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 ELECTRICITY CONSUMERS RESOURCE COUNCIL ("ELCON")

On September 22, 2016, the Commission issued a Notice of Inquiry (NOI) in which it seeks to explore whether, and if so, how, the Commission should revise its current approach to identifying and assessing market power in the context of utility mergers and acquisitions under section 203 of the Federal Power Act (FPA) and applications under section 205 of the FPA for market-based rate authority for wholesale sales of electric energy, capacity and ancillary services by public utilities.

In the NOI the Commission is seeking stakeholder input on whether it should: (1) establish a simplified analysis for certain section 203 transactions that are unlikely to raise market power concerns; (2) add a supply curve analysis to section 203 evaluations; (3) improve the Commission's single pivotal supplier analysis in reviewing market-based rate applications, and add a similar pivotal supplier analysis to section 203 evaluations; (4) add a market share analysis to review of section 203 transactions; (5) modify how capacity associated with long-term power purchase agreements (PPAs) should be attributed in section 203 transactions; and (6) require submission of applicant merger-related documents. In addition, the Commission seeks comment related to its scope of review under section 203, including whether there are existing blanket authorizations that may be overly broad or otherwise no longer appropriate, and

whether there are classes of transactions for which further blanket authorizations or form of expedited review would be appropriate.

ELCON appreciates the opportunity to respond to this important NOI. ELCON agrees with the Commission's stated reasons for this NOI and the need to engage in a public inquiry "to gauge whether there is a need to add, modify or eliminate certain requirements." NOI at ¶11. As the association representing large industrial end-use consumers, we have a strong interest in ensuring that the Commission's tools for assessing market power in wholesale electric markets are effective and up to date[1], including "harmonizing its analysis of transactions under section 203 and its market-based rate analysis under section 205, streamlining the process for certain applicants that submit section 203 filings, and obtaining additional information from applicants that may help better inform the Commission's analyses." NOI at ¶11-12.

SUMMARY OF ELCON'S POSITION

ELCON's comments primarily address strengthening the Commission's review of section 203 merger applications and in that regard our comments support almost all the proposals suggested in the NOI for the purpose of advancing to a Notice of Proposed Rulemaking (NOPR). The increased concentration of production capacity in the hands of a few major utility players is cause for concern because the power system is naturally prone to unilateral market power. The Commission's open-access policies have certainly added more "competition" to the industry but specific product markets remain hard to define and quantify in bilateral markets and the hybrid structures of ISOs and RTOs than they are in truly competitive markets. This dictates a need to tighten the Commission's section 203 analysis. It has been said that "[a]ll mergers affect

[1] This includes consistency with the horizontal merger guidelines of the Department of Justice (DOJ) and the Federal Trade Commission (FTC).

competition, some by creating superior competitors and others by creating potential monopolists."[2] The Commission's task is to avoid the latter.

COMMENTS

A. Simplified *De Minimis* Analysis in Section 203 Applications

An applicant for a section 203 merger approval can demonstrate that the proposed transaction will not have an adverse impact on competition by explaining how the transaction results in a *de minimis* change in its market power. The Commission seeks comment on whether a threshold is appropriate to determine whether a transaction's impact can be determined to be *de minimis*, and if so, how that threshold should be calculated. The Commission also seeks comment on whether the so-called "2ab analysis" sufficiently demonstrates that the transaction does not impact horizontal market power. The 2ab analysis is a calculation intended to demonstrate that a change in the Herfindahl-Hirschman Index (HHI), based on the installed capacity of the merger parties compared to the market size, is *de minimis*.

The Commission has put forward certain "preliminary steps" that a *de minimis* analysis could include to estimate market share:

> (1) identify the default relevant geographic market as the balancing authority area (BAA) or regional transmission organization/independent system operator (RTO/ISO) market (or submarket, if known or appropriate); (2) identify the default product market as installed capacity, or identify the actual transactions in the relevant geographic market; and (3) calculate the existing (i.e., pre-transaction) market shares of the two transacting parties in the default relevant geographic market, where the results of that calculation would be measured against a specific threshold, such that if the product of the pre-transaction market shares is less than the threshold, the Commission would not require a full Competitive Analysis Screen. NOI at ¶16.

ELCON supports this approach. ELCON takes no position on the continued efficacy of the 2ab analysis.

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[2] Robert J. Michaels, "Market Power in Electric Utility Mergers: Access, Energy, and the Guidelines," *Energy Law Journal*, Volume 17, 1996.

B. Serial *De Minimis* Mergers

As explained in the NOI: "Serial acquisitions have the potential to result in an applicant with a larger market share incrementally acquiring additional capacity such that each proposed transaction individually would not require a full Competitive Analysis Screen, but taken as a whole would require a more in depth examination. That is, a particular entity could be a serial acquirer and amass market power from a number of small incremental transactions." NOI at ¶19. The Commission requests comment on whether it should incorporate consideration of incremental acquisitions into its competition analysis as well as into its analysis of whether a proposed transaction is *de minimis*. ELCON supports the consideration of incremental acquisitions into its competition analysis. One approach for accomplishing this review is to retroactively analyze the net effect of past acquisitions.

C. Supply Curve Analysis

As explained in the NOI: "The Commission also seeks comment on whether the existing section 203 horizontal market power analysis could be strengthened by incorporating a supply curve analysis. A supply curve analysis overlays a demand curve and a supply curve in order to assess whether a merged company has the ability and incentive to exercise market power by withholding output from marginal units (i.e., ability units) to raise prices in order to benefit its baseload units (i.e., incentive units) and increase its total profits. The supply curve is constructed using generation dispatch costs from the market. The ability to withhold output depends on the amount of marginal capacity that would be controlled by the merged firm, and the incentive to withhold output depends on the amount of inframarginal capacity that could benefit from higher prices." NOI at ¶20.

ELCON strongly supports the inclusion of a supply curve analysis as a requirement of the section 203 horizontal market power analysis. The potential for the

exercise of unilateral market power is well known in wholesale electric markets,[3] and it is long overdue that merger reviews carefully scrutinize the potential for this anticompetitive behavior.

D. Pivotal Supplier Analysis

As explained in the NOI: "The Commission uses a pivotal supplier analysis as an indicative screen and for the delivered price test aspect of its assessment of whether an applicant seeking market-based rate authority under FPA section 205 has market power. The Commission is interested in receiving comment on its current use of the pivotal supplier test in the context of market-based rates, whether adding a pivotal supplier test in the Commission's FPA section 203 analysis would provide valuable information to assess whether a party to the transaction is pivotal prior to the transaction, whether the transaction would render the party pivotal, and whether the degree to which a party to the transaction is pivotal is enhanced by the transaction." NOI at ¶22.

ELCON supports the application of "an appropriately constructed pivotal supplier screen" to the Commission's review of section 203 merger applications. The analysis should also be applied to capacity and ancillary services markets as well as the energy markets. Because a pivotal supplier analysis can reveal the ability to exercise market power, as small changes in supply can lead to large changes in price, the pivotal supplier analysis is a critical component of section 205 reviews, and it should be extended to section 203 review as well. The analysis should be used both to determine if a merger transaction causes an applicant to become pivotal as well as to require mitigation to alleviate any enhancement in an applicant's status as a pivotal supplier resulting from the transaction.

[3] See Frank A. Wolak, "Unilateral Market Power in Wholesale Electricity Markets," *CESifo DICE Report*,. 2/2006. http://web.stanford.edu/group/fwolak/cgi-bin/sites/default/files/files/Unilateral%20Market%20Power%20in%20Wholesale%20Electricity%20Markets_Feb%202006_Wolak.pdf

E. Market Share Analysis

The Commission's section 203 analysis focuses primarily on changes in market concentration resulting from the proposed merger. It does not address market share. The Commission seeks comment on the potential benefits of expanding its section 203 analysis to include an examination of market share. NOI at ¶28. Unlike the pivotal supplier analysis that focuses on the size of the applicant relative to the maximum capacity needed to serve load, a market share analysis would focus on the size of the applicant relative to all other suppliers in the market.

ELCON supports the use of a market share analysis in section 203 reviews. We are amenable to a 20% threshold as currently used in evaluating applications for market-based rate authority. This should be a start. It should be applied to all relevant markets: energy, capacity and ancillary services. With respect to entities that engage in serial acquisitions, section 203 reviews must consider changes in market concentration resulting from the entity's past mergers and acquisitions going back at least to the implementation of Order No. 2000.

F. Capacity Associated with Power Purchase Agreements

When a section 203 applicant seeks to acquire an ownership interest in a generation facility that it controls pursuant to an existing Power Purchase Agreement (PPA), the Commission attributes the capacity of the facility to the applicant's pre-acquisition market share. In the NOI, the Commission states that it is concerned that this approach fails to consider the long-term competitive implications of the acquisition, including that the transaction may prevent competitive supply from reentering the market upon expiration of the PPA.

ELCON supports the use of alternative analytical tools to account for the capacity associated with long-term firm PPAs to increase the accuracy of the Commission's market power analyses with respect to such PPAs. This would include, for example, a requirement that the applicant provide a delivered price test analysis

showing the HHI impacts under two different scenarios: (1) with the capacity attributed solely to the current facility owner; and (2) with the capacity attributed solely to the applicant proposing to acquire the facility. Alternatively, the Commission could attribute a facility's capacity to the facility owner only under certain circumstances, including: (1) if the term of the PPA began one year or less prior to the filing of the section 203 application; (2) if the PPA expires prior to the end of the study period used in the applicant's delivered price test analysis; or (3) if the facility is external to the purchaser's Balancing Authority Area (BAA) but does not have firm transmission service to the purchaser's BAA. Applicants with long-term firm PPAs could also be required to justify in a detailed manner why the capacity in question should be attributed to the facility purchaser.

G. Applicant Merger-Related Documents

The Commission seeks comment on whether section 203 applications should include other documents privy to the applicant – such as consultant reports – and which have been submitted to other government agencies such as DOJ and/or FTC. ELCON supports this requirement.

H. Blanket Authorizations

After 2005, with the enactment of EPAct2005, the Commission granted blanket authorizations for certain types of transactions, including foreign utility acquisitions by holding companies, intra-holding company system financing and cash management arrangements, certain internal corporate reorganizations, and certain investments in transmitting utilities and electric utility companies. Under these blanket authorizations, even though the transaction may be jurisdictional under section 203, no application or prior Commission authorization is needed prior to completing the transaction although some have reporting requirements and other conditions. Later, the Commission established five additional blanket authorizations. Four of these blanket authorizations apply to transactions in which a public utility seeks to transfer its outstanding voting securities to another holding company that has already been granted blanket

authorization. The fifth blanket authorization applies to the acquisition or disposition of a jurisdictional contract where: (1) neither the acquirer nor transferor has captive customers or owns or provides transmission service over jurisdictional transmission facilities; (2) the contract does not convey control over the operation of a generation or transmission facility; (3) the parties to the transaction are neither affiliates nor associate companies; and (4) the acquirer is a public utility.

Since these blanket authorizations were granted, the electric industry has undergone substantial change including continued market development and expansion of RTOs/ISOs, consolidation among utilities, such that the conditions that gave rise to the blanket authorizations currently in effect may no longer be appropriate. For example, it may no longer be appropriate to grant blanket authorizations to holding companies that only hold exempt wholesale generators (EWGs), as EWGs now make up a significant portion of supply and any transaction involving these generators could affect wholesale rates by impacting competition. The Commission seeks comment on whether there are existing blanket authorizations under section 203 that are no longer appropriate.

ELCON believes that the simple answer is "yes" and with one exception we would defer to the Commission's judgment (and the recommendations of stakeholder groups that share our concerns regarding industry concentration and market power) for identifying suitable candidates that would no longer qualify for a blanket authorization. ELCON supports the continued blanket authorization for PURPA Qualifying Facilities (QFs) as they do not raise the same magnitude of market power issues as EWGs. We would welcome the opportunity to review the merits of these proposals in a future NOPR.

I. Transactions Subject to Only Section 203(a)(1)(B)

In EPAct 2005, Congress revised the scope of the Commission's jurisdiction under section 203. While certain provisions of Section 203 include a "minimum threshold" of $10 million for transactions requiring FERC approval, Section 203(a)(1)(B)

provides that a public utility must seek FERC authorization before it merges or consolidates its jurisdictional facilities with those of another person, without any minimum dollar threshold. FERC observes that the lack of a monetary threshold for mergers and consolidations has resulted in applicants seeking approval for transactions that do not pose competitive concerns and seeks comments on whether there are categories of transactions falling within the scope of Section 203(a)(1)(B) that should be subject to abbreviated filing requirements.

ELCON generally opposes the need for a monetary threshold associated with mergers or consolidations given that the potential for creating a new pivotal supplier could exist with a relatively small (in financial terms) merger or consolidation. We suspect that this was the reason for the Commission's existing interpretation of section 203(a)(1)(B). Should the Commission decide to propose a threshold, we highly recommend that it be rebuttable.

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Respectfully submitted,

/s/ JOHN P. HUGHES

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Dated: November 28, 2016

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary of this proceeding.

Dated at Washington, D.C.: November 28, 2016

/s/ W. RICHARD BIDSTRUP

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