

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

Refinements to Policies and Procedures for Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities)	Docket No. RM14-14-000
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**COMMENTS OF THE
AMERICAN ANTITRUST INSTITUTE**

I. Introduction

The American Antitrust Institute (“AAI”)¹ submits these comments in the Federal Energy Regulatory Commission’s Notice of Proposed Rulemaking (NOPR) in Docket No. RM14-14-000, issued June 19, 2014: *Refinements to Policies and Procedures for Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*.² AAI’s comments address the implications of the proposed changes in the Commission’s policies and procedures governing market-based rate authority for competition in wholesale electricity markets. The AAI believes that many of the Commission’s proposals are timely and justified by experience to date with wholesale electricity markets. However, the AAI urges the Commission to reconsider a number of proposals based on evidence from the operation of wholesale markets and likely future changes that will affect competition.

The AAI is an independent Washington D.C.-based non-profit education, research, and advocacy organization. Its mission is to advance the role of competition in the economy, protect consumers, and sustain the vitality of the antitrust laws. The AAI has offered legal and economic

¹ For more information, please see <http://www.antitrustinstitute.org>.

² Refinements to Policies and Procedures for Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities, 79 Fed. Reg. 43,536, 43,539 (proposed July 25, 2014) (to be codified at 18 C.F.R. pt. 35) (hereafter “FERC NOPR”), at PPs. 11, 36, and 39.

analysis and opinion on mergers, antitrust issues, and competition policy involving the energy industries. 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. Exempting Sellers in RTOs From Market Power Analysis Would Eliminate One of the Commission’s Most Effective Tools in Overseeing Competition in Wholesale Electricity Markets

The Commission proposes to permit sellers in Regional Transmission Organizations (RTOs) to address horizontal market power issues in a “streamlined” manner. Instead of submitting screen analysis to address horizontal market power effects, the Commission proposes instead that RTO sellers “simply state that they are relying on Commission-approved market monitoring and mitigation to address any potential market power they might have.”³ Filings would be limited to an asset appendix and description of an applicant’s generation and transmission assets. Moreover, under the Commission’s proposal, even if a seller has market power, such a seller would not need to submit indicative screens with a change in filing status.⁴ The Commission reasons that this approach would essentially codify current *practice* regarding sellers seeking market-based rate authority within RTOs. A move from practice to codified policy is a large step, and could impair the Commission’s ability to carry out its statutory responsibility by eliminating an important enforcement tool.

The AAI respectfully submits that the implications of the Commission’s proposal – regardless of whether it is *de facto* policy for sellers in RTOs – could have serious implications for competition in wholesale electricity markets. These markets handle over 50 percent of the

³ FERC NOPR, at PP. 36.

⁴ FERC NOPR, at PP. 39.

megawatt-hours generated in the United States. The Commission’s proposal to exempt sellers in RTOs from *ex ante* market power analysis rests on a simple declaration that the seller seeking market-based rate authority is subject to monitoring and mitigation. This is an attractive deal for generators, many of which possess market power, have exercised market power, and who will now enjoy market-based rates as a right, not a privilege. But it is likely to be a losing proposition for competition and consumers, and for the Commission in performing vital oversight of competition in the nation’s wholesale electricity markets.

A. The Proposal Trades *Ex Ante* Prevention For *Ex Post* Detection

The proposal would relinquish perhaps the most important tool the Commission has to *prevent* abusive conduct before it occurs – namely the ability to deny market-based rate authority based on an *ex ante* showing that a generator possesses market power. As sector regulator, the Commission is in a unique position to use its authority to grant or deny market-based rates to prevent sellers with market power from exercising it. This powerful tool would be exchanged for a system that relies entirely on the detection and mitigation of market power. A shift in regulatory enforcement focus from “prevention” of bad conduct to “policing” of bad conduct would give rise to perverse incentives. For example, knowing that FERC will no longer use its regulatory “stick” of denying market-based rate authority, generators will have stronger incentives to find ways to work around or game monitoring and mitigation regimes. This is arguably an inefficient use of public resources, as opposed to the prevention-oriented approach of granting or withholding market-based rate authority based on the findings of market power analyses.

B. The Proposal Further Removes the Commission From Oversight of Wholesale Electricity Markets

The NOPR’s proposal would further remove the Commission from oversight of the numerous and difficult competitive issues that arise in wholesale power markets. The Commission has largely outsourced the oversight of monitoring and mitigation to independent market monitors and the RTOs. In other words, the Commission is already one layer removed from the workings of wholesale markets. Providing easier, streamlined, and burdenless market-based rate authority procedures for powerful generators would seem to compound the Commission’s already significant distance from this crucial area of oversight.

This problem is exacerbated by the fact that there are two external monitors of RTO markets. The lack of competition in the “market” for market monitoring raises standard questions about whether there are sufficient competitive pressures and incentives for the incumbent firms to continue to innovate and improve their products and services. If the Commission is to depend in part on the reports and results of external monitors under its proposal to revise market-based rate policies, then at a minimum it should take steps to encourage entry and competition in the “market” for market monitoring.

C. The Proposal Would Place Additional Burden on Market Monitoring and Mitigation to Police the Exercise of Market Power

Reliance on market monitoring and mitigation as a “pass” for obtaining market-based rate authority is only as good as the monitoring and mitigation that underlies it. Much has been written on defining, identifying, detecting, and mitigating the exercise of market power in wholesale electricity markets and how the design of those markets eases or facilitates the exercise of market power. These issues were valid when monitoring and mitigation regimes for RTO markets were first being developed. They remain valid today, particularly in light of several

incidents involving the exercise of market power that were in fact *not* detected or mitigated. These events often revolve around capacity withholding, as part of unilateral or collusive schemes. Indeed, concerns over capacity withholding are only increasing, recently prompting the AAI to submit an analysis of antitrust and regulatory tools for addressing withholding to the U.S. Department of Justice (DOJ) and Federal Trade Commission.⁵

We need look no further than the Commission's own deliberations on the effectiveness of market monitoring and mitigation involving capacity withholding. One market participant recently withheld a significant amount of capacity from the New England ISO's 8th forward capacity auction, driving up prices to supra-competitive levels. Recent issuances in the FERC docket opened to investigate this incident (ER14-1409) illustrate the dissension regarding the ability of existing monitoring and mitigation regimes to adequately police the exercise of market power. Commissioners Clark and Bay wrote:

The ISO-New England's (ISO-NE) forward capacity market (FCM) is unique in that the auction results are subject to Commission review under the just and reasonable standard. This review process was part of a carefully negotiated settlement meant to allay stakeholder concerns over the market's design. Here, there is evidence suggesting the exercise of market power, and it is uncontroverted that the market power, if it existed, was not mitigated.⁶

The NOPR proposal would short circuit the important debate that has taken hold in ER14-1409.

Another example of the dangers of relying unduly on market monitoring and mitigation to police the exercise of market power is the physical-financial "swap" agreement between KeySpan and Morgan Stanley that was the subject of both antitrust and regulatory scrutiny in the

⁵ Letter from the American Antitrust Institute to U.S. Department of Justice Assistant Attorney General William J. Baer and Federal Trade Commission Chairwoman Edith Ramirez re: Antitrust Tools for Challenging Capacity Withholding in Wholesale Electricity Markets, July 22, 2014, *available at* <http://www.antitrustinstitute.org/content/aai-encourages-antitrust-enforcers-challenge-capacity-withholding-wholesale-electricity>.

⁶ Joint Statement by Commissioner Tony Clark and Commissioner Norman Bay, Federal Energy Regulatory Commission, ISO New England, Inc., Docket No. ER14-1409, September 16, 2014.

late 2000s. The agreement employed a scheme to hedge revenue risks from competitive bidding and entry of new generators in the New York ISO, with the effect of keeping prices at supra-competitive levels, notwithstanding new entry.⁷ While the Commission Staff found no tariff or market manipulation violation, the Commission approved strengthened market mitigation measures to prevent a repeat of the episode.⁸ No relief from the KeySpan-Morgan Stanley episode was available to affected ratepayers. This example illustrates how *ex post* market monitoring and mitigation should not be the first line of defense against the exercise of market power in wholesale markets.

D. The Proposal Would Deprive the Commission of Valuable Information on Wholesale Market Structures

Exempting sellers in RTOs from a market power study deprives the Commission and other market participants of valuable information that supports the Commission's ability to fulfill its statutory mandate to ensure just and reasonable rates. This information includes: (1) changes in the structure of wholesale electricity markets that are revealed through the analyses that are submitted with market-based rate applications and (2) changes in the ability and incentive of sellers to exercise market power. By removing the requirement that applicants submit such analysis, the Commission is foregoing a valuable source of information that would enable it to perform its oversight function and to support its responsibilities in other areas.

Relinquishing the important function of requiring and reviewing market power analyses as part of the market-based rate process also comes at a particularly troubling time. Concerns over the effectiveness of functional unbundling and the ability of RTOs to prevent powerful,

⁷ The DOJ challenged this conduct under the antitrust laws. *See, e.g.*, Complaint, at 2-3, United States v. Morgan Stanley, 11-CIV-6875 (S.D.N.Y. September 11, 2011), *available at* <http://www.justice.gov/atr/cases/f275700/275762.pdf>.

⁸ New York Independent System Operator, Inc., 131 F.E.R.C. P61,170 (2010).

integrated transmission owners from using their position to influence RTO governance, planning, and processes are on the rise.⁹ Market power analysis submitted as part of the market-based rate authorization process provides information and insight that enables the Commission to continue to improve and refine its policies designed to prevent integrated transmission owners from using their transmission to discriminate against rival generators. Ceasing to collect this critical information would do a disservice to competition and consumers.

III. FERC Should Continue to Require Generation Owners to List Passive Ownership Interests

The NOPR proposes to dispense with the requirement that generation owners be required to list assets in which “a passive ownership interest is claimed.”¹⁰ The AAI cautions against eliminating this valuable reporting requirement. A passive interest – even in the absence of any control rights – can still affect competitive dynamics in the market because control is not the sole determining factor in whether a firm exercises market power. Without a requirement to report passive ownership interests, sellers with market-based rate authority would avoid any scrutiny of such interests and the associated ability and incentive to exercise market power. By reducing the scope of FERC’s oversight, removal of the reporting requirement could actually encourage generation owners to acquire *undisclosed* passive interests that enhance their incentive to engage in generation withholding and other abusive market behavior.

⁹ See, e.g., Comments of the Independent Market Monitor for PJM, in re Exelon Corporation and Pepco Holdings, Inc., Federal Energy Regulatory Commission, Docket No. EC14-96, July 21, 2014, at pp. 6-7.

¹⁰ FERC NOPR, at PP 19.

A. Passive Owners Can Still Exercise Market Power

Ownership confers the power to exercise control, but in the words of two noted economists, “control or ownership are never absolute.”¹¹ Competition enforcers consider how a passive interest affects both the ability and the incentive to exercise market power.¹² For example, the DOJ and FTC acknowledge in the 2010 *Horizontal Merger Guidelines* that a passive interest can increase a party’s incentive to engage in anticompetitive conduct, even though it does not affect its ability to engage in such conduct.¹³ As a result, analyzing competitive effects when control is a key question depends on evidence that bears on the ability of owners to influence decisions regarding output, pricing, innovation, and other strategic variables. Under the NOPR proposal, the accretion of market power through passive interests would go unmonitored by the Commission.

B. Passive Ownership Can Constrain Competition in Numerous Ways

There are a number of ways in which a passive ownership interest can affect the ability and incentive of generators to exercise market power. For example, by diverting sales to the entity in which a passive interest is held, a firm’s contemplated price increase, which was previously unprofitable, may become profitable.¹⁴ In wholesale electricity markets that employ single price auctions where all inframarginal bidders receive the market-clearing price, partial

¹¹ Sanford J. Grossman and Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691 (1986), at 694.

¹² See, e.g., *U.S. vs. AT&T Inc. and Dobson Communications Corp.*, Complaint, at 22, Civil No. 1:07-CV-01952, U.S.D.C. (D.C. Cir.) (October 30, 2007); and *U.S. v. Commscope, Inc. and Andrew Corp.*, Complaint, Civil No. 1:07-cv-02200, U.S.D.C. (December 6, 2007).

¹³ See U.S. DEP’T OF JUSTICE & FED. TRADE COMM’N, HORIZONTAL MERGER GUIDELINES § 13 (2010).

¹⁴ Daniel P. O’Brien & Steven C. Salop, *Competitive Effects of Partial Ownership: Financial Interest and Corporate Control*, 67 ANTITRUST L.J. 559, 576 (2000). The DOJ and FTC have found that an acquisition of a passive interest may reduce competition and thereby violate Section 7 of the Clayton Act. See, e.g., In the Matter of TC Group, L.L.C., No. 061-0197 (Jan. 25, 2007) (Decision and Order), available at <http://www.ftc.gov/os/caselist/0610197/decisionorder.pdf>.

ownership can make withholding strategies more profitable than they would have been without partial ownership relationships.

A passive ownership interest can also be substantial enough to provide an incentive for two rivals to compete less aggressively. For example, passive owners may have the liberty to discuss market issues with other partial owners, have advance access to competitively sensitive information regarding its “rival(s),” or require that it be notified in advance of important strategic decisions. Such advance notice could include information on prices, capacity, transmission constraints, costs, and strategic plans. Passive ownership can also facilitate the exchange of competitive information between two market participants in an partial ownership relationship, either directly or using each other as a conduit.¹⁵ Collusion or reduction in aggressive competition between partial generation owners would be beneficial to them, but not to competition and consumers. Retaining the requirement that market-based rate applicants report their passive interests will facilitate competition enforcement in wholesale electricity markets.

IV. FERC Should Continue to Mandate Disclosure of Generation Site Acquisitions

The Commission proposed that sellers with market-based rates be relieved of their obligation to file quarterly land acquisition reports and to provide information on sites for generation capacity development. The Commission reasons that the burden of such reporting outweighs the benefits. Moreover, the Commission states, “[I]n the more than six years since issuance of Order No. 697, intervenors have not challenged whether sites for new generation capacity development created a barrier to entry.”¹⁶ While this streamlining might be helpful to applicants, removal of the requirement to disclose the acquisition of generation sites would

¹⁵ See, e.g., Laura A. Wilkinson & Jeff L. White, *Private Equity: Antitrust Concerns with Partial Acquisitions*, 21 ANTITRUST at 28, 30 (2007)..

¹⁶ FERC NOPR, at PP. 89-90.

eliminate an important source of information on barriers to entry. This issue is relevant for all generation, particularly sites located in strategically important areas where load pockets and transmission constraints are present. However, the proposed elimination of the reporting requirement also raises concerns in the context of renewable energy.

A. Land and Site Acquisition Can Be a Potent Barrier to Entry

An inability to obtain land with both renewable energy potential (e.g., solar or wind) and proximity to transmission lines can be a potent barrier to entry. Unless the Commission has another source of data regarding the control of renewable energy generation sites, it may be unable to identify prospectively whether site leases and ownership are impeding the development of this important generation segment. Along with distinguishing features such as their intermittency and variability, several forms of renewable energy are much more tied to particular locations than fossil fuel or nuclear generation. While access to the grid and fuel sources and zoning laws represent potential obstacles barriers for all generation development, utility-scale concentrated solar and photovoltaic plants and wind farms face even more acute locational constraints. In contrast to coal and natural gas, solar energy and wind cannot be “transported” to generation facilities closer to metropolitan areas and other load centers. Solar and wind generation facilities must be built in areas in which the sun shines intensely or the wind blows strongly.

In the United States, many of the most promising areas for siting renewable generation are located far from population centers. For example, the region with the greatest onshore wind energy potential is a sparsely populated corridor in the Midwest stretching from the Dakotas to Texas.¹⁷ The desert southwest, another region with low population density, offers the greatest

¹⁷ U.S. ENERGY INFO. ADMIN., WIND GENERATING CAPACITY IS DISTRIBUTED UNEVENLY ACROSS THE UNITED STATES, Aug. 2, 2011, *available at* <http://www.eia.gov/todayinenergy/detail.cfm?id=2470>.

solar energy promise.¹⁸ These areas have an underdeveloped transmission network because they were historically neither generation sources nor load sinks.¹⁹ Even with the anticipated transmission investments in the coming years, land with renewable energy potential and proximity to transmission lines will likely continue to be at a premium.²⁰

Due to the relative scarcity of land suitable for renewable energy development, incumbents can erect barriers to entry through strategic generation site acquisitions. Specifically, generation companies can accumulate renewable energy sites with the aim of preventing rivals from developing them. Because the construction of new solar plants and wind farms can dampen market prices, incumbents can have an incentive to block the development of renewable resources. In some parts of the country, an abundance of wind-generated electricity, with its zero fuel cost, has depressed wholesale prices. When wind energy is on the margin, market prices have fallen to zero, or even below zero, at times.²¹ Additionally, speculators can acquire large tracts of such land and restrict development for an extended time.²² Under these scenarios, the growth of renewable generation may be impeded because suitable land cannot be acquired.

B. History Is Not a Useful Guide to the Future of Entry of Renewable Resources

While the NOPR states that strategic land acquisitions have not created barriers to entry in generation, history is not necessarily a useful guide for the future. The composition of

¹⁸ NAT'L RENEWABLE ENERGY LAB., CONCENTRATING SOLAR RESOURCE OF THE UNITED STATES, Sep. 19, 2012.

¹⁹ See, e.g., Alexandra B. Klass & Elizabeth J. Wilson, *Interstate Transmission Challenges for Renewable Energy: A Federalism Mismatch*, 65 VAND. L. REV. 1801, 1811-12 (2012).

²⁰ E.g., Louis Sahagun, *Renewable Energy Sparks a Probe of a Modern-Day Land Rush*, L.A. TIMES, June 1, 2009, available at <http://articles.latimes.com/2009/jun/01/local/me-solar1>; Joanne Ditmer, *A Land Grab for Renewable Energy*, DENVER POST, Feb. 25, 2011, available at http://www.denverpost.com/ci_17476154.

²¹ U.S. ENERGY INFO. ADMIN., NEGATIVE WHOLESALE ELECTRICITY PRICES OCCUR IN RTOS, June 18, 2012, available at <http://www.eia.gov/todayinenergy/detail.cfm?id=6730>.

²² Julie Cart, *Land Speculators See Silver Lining in Solar Projects*, L.A. TIMES, Feb. 18, 2012, available at <http://articles.latimes.com/2012/feb/18/local/la-me-solar-land-20120218>.

generation in the United States may be on the cusp of radical restructuring. A majority of states have enacted Renewable Portfolio Standards that mandate that utilities obtain a specific minimum fraction of power from renewable sources.²³ The Environmental Protection Agency has proposed a rule to reduce greenhouse gas emissions from new and existing power plants.²⁴ These climate change mitigation policies may accelerate the shift away from coal-fired generation and toward renewables (and natural gas).²⁵ For the intended change in the generation fleet to occur, barriers to entry, including access to generation sites, must be minimized.

In light of the federal and state political commitment to developing solar and wind resources, the Commission should remain alert to all barriers to entry in generation. It is too soon to tell whether the threat of strategic land acquisitions will materialize but to dismiss the concern categorically would be a mistake. The Commission should continue to collect data on the acquisition of generation sites. A comprehensive database would allow the Commission to monitor this issue in a systematic fashion, as opposed to relying entirely on complaints of affected parties. Five or ten years of intensive renewable energy development may reveal that the threat is not a serious one. At that point, the Commission might consider revisiting the issue. But given the anticipated high growth in renewable energy, revising reporting rules at the present time would be premature.

²³ U.S. ENERGY INFO. ADMIN., MOST STATES HAVE RENEWABLE PORTFOLIO STANDARDS, Feb. 3, 2012, *available at* <http://www.eia.gov/todayinenergy/detail.cfm?id=4850>.

²⁴ Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units, 79 Fed. Reg. 34,830 (proposed June 18, 2014) (to be codified at 40 C.F.R. pt. 60).

²⁵ U.S. ENERGY INFO. ADMIN., RENEWABLE ELECTRICITY GENERATION PROJECTIONS SENSITIVE TO COST, PRICE, POLICY ASSUMPTIONS, Apr. 29, 2014, *available at* <http://www.eia.gov/todayinenergy/detail.cfm?id=16051>.

Respectfully submitted,



Diana Moss
Vice President
American Antitrust Institute
720-233-5971
dmoss@antitrustinstitute.org



Sandeep Vaheesan
Special Counsel
American Antitrust Institute
202-230-5920
svaheesan@antitrustinstitute.org