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 NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

The National Rural Electric Cooperative Association ("NRECA") appreciates this opportunity to submit comments addressing the Federal Energy Regulatory Commission's ("FERC" or "Commission") September 22, 2016 Notice of Inquiry ("NOI") in this proceeding (81 Fed. Reg. 66,649 (Sept. 28, 2016)) to examine and potentially to revise the Commission's current approach to identifying and assessing market power in the context of transactions under Federal Power Act ("FPA") section 203 and applications under FPA section 205 for market-based rate authority for by public utilities.

As explained in these comments, NRECA urges the Commission to:

1. Reject proposals for a simplified *de minimis* analysis of proposed mergers;

2. Add a supply curve analysis and/or a pivotal supplier analysis to its review of proposed mergers under section 203;

3. Add evaluation of market share to its evaluation of proposed mergers;

4. Adopt requirements that merger applicants make both merger-related documents and transmission modeling cases and studies relevant to the delineation of geographic markets available on a confidential and expedited basis to intervenors requesting such information;

5. Eliminate the blanket exemption from section 203 for holding company acquisitions of exempt wholesale generators ("EWGs"); and

6. Adopt other measures foreseeably effective to ensure that mergers and consolidations of jurisdictional facilities are in fact consistent with the public interest.

I. DESCRIPTION OF NRECA

NRECA is the national service organization for more than 900 not-for-profit rural electric utilities that provide electric energy to approximately 42 million consumers in 47 states or 12 percent of the nation's population. Kilowatt-hour sales by rural electric cooperatives account for approximately 11 percent of all electric energy sold in United States. NRECA members generate approximately 50 percent of the electric energy they sell and purchase the remaining 50 percent from non-NRECA members. The vast majority of NRECA members are not-for profit, consumer-owned cooperatives. NRECA's members also include approximately 66 generation and transmission ("G&T") cooperatives, which generate and transmit power to 668 of the 846 distribution cooperatives. The G&Ts are owned by the distribution cooperatives they serve. Remaining distribution cooperatives receive power directly from other generation sources within the electric utility sector. Both distribution and G&T cooperatives were formed to provide reliable electric service to their owner-members at the lowest reasonable cost.

NRECA and its respective members may be directly affected by the outcome of this proceeding. NRECA has participated actively in numerous proceedings before this Commission concerning wholesale competition and merger-related issues.

II. GENERAL COMMENTS

NRECA generally supports harmonizing the Commission's analysis of transactions under section 203 and its market-based rate analysis under section 205. Analysis under both sections should address the potential for coordinated interaction among sellers to withhold supply and profitably increase market prices. Opportunities for coordinated interaction increase with higher market concentrations. Given the unique characteristics of electric markets such as real time production to meet real time demand, non-differentiated products among competitors, and limited transfer capability between geographic markets, it is also important for the Commission's analysis under FPA section 203 to assess directly the potential impact of a single seller unilaterally withholding part of its supply in order to move prices and profits upwards for its remaining supply in the market.

The current FPA section 205 market-based rate analysis relies on two screens.[1] The first of these is a market share screen which essentially limits a seller in a relevant geographic market area to less than a 20 percent share of uncommitted capacity. This market share screen implicitly provides an upper limit on the overall concentration of the market. The Commission's second screen is the pivotal supplier analysis. The pivotal supplier analysis determines whether the competitive wholesale load in the market area at the time of peak demand can be served without the seller's generating capacity. If so, this is an indication that the seller is not likely to profit from unilaterally withholding its supply from the market.

For FPA section 203 transactions, the Commission has adopted the delivered price test as its competitive analysis screen. The delivered price test measures pre-merger market

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[1] The Commission's market-based rate screens were adopted in *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252, at P 1, 4, *clarified*, 121 FERC ¶ 61,260 (2007), *order on reh'g*, Order No. 697-A, FERC Stats. & Regs. ¶ 31,268, *clarified*, 124 FERC ¶ 61,055, *order on reh'g*, Order No. 697-B, FERC Stats. & Regs. ¶ 31,285 (2008), *order on reh'g*, Order No. 697-C, FERC Stats. & Regs. ¶ 31,291 (2009), *order on reh'g*, Order No. 697-D, FERC Stats. & Regs. ¶ 31,305 (2010), *aff'd sub nom. Montana Consumer Counsel v. FERC*, 659 F.3d 910 (9th Cir. 2011).

concentration in economic capacity and available economic capacity within each geographic market relevant to the analysis of the competitive effects of a proposed merger, and then assesses the changes in market concentration in economic capacity and available economic capacity that would result from a proposed merger. Transactions which increase concentration above the concentration thresholds established in the Department of Justice/Federal Trade Commission 1992 *Horizontal Merger Guidelines* will fail the screen.[2] This approach provides effective protection from market concentration increases that could provide fertile ground for coordinated interaction among sellers to increase market prices. However, unlike its analysis under FPA section 205, the Commission's FPA section 203 analysis does not directly address the potential for unilateral withholding. The Commission should adopt a supply curve analysis or a pivotal supplier screen to address this deficiency.

III. COMMENTS ON SPECIFIC TOPICS RAISED IN THE NOI

A. *Simplified De Minimis Analysis*

The Commission requests comment on whether it should establish a simplified analysis for certain section 203 transactions that are unlikely to raise market power concerns.[3] If a transaction is found to have *de minimis* impacts on competition using the simplified analysis, the full application of the delivered price test could be avoided. To date, the Commission has not defined any *de minimis* levels of concentration or other criteria on which it might premise such a simplified analysis, and it has not established any thresholds that it would deem sufficient to

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[2] The Commission originally adopted the delivered price test in *Inquiry Concerning the Commission's Merger Policy under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996) (Merger Policy Statement), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997); *see also FPA Section 203 Supplemental Policy Statement*, FERC Stats. & Regs. ¶ 31,253 (2007) (Supplemental Policy Statement). The Commission determined to continue to use the thresholds established in the 1992 *Merger Guidelines*, and not to adopt the revised thresholds adopted by the DOJ and FTC in 2010, in *Analysis of Horizontal Market Power under the Federal Power Act*, 148 FERC ¶ 61,109 at PP 34-46 (2012).

[3] NOI at P 13.

meet this requirement. The NOI indicates that the Commission has accepted various representations made by applicants regarding this issue.[4]

One approach sometimes proposed by Section 203 applicants is referred to as the "2ab analysis." This method multiplies the product of the pre-merger shares of installed capacity by 2 to derive the resulting change post-merger change in the HHI. Under the delivered price test, the maximum acceptable change in the HHI in highest concentrated markets, *i.e.* with a post-merger HHI greater than 1800, is 50. Applicants using the "2ab analysis" with a HHI change value of less than 50 would be found to have only a *de minimis* effect on competition and could move forward without any additional analysis of the transaction's effect on competition.

A weakness of the "2ab analysis" is its reliance on installed capacity as the product market. This data may be more easily accessible than the economic and available economic capacity values often used in the delivered price test, but it does not provide the same quality of information concerning the potential for merger-induced increases in market concentration and the resulting enhancement of the merging entities' ability to control price or foreclose competition – *i.e.*, to exert market power. Using installed capacity as a product market proxy is likely in most instances to understate substantially the effects of a merger on concentration in relevant product markets. This is particularly true where, as in the Commission's current delivered price test, more granular capacity metrics (economic capacity and available economic capacity) are themselves proxies for more specific products (including energy under various seasonal load conditions). It is not clear that reliance on installed capacity as the product market would provide the same meaningful results when compared to the economic capacity and available economic capacity values used in the delivered price test.

[4] *Id.* at P 15.

The NOI suggests an approach similar to the "2ab analysis" where the product market could be installed capacity or the actual transactions in the relevant geographic market. While NRECA urges rejection of a simplified *de minimis* analysis of proposed mergers, in the event the Commission chooses to pursue any simplified approach to identifying *de minimis* transactions, then the analysis should be based on actual market transactions rather than the broad installed capacity definition. As discussed above, the use of installed capacity tends to understate significantly the anticompetitive effects of a potential merger.

B. Serial De Minimis Mergers

The NOI raises a concern that an applicant could potentially be a serial acquirer and accumulate market power from a number of small *de minimis* acquisitions.[5] It requests comment on whether FERC should consider this issue in its competition analysis as well as its analysis of whether a proposed transaction is *de minimis*. This is a legitimate concern. Indeed, it is fundamental to the prevention of monopolization in its incipiency that is the focus of Section 7 of the Clayton Act, which is in turn the essential foundation of the Commission's merger policy. NRECA believes that the incipiency problem could be addressed most effectively by ensuring the Commission's approach to defining *de minimis* transactions protects against this outcome. For example, the Commission could define *de minimis* as taking into account similar transactions by the same applicant or its affiliates, within a specified period of time. Such an approach appears to be more foreseeably effective than the alternative of building additional levers into the Commission's competition analysis to account for previously approved *de minimis* transactions.

C. Supply Curve Analysis

[5] *Id.* at P 19.

The Commission requests comment on whether the existing section 203 horizontal market power analysis could be strengthened by incorporating a supply curve analysis.[6] Adding a supply curve analysis could enhance the Commission's analysis of whether a transaction provides the ability and incentive for the post-merger entity to unilaterally withhold capacity from the market. As the NOI explains, a supply curve analysis can calculate the responsiveness of prices to a reduction in supply for any given quantity of demand. An applicant with multiple generating units dispersed at different price-quantity combinations along the supply curve may have the ability to withhold some (but not all) of its inframarginal units. This strategy is pursued with the expectation that higher cost units in the market would be required to meet demand and thus would set the market clearing price. Successful execution of this strategy would reward the applicant with additional profits to its remaining inframarginal units, more than sufficient to offset revenues foregone from withholding the lowest cost unit. A supply curve analysis should be considered because it is a more informative tool than the delivered price test to evaluate this potential threat and determine whether a merger might facilitate strategic withholding that would be profitable for the post-merger entity.

D. Pivotal Supplier Analysis

The NOI requests comment on the current use of the pivotal supplier screen in the Commission's review of FPA section 205 applications for market-based rate authority.[7] This screen evaluates the seller's potential to exercise unilateral market power based on the seller's uncommitted capacity. The NOI points out that market-based rate applicants rarely fail the pivotal supplier screen, meaning the study area's wholesale load at peak demand can be met

[6] *Id.* at P 20.
[7] *Id.* at P 22.

solely by remote suppliers and it says this is a result that is unlikely in practice.[8] Specifically, the Commission wants to know if the wholesale load proxy (area annual peak demand less native load) is an effective metric in examining whether a supplier is pivotal in the study area. It also requests comment on replacing the wholesale load proxy with the area's annual peak load.

The pivotal supplier analysis screen works in conjunction with the wholesale market share screen which requires applicants to have less than a 20 percent market share of uncommitted capacity for all seasons of the year. An applicant who satisfies the wholesale market share screen would be less likely to fail the pivotal supplier screen compared to a generator with a much higher share of the market. Having applicants rarely fail the pivotal supplier screen is not harmful as long as real world occurrences of unilateral withholding do not happen.

With respect to substituting an area's peak load for the wholesale load proxy, the NOI indicates that this approach may lead to more "false positive" screen failures and place additional burden on applicants to rebut the presumption of market power that the screen failure implies.[9] NRECA does not believe that modifying the pivotal supplier analysis in this manner will provide a screen that more precisely predicts a seller's potential to exercise market power. Historically, the Commission's market power screens have focused on market measures which reflect a seller's ability and incentive to profitably raise the market price. It is unlikely that refocusing the Commission's screen on measures which include committed capacity – capacity committed to the market and not subject to withholding – would provide a more meaningful analysis. Such an

[8] *Id.* at P 24.
[9] *Id.* at P 25.

approach would be at odds with longstanding principles in the antitrust context,[10] and would tend to overstate the size of the relevant product market, thereby understating the impact of merger-induced increases in concentration of control. The Commission should refrain from this direction, which does not appear likely to result in more effective prevention of the acquisition and exercise of market power.

The NOI also request comments on whether a pivotal supplier screen should be added to its review of section 203 transactions.[11] As discussed above, the Commission should consider enhancing its review of the competitive effects of section 203 transactions by incorporating a measure that directly focuses on the ability of the post-merger applicant to unilaterally withhold capacity from the market. Incorporating a pivotal supplier analysis screen in this manner could provide more additional information on the potential for unilateral withholding than what is provided by the delivered price test.

E. Market Share Analysis

The NOI says that the Commission's section 203 delivered price test analysis focuses primarily on changes in market concentration arising from a proposed transaction and not an examination of market share or accumulation of market share over time.[12] The concern is that the FPA section 203 analysis may not include complete information about an applicant's overall presence in a market. The Commission seeks comment on the potential benefits of expanding its section 203 analysis to include an examination of market share.

Including a market share analysis in the FPA section 203 review would provide a simple way to assess the size of the applicant relative to the market. It would also capture any market

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[10] *See United States v. General Dynamics Corp.*, 415 U.S. 486, 506 (1974) (holding that commitment of coal reserves under long-term contracts precluded reliance on market share associated with already committed productive capacity to show merger-induced increase in market concentration).
[11] *Id.* at P 26.
[12] *Id.* at P 28.

share increases from previous transactions involving the applicants which were deemed *de minimis*. An entity's market share may provide limited insight on the risk of unilateral withholding from the newly merged entity. Moreover, the market share data is likely readily assessable from the data required to conduct the delivered price test. Ultimately, the Commission could set a market share threshold that could limit the market share under section 203 transactions. However, a more effective approach to guard against the potential for unilateral withholding would be to adopt either a supply curve analysis or pivotal supplier analysis which would provide a more detailed assessment of this risk.

F. Capacity Associated with Power Purchase Agreements

Currently, if a purchasing utility entered into a long term firm power purchase agreement for the output of a transacting facility before filing a section 203 application to acquire the same facility, the Commission has generally considered the generation capacity of that facility to be attributed to the purchaser. As a result, the acquisition of the facility will not increase the purchaser's market share under the Commission's screens leading to a finding of no adverse effect on competition.

The Commission's NOI proposes where a section 203 applicant seeks approval to purchase a generating facility from which it already purchases the output under a long term PPA, that applicant could be asked to provide a delivered price test with the capacity attributed solely to the current facility owner and a second delivered price test with the capacity attributed solely to the applicant.[13] The Commission should explore this approach along with its suggested alternatives including a detailed explanation from the applicants why the capacity in question should be attributed to the facility purchaser.

G. Applicant Merger-Related Documents

[13] *Id.* at P 32.

The NOI explains that applicants are often required to submit consultant and internal reports that assess the competitive effects of a proposed merger to the U.S. Department of Justice (DOJ) and the Federal Trade Commission (FTC). The Commission seeks comment on whether it should require applicants to submit these documents as part of their section 203 application.[14]

The provision of relevant information to reviewing agencies is essential to effective decision making. The Commission should require these reports as part of its section 203 review, provided that it can ensure the same confidentiality protections as granted by the FTC and DOJ. In addition, the Commission should require merger applicants to arrange – in advance of the filing of a Section 203 application – for release of the regional transmission modeling cases on which evaluation of Simultaneous Import Limitations and transmission constraints that are potentially definitive of smaller relevant geographic markets than those on which merger applicants' Appendix A analyses are premised. The current practice of requiring potential intervenors to submit requests and obtain approval for access to models deemed to contain Critical Energy Infrastructure Information generally does not allow intervenors meaningful access to this essential information within the 60 days provided for the development and submittal of protests in Section 203 cases. It is simply not acceptable to permit the statutory time limits that Section 203 places on the Commission's deliberations to be coupled with a cumbersome approach to accessing critical data and assumptions under the control of merger applicants in order to disadvantage intervenors who may wish to develop market power analyses that are more informative than those submitted in support of Section 203 applications.

H. Blanket Authorizations

Currently, FERC grants a blanket authorization to holding companies whose holdings are limited to only EWGs. Even though the acquisition of an EWG by a utility holding company

[14] *Id.* at P 33.

whose holdings are made up entirely of EWGs is jurisdictional under section 203, no application or prior Commission authorization is needed prior to completing the transaction. The NOI explains that this approach was adopted after EPAct 2005 which shifted the review of utility holding company mergers from the Securities and Exchange Commission to FERC. Because of the continued development of wholesale electric markets, today EWGs make up a significant portion of the generating fleet in the U.S. The NOI correctly points out that these generators can impact wholesale rates and competition. NRECA believes this blanket authorization should be eliminated.

I. Distributed Energy Resources in Market Power Analyses

Historically, the Commission's market power analysis has involved the analysis of central station generating assets and has incorporated the emergence of intermittent generators selling exclusively into the wholesale market. In its recent Notice of Proposed Rulemaking, [15] the Commission proposes to define distributed energy resource aggregators as a type of market participant that can participate in the organized wholesale electric markets. As the Commission considers harmonizing analysis of transactions under section 203 and its market-based rate analysis under section 205, NRECA urges the Commission to fully engage industry stakeholders and market participants in terms of how it intends to incorporate distributed energy resources into its market power analyses.

[15] *Electric Storage Participation in Markets Operated by Regional Transmission Organizations and Independent System Operators*, 157 FERC ¶ 61,121 (2016).

IV. CONCLUSION

For the foregoing reasons, the NRECA respectfully urges the Commission to:

1. Reject proposals for a simplified *de minimis* analysis of proposed mergers;

2. Add a supply curve analysis and/or a pivotal supplier analysis to its review of proposed mergers under Section 203;

3. Add evaluation of market share to its evaluation of proposed mergers;

4. Adopt requirements that merger applicants make both merger-related documents and transmission modeling cases and studies relevant to the delineation of geographic markets available on a confidential and expedited basis to intervenors requesting such information;

5. Eliminate the blanket exemption from Section 203 for holding company acquisitions of EWGs; and

6. Adopt such other and further improvements to its evaluation of market power and adverse effects on competition as will assist in ensuring that mergers and consolidations of jurisdictional facilities in a market-based rate environment will actually and genuinely be consistent with the public interest.

Respectfully submitted,

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