerns – the unilateral and coordinated exercise of market power – both of which can arise on the seller and the buyer sides of a market.⁷ It is important to note that a powerful wholesale seller with MBR authority is, in theory, capable of exercising market power unilaterally, *and* in coordination with rivals (who also have MBR authority) in markets that are not conducive to competitive outcomes.

As it stands, the Commission's approach to MBR requests focuses largely on the potential for the unilateral exercise of market power. But in concentrated wholesale markets defined according to geographic and time-differentiated product dimensions, there is a real risk that a small group of sellers with MBR authority could engage in coordinated conduct. This includes restricting capacity, fixing prices, or otherwise tacitly agreeing to market practices or "rules" that restrain competition. And the same is true of mergers. As a result of these similarities in competitive concerns, the AAI encourages the Commission to consider requiring the same type of competition analysis in both types of applications.

⁷ The emergence of powerful buyers in many industries, including energy and electricity, has significantly raised the profile of buyer market power issues.

VI. The Commission Should Work to Conform Its Competitive Analysis Across 203 and 205 MBR Applications

In its Merger Policy Statement,⁸ the Commission correctly recognizes the importance of the approach taken by the DOJ/FTC Horizontal Merger Guidelines (Guidelines) in assessing whether transactions raise competitive concerns.⁹ The 2010 revisions to the GUIDELINES set forth various types of evidence and analysis that aid in determining if a merger is likely to substantially lessen competition. Among the different types of evidence that are most relevant for the Commission's inquiries in merger and MBR applications are market concentration (i.e., HHI) analysis and competitive effects analysis.¹⁰ But these complementary analyses can provide important information in determining how a merger and a grant of MBR authority can potentially affect competition.

The AAI encourages the Commission to consider how the various tests described in the NOI fit into the types of analysis described above. HHI analysis, as it is currently used in Section 203 applications, essentially screens for transactions that are likely to raise competitive concerns. This is an important source of evidence in assessing a merger's effect on competition. For example, mergers in highly concentrated markets are presumed likely to enhance market power. It is important to note that the Commission's market share test, 2ab, and pivotal supplier tests are also tools for determining whether a merger or grant of MBR authority raise competitive concerns. In contrast, the supply curve analysis provides insight into competitive effects, or how a merger or grant of MBR authority could enhance the ability and/or incentive for an applicant to exercise market power.

⁸ *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*. Order No. 592, FERC Stats. & Regs. ¶ 31,044 at 27 (1996) (1996 Merger Policy Statement).

⁹ U.S. Department of Justice/Federal Trade Commission, *Horizontal Merger Guidelines (2010)*, available at <https://www.justice.gov/atr/file/810276/download>.

¹⁰ Other types of evidence considered by the DOJ and FTC that is potentially relevant to FERC's analysis is direct evidence such as actual effects observed in previous mergers (e.g., post-merger price increases) or natural experiments related to entry, expansion, or merger in the same markets or similar markets.

The AAI encourages the Commission to maintain a focus on both types of analysis. Moreover, we encourage the Commission to adopt and utilize these approaches uniformly in both merger and MBR applications. For example, HHI analysis serves to identify markets that are conducive to anticompetitive outcomes, either as a result of unilateral or coordinated conduct. Changes in market concentration, as well as post-merger levels of concentration, are the focus in merger reviews. But MBR applications would also significantly benefit from concentration analysis, even there is no change in the structure of a market, as there would be in a merger.

Likewise, supply curve analysis provides insight into how a merged market participant, or a market participant with MBR authority, could strategically exercise market power by strategically withholding capacity. The supply curve analysis assessment of marginal and inframarginal capacity makes the important connection to whether the applicant (1) controls the economic resources to raise the clearing price and (2) would profit from such a strategy. It is useful for both merger and MBR applications and for assessing both unilateral and coordinated effects. The AAI therefore encourages the Commission to consider conforming their approach to assessing competition concerns in both types of applications.

VII. The Commission Should Consider Eliminating Multiple Tests That Can Create Inconsistency and Conflicts

The NOI asks whether the Commission should utilize additional or different tests in merger and MBR analysis. The AAI strongly encourages the Commission to avoid the use of multiple tests for determining whether a merger or grant of MBR authority is likely to raise competitive concerns. As noted above, the HHI, market share, 2ab, and pivotal supplier tests all capture some aspect of market structure. Any market-share based test provides an estimate of an applicant's presence in the market in relation to other market participants.

This is important information in evaluating the potential unilateral exercise of market power. Market concentration metrics provide important, additional information on whether the market is conducive to coordinated conduct among rivals.

However, in using multiple tests – the market share, 2ab, and pivotal supplier tests, in particular – the Commission runs the risk of obtaining different answers to essentially the same question. These tests may not obtain the same directional result or corroborate the results of other, similar tests. This forces the Commission to compare and contrast, justify, and implicitly weight the value of various tests in its determinations. This potential conflict raises a number of serious concerns. It increases the risk of applicants "gaming" multiple tests to most favorably present their applications. More important, it makes it more difficult for the Commission to reach determinations and defend them in court, and to provide transparency and clarity to applicants in Section 203 and Section 205 MBR applications.

In light of these concerns, the AAI suggests that the Commission consider relying primarily on a generally accepted, robust test to make determinations about competitive effects in both merger and MBR requests. That test should provide clear information on potential unilateral and coordinated effects. Market concentration analysis incorporates both of these elements in identifying competitive concerns. Supply curve analysis provides additional, important information on the likely competitive effects of a merger or grant of MBR authority.

VIII. Conforming Section 203 and 205 MBR Analysis Will Filter Out Transactions that are Unlikely to Raise Competitive Concerns

A conformed analysis of competition issues raised in merger and MBR applications has many benefits. In addition to those described above, such analysis minimizes or eliminates the need to create safe harbors such as *de minimis* thresholds and blanket authorizations based on potentially inaccurate or arbitrary criteria. These types of special

circumstances pose a potentially large risk of error. Those errors, of course, are revealed in harm to competition and consumers caused by exempted or safe harbor transactions and authorities that created anticompetitive opportunities.

A uniform approach to competition analysis provides the Commission with both a reliable and durable way to identify competitive concerns (concentration analysis) as well as a "story" of how market power could be exercised (supply curve analysis). Applied consistently and correctly, such an approach will quickly weed out transactions that do not raise competitive issues. At the same time, it gives the Commission the ability and tools to fully consider the effects of transactions such as those involving partial ownership of generation and/or transmission facilities. It also avoids the problem of exempting transactions under blanket authorizations that are part of a firm's broader successive (i.e., serial) acquisition strategy that raise potentially serious competition concerns.

IX. The Commission Should Conform Its Approach to Market Definition and Capacity Measures Across Section 203 and Section 205 MBR Applications

Defining relevant geographic and product markets is a key component of competition analysis, whether performed by regulators or antitrust enforcers. Likewise, measuring the presence (i.e., market shares) of market participants in relevant markets is critically important. Both of these issues raise special concerns in electricity and have evolved over time as markets have changed and analysis has become more sophisticated. While the NOI does not raise significant issues relating to market definition and the use of capacity measures to assess market shares, the AAI suggests that the Commission consider them nonetheless. Namely, if the Commission is deciding which tests to employ in its competition analysis for merger and MBR applications, it is equally important to consider the inputs to and assumptions upon which those tests rely.

For example, electricity markets are well known to exhibit distinct, time-

differentiated demand conditions, as well as geographic dimensions that are defined by transmission constraints, production cost differentials, and energy losses. Moreover, electricity cannot be stored, there is significant potential for price volatility, and there are different distributions of capacity ownership in electricity markets. As a result, a market participant's incentive and ability to exercise market power can change depending on market conditions. The Commission should establish consistent parameters for the types of products it will consider in assessing competitive effects of mergers and MBR requests across capacity, energy, and ancillary services markets. These parameters should recognize conditions that are the most relevant to creating opportunities for anticompetitive outcomes and should be used consistently across both merger and MBR analyses.

Moreover, the types of capacity used in calculating market participation in these markets should be updated to reflect the current realities of wholesale markets. Measures ranging from installed capacity, economic capacity, available economic capacity, and uncommitted capacity were developed largely to create distinctions between wholesale and retail markets, including native load and contractual wholesale commitments (e.g., power purchase agreements). However, among other developments, the complexity of physical and financial electricity products has increased over time, as has the sophistication of market design and rules. For example, withholding strategies and anticompetitive agreements may be possible to implement through complex physical and financial product schemes that bear no resemblance to the types of products that are currently considered in the Commission's competition analysis.

In light of this, the Commission may want to consider revisiting whether the current capacity measures can skew or mask competitive concerns in markets. The AAI suggests that measures of a market participant's capacity relate directly to its ability to exercise physical

and economic control over generation or transmission facilities. The AAI also suggests that the Commission avoid *a priori* adjustments to capacity. Applicants should be free to make the case that they face material constraints on their ability to exercise market power that relate specifically to retail/wholesale load distinctions or contractual commitments. But that case should be made *after* their quantitative analyses of the effect of a merger or MBR request on competition.

X. Requiring Applicants to Submit Analyses Provided to the Antitrust Agencies Will Go a Long Way to Improving Coordination Between FERC and the DOJ and FTC

Very few sector regulators work in close coordination with the DOJ or FTC in reviewing mergers that are subject to both antitrust and regulatory review. The DOJ's coordination with the Federal Communications Commission is one notable exception. Ideally, dual review of competition matters should create complementarities between regulatory agencies and antitrust agencies. The former hold significant technical and institutional industry expertise, while the latter possess a broad range of experience in identifying competitive problems and crafting remedies.

Because the FERC does not routinely coordinate with the antitrust agencies in its review process, any steps that would enhance the Commission's ability to assess competition issues would be beneficial. As a result, the AAI strongly endorses the Commission suggestion in the NOI that merger applicants be required to submit analyses also submitted to the DOJ or FTC. Not only will this promote more consistent outcomes across the agencies and more clarity and transparency to applicants, access to such analysis will enable the Commission to corroborate or dispute the results of its own required analyses.