

112 FERC ¶ 61,054
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, and Joseph T. Kelliher.

Southern Company Energy Marketing, Inc. and
Southern Company Services, Inc.

Docket Nos. ER97-4166-019
ER96-780-007
ER96-780-009
EL04-124-000
EL04-124-002

ORDER ESTABLISHING HEARING PROCEDURES

(Issued July 8, 2005)

1. In this order, the Commission establishes a trial-type evidentiary hearing to resolve issues of material fact regarding and to address the serious deficiencies in Southern Companies¹ Delivered Price Test (DPT) for the Southern control area² submitted in response to the Commission's order issued on December 17, 2004³ in this

¹ Southern Companies include Southern Company Services, Inc. (SCS), Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company, Savannah Electric and Power Company, and Southern Power Company (Southern Power).

² Southern Companies identify the Southern control area as the control area operated by SCS.

³ *Southern Company Energy Marketing, Inc. and Southern Company Services, Inc.*, 109 FERC ¶ 61,275 (2004) (December 17 Order).

proceeding. Pending the outcome of this evidentiary hearing, Southern Companies' sales at market-based rates in the Southern control area will remain subject to refund for the statutory refund period commencing with the refund effective date established in the December 17 Order.

2. The evidentiary hearing established in this order will protect customers from the potential unjust and unreasonable rates and charges that could result from the exercise of market power.

Background

3. On August 9, 2004, as amended on August 27, 2004, November 19, 2004, and December 9, 2004, Southern Companies submitted for filing revised generation market power screens in compliance with the Commission's April 14 and July 8 Orders. The filing, as amended, indicated that Southern Companies passed the pivotal supplier screen but that it failed the wholesale market share screen for each of the four seasons considered in the Southern control area. As we stated in the April 14 Order, where an applicant is found to have failed either generation market power screen, such failure provides the basis for instituting a proceeding under section 206 of the Federal Power Act (FPA)⁴ and establishes a rebuttable presumption of market power in the resulting section 206 proceeding. Accordingly, because Southern Companies' filing indicated that it failed the wholesale market share screen, the Commission instituted in the December 17 Order a section 206 proceeding to investigate Southern Companies' generation market power in the Southern control area. The Commission also established a refund effective date pursuant to the provisions of section 206. In its compliance filing, Southern Companies submitted the instant DPT analysis, as well as additional historical sales data and alternative market power studies, to rebut the presumption of market power established by its failure of the wholesale market share screen in the Southern control area.

4. As discussed in the Commission orders issued on April 14, 2004 and July 8, 2004,⁵ the screens are conservatively designed to identify the subset of applicants who require closer scrutiny. Accordingly, in the December 17 Order, the Commission directed Southern Companies, for the Southern control area, to: (1) file a DPT analysis; (2) file a mitigation proposal tailored to its particular circumstances that would eliminate

⁴ 16 U.S.C. § 824e (2000).

⁵ *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018 (2004) (April 14 Order), *order on reh'g*, 108 FERC ¶ 61,026 (2004) (July 8 Order).

the ability to exercise market power; or (3) inform the Commission that it will adopt the April 14 Order's default cost-based rates or propose other cost-based rates and submit cost support for such rates.⁶ In addition, as the Commission stated in the April 14 Order,⁷ the applicant or intervenors may present evidence such as historical sales data to support whether the applicant does or does not possess market power.

5. On February 15, 2005, Southern Companies made a filing in compliance with the December 17 Order (compliance filing).

6. American Public Power Association (APPA), Electricity Consumers Resource Council, National Rural Electric Cooperative Association (NRECA), Tractebel Energy Marketing, Inc., Calpine Corporation (Calpine) and Shell Trading Gas & Power Company (Shell Trading) filed a joint request for rehearing, and Calpine and Shell Trading filed a separate request for rehearing of the December 17 Order (collectively, petitioners). Petitioners sought rehearing of the Commission's determination in the December 17 Order that Southern Companies satisfied the other three parts of the Commission's market-based rate analysis regarding transmission market power, barriers to entry and affiliate abuse. In an order issued May 5, 2005,⁸ the Commission granted petitioners' rehearing request and instituted a separate section 206 proceeding in Docket No. EL05-104-000 to investigate whether Southern Companies satisfies the remaining three parts of the Commission's market-based rate analysis, which will be held in abeyance pending the outcome of the section 206 proceeding in Docket No. EL05-102-000 to investigate related allegations of affiliate abuse.

7. Southern Companies also filed a request for clarification and rehearing of the Commission's December 17 Order. Southern Companies sought rehearing of the December 17 Order on the ground that the Commission's finding of a rebuttable presumption of generation market power there was erroneous and that the Commission unlawfully shifted its statutory burden of proof under section 206 to Southern Companies. In addition, Southern Companies requested clarification, and in the alternative rehearing, that the economic capacity measure of the DPT need not be submitted. In the May 5 Order, the Commission denied Southern Companies' request for rehearing and clarification of the December 17 Order.

⁶ *Id.* at P 201, 207-209.

⁷ *Id.* at P 37 n.11.

⁸ *Southern Companies Energy Marketing, Inc. and Southern Companies Services, Inc.*, 111 FERC ¶ 61,144 (2005) (May 5 Order).

8. On December 30, 2004, Southern Companies also filed a revised tariff sheet correcting its market behavior rules in compliance with the December 17 Order.⁹

Description of Filing

9. In compliance with the December 17 Order, Southern Companies submitted on February 15, 2005, a DPT for the Southern control area (compliance filing). In its compliance filing, Southern Companies states that, under the available economic capacity measure of the DPT, Southern Companies is not a pivotal supplier, it does not possess more than a 20 percent market share in any of the season/load conditions, and the Hirschman-Herfindahl Index (HHI) is less than 2500 for all season/load conditions. Southern Companies' submittal indicates that, under the economic capacity measure of the test, Southern Companies possesses market shares in excess of 62 percent in all season/load conditions and that the HHI exceeds 4000 in all season/load conditions.

10. Southern Companies also presents three alternative market power studies – a modified pivotal supplier screen, a surplus capacity index, and a contestable load analysis. Southern Companies also presents certain historical evidence to rebut the presumption of market power. Specifically, Southern Companies examines the resource positions of certain load-serving entities (LSEs) in the Southern control area relative to their resource requirements; the construction of new generation in the Southern control area; historical purchase and sales data for Southern Companies; and the historical amount of import capability available for use by LSEs in the Southern control area to access out-of-control area supplies. Southern Companies asserts that this evidence of actual market conditions based on historical information presents a steady stream of facts that are not indicative of the exercise of market power or the presence of market power concerns.

11. Southern Companies also argues that the Commission's pivotal supplier screen is a flawed implementation of a valid concept. Specifically, Southern Companies objects to the Commission's use of a proxy for wholesale load stating that it bears no relationship to the actual level of wholesale load. In addition, Southern Companies argues that the Commission's wholesale market share is also flawed. First, Southern Companies claims that the wholesale market share screen is flawed because it is based upon a computation of capacity deemed to be available to serve the wholesale market without adequately taking into account the size of the wholesale market to be served. Second, Southern

⁹ December 17 Order, 109 FERC ¶ 61,275 at Ordering Paragraph B. The designation is Substitute Original Sheet No. 7, FERC Electric Tariff, Second Revised Volume No. 4.

Companies takes issue with the determination of an applicant's native load and the determination of uncommitted capacity in the wholesale market share screen. Southern Companies also lists three additional problems it sees in the wholesale market share screen including (i) its diverting focus upon non-peak time periods when market power concerns are not likely to be great, (ii) the very low 20 percent threshold that is used to support a presumption of market power, and (iii) the use of nameplate capacity values rather than seasonal or dependable capability ratings. Our July 8 Order considered and rejected Southern Companies' criticisms of the indicative screens, and we reject them here as collateral attacks on the April 14 and July 8 Orders.¹⁰

12. Finally, Southern Companies states that no mitigation measures have been proposed because there is no market power to mitigate. Although market power mitigation measures are neither necessary nor appropriate for itself, Southern Companies counsels the Commission against the use of the cost-based mitigation measures contained in the April 14 Order.

Notice and Responsive Pleadings

13. Notice of Southern Companies' compliance filing was published in the *Federal Register*, 70 Fed. Reg. 13,022 (2005), with interventions and protests due on or before March 23, 2005. As discussed below, the comment date was subsequently extended to allow the parties to the proceeding to adopt a protective agreement to govern the disclosure and use of confidential, proprietary information contained in the compliance filing. On March 15, 2005, Longleaf Energy Associates, LLC (Longleaf) filed an intervention. On March 22, 2005, Dalton Utilities (Dalton) filed an intervention and comments. On April 21, 2005, Alabama Municipal Electric Authority (AMEA) filed an intervention and comments. On April 25, 2005, Sawnee EMC and Coweta-Fayette EMC filed an intervention and comments. On April 29, 2005, Calpine and Shell Trading filed a protest and comments.

14. Dalton states that it has entered into a long-term supply contract with Southern Companies, which was the result of an arms-length negotiation, and that it believes that the wholesale power markets in the Southern control area are competitive and without market power concerns. Dalton notes that it discussed power supply alternatives with other suppliers in addition to Southern Companies and that, after considering the various

¹⁰ July 8 Order, 108 FERC ¶ 61,026 at P 77, 89-91, 93, 95; December 17 Order, 109 FERC ¶ 61,275 at P 8 n.8.

alternatives, Dalton ultimately decided to enter into a supply contract with Southern Power. Dalton encourages the Commission to refrain from taking any action that would alter or disrupt these markets or prevent Southern Companies from participating in these markets and complying with their sales and service contracts.

15. In their comments, Sawnee EMC and Coweta-Fayette EMC state that they have entered into long-term contracts with Southern Companies and that, in each case, they had several competitive offers for power supply from suppliers not affiliated with Southern Companies. Sawnee EMC and Coweta-Fayette EMC further assert that the processes for both were competitive, and in assessing the responses and negotiating with potential suppliers, they believe that the resulting contracts with Southern Companies were, given the alternatives, in the best interests of their customers.

16. AMEA submits that the historical contestable load analysis presented by Southern Companies does not rebut the presumption that Southern Companies is able to exercise market power in selling power at wholesale in its control area. AMEA notes that, in the pending rulemaking proceeding, Market-Based Rates for Public Utilities, Docket No. RM04-7, the Edison Electric Institute and its affiliated Alliance of Energy Suppliers (EEI) have proposed that the Commission employ a substantially identical contestable load analysis in evaluating whether to allow public utilities to charge market-based rates. AMEA states that the APPA and the Transmission Access Policy Study Group (TAPS), both of which include AMEA among their members, have filed comments in the Docket No. RM04-7 proceeding, demonstrating substantive flaws in the historical contestable load analysis proposed by EEI and Southern Companies in that rulemaking proceeding and—by necessary implication—employed by Southern Companies in this proceeding. AMEA requests that the Commission incorporate by reference the comments of APPA, TAPS and NRECA in reaching its decision in the instant proceedings, supporting rejection of the historical contestable load analysis presented by Southern Companies.

17. Calpine and Shell Trading submitted comments arguing that Southern Companies has not adequately rebutted the presumption of generation market power. Calpine and Shell Trading assert that Southern Companies' criticism of the indicative screens lacks merit, and that its contestable load analysis deserves no weight. Calpine and Shell Trading state that Southern Companies' DPT is flawed and deficient, and present their own DPT analysis showing that Southern Companies fails both the economic capacity and available economic capacity measures. Calpine and Shell Trading argue that there is no reason to reject the economic capacity measure. Further, Calpine and Shell Trading state that the historical data presented by Southern Companies is not only insufficient to rebut the presumption of market power, but also confirms that Southern Companies understates its market power. Calpine and Shell Trading recommend particular mitigation measures.

18. On February 24, 2005, Calpine and Shell Trading submitted a motion for the adoption of a protective order to govern the disclosure and use of confidential, proprietary information contained in the compliance filing. On March 2, 2005, Southern Companies submitted an answer to Calpine and Shell Trading's motion, and on March 14, 2004, Southern Companies filed an unopposed motion for the adoption of a protective order in this proceeding. On April 8, 2005, the Commission issued an order denying these motions for a protective order, which stated that Calpine and Shell Trading should enter into a protective agreement with Southern Companies if they wish to gain access to the information at issue and extended the comment date to 15 days after Southern Companies, Calpine, and Shell Trading have entered into the proposed protective agreement with Southern Companies.¹¹

19. On May 16, 2005, Southern Companies submitted a motion to strike and response to certain materials filed by Calpine and Shell Trading. First, Southern Companies argues that the allegations by Calpine and Shell Trading concerning transmission market power, affiliate abuse and barriers to entry should be disregarded because they are unsupported by evidence, the Commission has instituted a separate section 206 proceeding to address these parts of the Commission's market-based rate analysis, and Southern Companies has had no opportunity to present evidence on these issues, as required by fundamental due process.

20. Southern Companies states that Calpine and Shell Trading's filing should be afforded no weight in the Commission's consideration of the matters at issue in this proceeding because it is replete with conceptual and methodological errors and because it contains material misrepresentations, misstatements and unsupported allegations. Moreover, Southern Companies argues that Calpine and Shell Trading fail to rebut Southern Companies' demonstration, based on historical data, of active competition in wholesale markets in the Southern control area. Finally, Southern Companies contends that mitigation is unnecessary and inappropriate because its compliance filing conclusively rebutted a presumption of generation market power that was supposedly established by its failure of the indicative screens.

¹¹ *Southern Companies Energy Marketing, Inc. and Southern Companies Services, Inc.*, 111 FERC ¶ 61,011 (2005).

21. Alternatively, if Calpine and Shell Trading's filing is not struck, Southern Companies concludes that the errors and omissions made by Calpine and Shell Trading show the existence of genuine issues of material fact. According to Southern Companies, these issues of material fact cannot be resolved in a "paper hearing" and hence require a trial-type evidentiary hearing to resolve these issues that comports with fundamental principles of due process and fair play.

22. On May 31, 2005, Calpine and Shell Trading filed an answer to Southern Companies' motion to strike and response, in which they urge the Commission to reject all aspects of Southern Companies' motion to strike and response. Calpine and Shell Trading first argue that Southern Companies has provided no credible reason for striking any portion of the comments and supporting affidavit previously submitted by Calpine and Shell Trading, much less satisfied the heavy burden applicable to motions to strike. Furthermore, Calpine and Shell Trading contend that the accompanying response and supplemental testimony are unauthorized, as they contravene the procedures established by the Commission in this matter and that Southern Companies is not entitled to "the last word" here because, as even it concedes, it does not bear the ultimate burden of proof.

Discussion

Procedural Matters

23. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2004), the timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding.

24. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2004), prohibits an answer to a protest or answer unless otherwise ordered by the decisional authority. We will accept the answers and responses filed by Southern Companies and Calpine and Shell Trading because they have provided information that assisted us in our decision-making process.

Delivered Price Test

25. In the April 14 Order, we stated that an applicant's failure of one or more of the indicative screens establishes a rebuttable presumption of market power. If such an applicant chooses not to proceed directly to mitigation, it must present a more thorough analysis using the Commission's DPT.¹² The DPT is used to analyze the effect on

¹² April 14 Order, 107 FERC ¶ 61,018 at P 105-12.

competition for transfers of jurisdictional facilities in section 203 proceedings,¹³ using the framework described in Appendix A of the Merger Policy Statement and revised in Order No. 642.¹⁴ The DPT is a well-established test that the Commission has used routinely to analyze market power in the merger context for many years, and it has been affirmed by the courts.¹⁵

26. The DPT defines the relevant market by identifying potential suppliers based on market prices, input costs, and transmission availability, and calculates each supplier's economic capacity and available economic capacity for each season/load condition.¹⁶ The results of the DPT are then used to perform the pivotal supplier, market share and market concentration analyses. A detailed description of the mechanics of the DPT is provided in Appendix F of the April 14 Order and Appendix A of the Merger Policy Statement.

27. Using the economic capacity for each supplier, applicants should provide pivotal supplier, market share and market concentration analyses. Examining these three factors with the more robust output from the DPT will allow applicants to present a more complete view of the competitive conditions and their positions in the relevant markets.¹⁷

¹³ 16 U.S.C. § 824b (2000).

¹⁴ *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595 (1996), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement); *see also Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, 65 Fed. Reg. 70,983 (2000), FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 66 Fed. Reg. 16,121 (2001), 94 FERC ¶ 61,289 (2001).

¹⁵ *See, e.g., Wabash Valley Power Associates, Inc. v. FERC*, 268 F. 3d 1105 (D.C. Cir. 2001).

¹⁶ Super-peak, peak, and off-peak, for Winter, Shoulder and Summer periods and an additional highest super-peak for the Summer.

¹⁷ April 14 Order, 107 FERC ¶ 61,018 at P 107-08.

28. Under the DPT, to determine whether an applicant is a pivotal supplier in each of the season/load conditions, applicants should compare the load in the destination market to the amount of competing supply (the sum of the economic capacities of the competing suppliers). The applicant will be considered pivotal if the sum of the competing suppliers' economic capacity is less than the load level (plus a reserve requirement that is no higher than state and regional reliability council operating requirements for reliability) for the relevant period. The analysis should also be performed using available economic capacity to account for applicants' and competing suppliers' native load commitments. In that case, native load in the relevant market would be subtracted from the load in each season/load period. The native load subtracted should be the average of the actual native load for each season/load condition.

29. Each supplier's market share is calculated based on economic capacity (the DPT's analog to installed capacity). The market shares for each season/load condition reflect the costs of the applicant's and competing suppliers' generation, thus giving a more complete picture of the applicant's ability to exercise market power in a given market. For example, in off-peak periods, the competitive price may be very low because the demand can be met using low-cost capacity. In that case, a high-cost peaking plant that would not be a viable competitor in the market would not be considered in the market share calculations because it would not be counted as economic capacity in the DPT. Applicants must also present an analysis using available economic capacity (the DPT's analog to uncommitted capacity) and explain which measure more accurately captures conditions in the relevant market.

30. Under the DPT, applicants must also calculate the market concentration using the HHI based on market shares.¹⁸ HHIs are usually used in the context of assessing the impact of a merger or acquisition on competition. However, as noted by the

¹⁸ The HHI is the sum of the squared market shares. For example, in a market with five equal size firms, each would have a 20 percent market share. For that market, $HHI = (20)^2 + (20)^2 + (20)^2 + (20)^2 + (20)^2 = 400 + 400 + 400 + 400 + 400 = 2000$. Equal-size firms in this illustration will not necessarily be observed in an actual market where one or more firms may have greater than a 20 percent market share and other firms less than a 20 percent market share. In that case, the HHI may be 2000 but the contributions of the individual firms to that concentration will vary.

U.S. Department of Justice in the context of designing an analysis for granting market-based pricing for oil pipelines, concentration measures can also be informative in assessing whether a supplier has market power in the relevant market.¹⁹

31. A showing of an HHI less than 2500 in the relevant market for all season/load conditions for applicants that have also shown that they are not pivotal and do not possess more than a 20 percent market share in any of the season/load conditions would constitute a showing of a lack of market power, absent compelling contrary evidence from intervenors. Concentration statistics can indicate the likelihood of coordinated interaction in a market. All else being equal, the higher the HHI, the more firms can extract excess profits from the market. Likewise a low HHI can indicate a lower likelihood of coordinated interaction among suppliers and could be used to support a claim of a lack of market power by an applicant that is pivotal or does have a 20 percent or greater market share in some or all season/load conditions. For example, an applicant with a market share greater than 20 percent could argue that that it would be unlikely to possess market power in an unconcentrated market (HHI less than 1000).

32. As with our initial screens, applicants and intervenors may present evidence such as historical wholesale sales, which can be used to calculate market shares and market concentration and to refute or support the results of the DPT. In the April 14 Order, we encouraged applicants to present the most complete analysis of competitive conditions in the market as the data allow. We have used actual data in our analysis of mergers and other section 203 jurisdictional transactions to supplement or support the analysis of the effect of such transactions on competition. As we stated in Order No. 642:

If sales data indicate that certain participants actually have been able to reach the market in the past, it is appropriate to consider whether they are likely candidates to be included in the market in the future. It is for this reason that we will require a “trade data check” as part of the competitive analysis test.²⁰

¹⁹ See *Comments of the United States Department of Justice in response to Notice of Inquiry Regarding Market-Based Ratemaking for Oil Pipelines*, Docket No. RM94-1-000 (January 18, 1994). “The Department and the Commission staff have previously advocated an HHI threshold of 2,500, and it would be reasonable for the Commission to consider concentration in the relevant market below this level as sufficient to create a rebuttable presumption that a pipeline does not possess market power.”

²⁰ Order No. 642, FERC Stats. & Regs. ¶ 31,111 at 31,887 n. 41.

33. Applicants are required to file historical trade and transmission service data that can be used to corroborate the results of the DPT. Applicants must provide actual trade data regarding electricity sales and purchases in which they participated for the most recent two years for which data are available, identifying the seller, the buyer, the characteristics of the product traded and the price.²¹ Further, applicants must provide an explanation of any significant differences between the results obtained by the DPT and recent trade patterns. Applicants must also submit a description of all instances in the two years preceding the application in which transmission service on systems owned or operated by the applicants had been denied, curtailed or interrupted.

Southern Companies' Delivered Price Test

Results

34. Southern Companies' DPT²² indicates that it satisfies the Commission's standards for the pivotal supplier, market share and market concentration analyses under the available economic capacity measure for all ten season/load periods under study. However, with respect to the economic capacity measure, Southern Companies' DPT indicates that it fails the market share and market concentration analyses for all ten season/load periods; Southern Companies did not submit the pivotal supplier analysis under the economic capacity measure.

35. Southern Companies provides an analysis of the sensitivity of the available economic capacity measure results to a \$25 increase of the market price in the summer super-peak period, reporting that the market share for this period increases from 6.1 to 17.7 percent and the HHI remains below 2500.

²¹ Appendix A of the Merger Policy Statement (Order No. 592) also requires submittal of trade data as a check to compare actual trade patterns with the results of the DPT.

²² Southern Companies chose to submit its DPT analysis using 2005 prices forecasted by Henwood, a commercial source of energy industry data. Southern Companies' analysis also employs forecasted 2005 loads and generation capacity of Southern Companies and competitors.

36. Southern Companies asserts that the economic capacity measure of the DPT has no applicability to this generation dominance inquiry because the economic capacity measure ignores native load and firm wholesale obligations. According to Southern Companies, this is both conceptually wrong and inconsistent with Commission orders in these dockets that emphasize the need to recognize those load obligations.

Calpine and Shell Trading Comments

37. Calpine and Shell Trading argue that the Southern Companies' DPT analysis should be rejected because it contains flawed assumptions, which, when corrected, indicate that Southern Companies fails both measures of the DPT.

Comments on Available Economic Capacity Measure

38. Calpine and Shell Trading argue that the available economic capacity measure presented by Southern Companies makes problematic and unrealistic assumptions regarding native load. In particular, they submit that Southern Companies assumes that its lowest cost generation, including capacity owned by Southern Power, is used to serve native load, an assumption at odds with available evidence regarding Southern Power's wholesale transactions. Calpine and Shell Trading point to Southern Companies' filings with the Securities and Exchange Commission, in which it states that Southern Power sold energy to affiliates to serve their retail load at a higher price than it sold energy to non-affiliates (an average of \$14.94 per MWh higher). Calpine and Shell Trading argue that Southern Power sold energy to affiliates at a price approximately 45 percent above cost, while it sold to non-affiliates at a price approximately 11 percent above cost, and since Southern Power sells a significant amount of power to the Southern utilities at market-based rates from capacity that would be effectively excluded from the available economic capacity measure, the economic capacity measure cannot be ignored. Calpine and Shell Trading also claim that since capacities, rather than actual sales, are used in the DPT, the available economic capacity analysis creates results inherently biased downward for utilities that own the transmission system. Calpine and Shell Trading assert that adjusting a utility's market share to account for native load can restrict the results to a very narrow portion of the hours in a year, ignoring the potential for the exercise of market power in other hours and in long-term markets and leading to false negatives for utilities.

Comments on Economic Capacity Measure

39. Calpine and Shell Trading contend that there is no legitimate reason to reject the economic capacity measure of the DPT. Calpine and Shell Trading further assert that Southern Companies does not distinguish between capacity used for native load purposes and capacity available for the wholesale market and note that Southern Companies

concedes that there is no bright line. Calpine and Shell Trading assert that the fact that a supplier's entire generation fleet potentially stands ready to serve both native and "contestable" loads at any given time is why the economic capacity measure is appropriate and valid. Calpine and Shell Trading emphasize that the Commission has long used both in the merger context and that there is no economic basis to differentiate the merger context from the market-based rate context.

40. By not deducting native load, Calpine and Shell Trading contend that the economic capacity measure allows detection of market power due to foreclosure of competing generators from making wholesale sales destined for the retail market. In addition, the economic capacity measure accounts for the possibility that Southern Companies may be able to sell power under bilateral contracts without the price of that power necessarily being disciplined by the price paid by Southern Companies in their purchases from other generators or the prices paid by Southern Companies' retail customers. Calpine and Shell Trading also argue that subtracting native load understates the extent of a utility's sales to wholesale customers. Finally, Calpine and Shell Trading assert that the economic capacity measure should be given more weight than the available economic capacity measure because it accounts for the fact that a utility subject to cost-of-service rate regulation generally profits from higher wholesale prices, and thus it may have the incentive to raise wholesale prices, regardless of its net position with respect to its retail load.

Other Comments on Southern Companies' Delivered Price Test

41. Moreover, Calpine and Shell Trading assert the Southern Companies' DPT is deficient. Calpine and Shell Trading state that Southern Companies uses total transfer capability (TTC) instead of simultaneous import capability, which results in a much higher number of imports considered in the analysis. Calpine and Shell Trading also state that Southern Companies' DPT assumes that all of the available generation capacity in the market is fully deliverable, which understates the level of market concentration by incorporating suppliers that have limited market access such as merchant generators located in the southwest quadrant who experience internal transmission constraints. Further, Calpine and Shell Trading take issue with Southern Companies' use of a load projection rather than historical data, which increases the native load proxy by 15 to 20 percent.

42. Calpine and Shell Trading note that Southern Companies' sensitivity analysis only tests for sensitivity to market prices in the highest super-peak for the summer under the available economic capacity measure and does not adequately test the sensitivity of its DPT results to changes in underlying assumptions. Calpine and Shell Trading state that their analysis shows similar price changes would have a much larger impact on the results of the available economic capacity measure for other periods. Calpine and Shell Trading

further contend that Southern Companies fails to perform sensitivity runs for changes in fuel prices, native load proxies, existing wholesale contracts, import capability, and internal transmission constraints, as required by Order No. 642.²³

43. Calpine and Shell Trading explain that their analysis finds Southern Companies fails the economic capacity measure for every season/load condition and that they have confirmed this result using sensitivity analyses for a wide range of prices. Calpine and Shell Trading also calculated the available economic capacity relying on Southern Companies' market load assumptions (which exclude native load) and assuming no internal constraints and concluded that Southern Companies still fails the available economic capacity measures in four of the ten season/load conditions analyzed. Calpine and Shell Trading argue that, because Southern Companies' native load assumptions produce a negative number for available economic capacity during several periods, Southern Companies either overstates actual native load obligations or has not purchased the economic capacity from competitors necessary to minimize energy costs for their customers. Calpine and Shell Trading state that they have confirmed these results in a sensitivity analysis using 2003 hourly load data from FERC Form 714, noting that the use of actual load data rather than projected load widens the margin of failure. Calpine and Shell Trading state that they have also performed an analysis of the sensitivity of the DPT results to market price and found that Southern Companies exceeds the market share threshold in the available economic capacity analysis in all season/load conditions and the market concentration threshold in one season/load condition.

Internal Transmission Constraints and the Relevant Geographic Market

44. Calpine and Shell Trading assert that there are widely recognized transmission constraints within the Southern control area. They present evidence that Southern Companies failed to incorporate internal transmission constraints within the Southern control area in determining the economic supply in the market, from which they conclude that Southern Companies' DPT results understate Southern Companies' market power by including within the relevant geographic market suppliers that do not have market access.

²³ Order No. 642, FERC Stats. & Regs. ¶ 31,111 at 31,891-82; 18 C.F.R. § 33(d) (2004).

Calpine and Shell Trading contend that this failure – in addition to the use of TTC rather than SIC, as required by the Commission, for estimating the amount of available competing imports into the Southern control area – contradicts the Commission’s requirement that an applicant only include physically deliverable energy in performing the DPT analysis.

45. Calpine and Shell Trading present a DPT that, they assert, takes into account the transmission constraints in the Southern control area. Based on that test, they claim that: (a) not all of the economic capacity according to the “unconstrained” DPT would actually be deliverable when considering internal transmission constraints; (b) the physical transmission constraints in the Southern control area disproportionately limit merchant generators compared to generators owned by Southern Companies; and, (c) due to internal transmission constraints, not all of the new merchant generation built after 2002 was able to physically deliver energy to reduce Southern Companies’ market share and market concentration. Calpine and Shell Trading thus conclude that taking account of internal transmission constraints in the DPT for the Southern control area further increases Southern Companies’ market share and market concentration.

46. Calpine and Shell Trading also present an Optimal Power Flow analysis, which simulates economic dispatch while taking account of transmission constraints, i.e., it simultaneously minimizes the total generation cost necessary to meet the control area load while maintaining the security of the system. They assert that the Optimal Power Flow analysis confirms that Southern Companies holds a dominant market position (approximately a 70 percent market share of economic capacity) in the Southern control area.

Southern Companies’ Response

47. In its motion to strike and response, Southern Companies submits a number of criticisms of the methodology and data used by Calpine and Shell Trading in performing their DPT. Southern Companies argues that Calpine and Shell Trading’s analysis contains flaws and that, when these are corrected, that analysis is consistent with Southern Companies’ own analysis. Southern Companies states that Calpine and Shell Trading attributed to Southern Companies more generation capacity than is appropriate for the period during which Calpine and Shell Trading’s analysis shows Southern Companies’ market share to be greater than 20 percent and that this results from Calpine and Shell Trading’s unexplained reliance on Platts’ BaseCase rather than Henwood. Southern Companies also states that Calpine and Shell Trading used inappropriately low and unsupported variable costs (as much as 35 percent lower on a MW-weighted average basis across all coal-fired units for the summer), as well as low scheduled and forced

outage rates for Southern Companies' coal-fired generators. Moreover, Southern Companies asserts that the Platts' data is inconsistent with the competitive market-clearing prices used in Calpine and Shell Trading's study. Southern Companies also claims that Calpine and Shell Trading did not properly account for Southern Companies' hydroelectric generation, by assuming that this generation runs at full capacity year-round. Southern Companies disputes Calpine and Shell Trading's claim that the negative available economic capacity measure for Southern Companies indicates that it does not have sufficient capacity to meet its load obligations, arguing that this instead suggests that at times it might be more economical to purchase to meet some of its requirements. Southern Companies also asserts that Calpine and Shell Trading's analysis does not reflect the same underlying consistency that Southern Companies' does.

48. Southern Companies also disputes Calpine and Shell Trading's assertion that Southern Companies improperly used TTC rather than simultaneous import capability in its analysis. Southern Companies states that its TTC values already take into account, as appropriate, simultaneous limits and that Calpine and Shell Trading made further errors in this regard. Moreover, Southern Companies rejects Calpine and Shell Trading's accusation that Southern Companies did not perform sensitivity analyses as required and appropriate. Southern Companies states that these sensitivities are encouraged and not required and that its study is not sensitive to small variations in price. Southern Companies states that Calpine and Shell Trading's sensitivity analyses are meaningless because they use 2003 load data and 2005 generation data and overlook the fact that fuel price changes and competitive market-clearing prices will move together.

49. Southern Companies rejects Calpine and Shell Trading's analysis of internal transmission constraints in the Southern control area and contends that their analysis relies on improper assumptions. Southern Companies further argues that their analysis is conceptually meaningless, in that it introduces an uneconomic, artificial and unnecessary "transmission constraint" concept into the DPT calculations, and that it contains additional flaws, in particular, a biased presumption that transmission constraints disproportionately affect Southern Companies' competitors. Southern Companies also states that Calpine and Shell Trading's analysis has mischaracterized Commission precedent, fails to understand the DPT, ignores the role of state regulators, and relies on extraneous or irrelevant information. Southern Companies contends that Calpine and Shell Trading's mitigation proposals are inappropriate as they do not relate to horizontal market power.

50. In addition, Southern Companies contends that the economic capacity measure ignores native load obligation entirely and should be rejected, contrary to Calpine and Shell Trading's assertions that the measure is relevant.

Commission Determination

Southern Companies' Use of Total Transfer Capability

51. We find that Southern Companies' DPT overstates the amount of the non-Southern Companies generation that can be imported into the Southern control area because it uses TTC, which the Commission has previously found assumes an unrealistically high degree of transmission access for competitors.²⁴ Southern Companies states that it uses TTC to allow for the "full capability of the transmission system to move power." Southern Companies claims that the TTC measures take into account simultaneous limits, but it does not state how this is accomplished nor does it support this claim or otherwise address the Commission's specific determination that simultaneous import capability is the more accurate and appropriate measure of the effect of transmission limitations on how much generation can actually be imported into the relevant market.²⁵

52. The Commission rejected the use of TTC, in favor of the simultaneous import capability measure, for transmission constraints on the grounds that, while TTC is a measure of maximal transmission capability, it does not reflect reliability and operational limits on the line.²⁶ We note that Southern Companies had already performed and submitted the required simultaneous import capability study, which we accepted in the December 17 Order.²⁷ Accordingly, we find that Southern Companies' use of TTC in its DPT is inappropriate and understates Southern Companies' position in the market by overstating the amount of non-Southern Companies generation.

²⁴ April 14 Order, 107 FERC ¶ 61,018 at P 82.

²⁵ July 8 Order, 108 FERC ¶ 61,026 at P 46.

²⁶ April 14 Order, 107 FERC ¶ 61,018 at P 84; July 8 Order, 108 FERC ¶ 61,026 at P 46.

²⁷ December 17 Order, 109 FERC ¶ 61,275 at P 30.

Southern Companies' Failure to Perform Pivotal Supplier Analysis Using Economic Capacity Measure

53. Southern Companies did not perform the pivotal supplier analysis based on the economic capacity measure, as required by the April 14 Order.²⁸ As discussed above, Southern Companies contends that the pivotal supplier analysis is superfluous. According to Southern Companies, since Southern Companies is not pivotal based on available economic capacity, it is not pivotal by a greater margin based on economic capacity. The Commission finds that Southern Companies' failure to comply with this directive of the April 14 Order results in a DPT analysis that is incomplete and, therefore, not fully reliable.

Southern Companies' Use of Projected Data

54. Southern Companies used projected data for 2005, rather than historical data as the Commission specifically requires.²⁹ In particular, Southern Companies calculates the available economic capacity measure based on the assumption that peak load would grow at a rate of 7.5 percent between 2003 and 2005, which we find to be unrealistically high given the 3 percent average annual growth in the Southern control area peak load per year from 1989-2003.³⁰ Similarly, Southern Companies' own forecasts contradict its estimates that demand would grow at a 7.5 percent annual rate during this period and instead indicate that its expected demand growth is approximately 3 percent per year.³¹

²⁸ April 14 Order, 107 FERC ¶ 61,018 at P 108.

²⁹ *Id.* at P 118. Order No. 642 states that the Commission will consider the use of estimated prices if they are accurate representations of prevailing market conditions and are supported by available data. FERC Stats. & Regs. ¶ 31,111 at 31,891.

³⁰ NERC Electric Supply & Demand (ES&D) database. The 3 percent growth rate is a compounded growth rate. *See also NERC 2004 Long-Term Reliability Assessment* at 80 (2005) (forecasting summer peak demand growth at 2.4 percent annual average rate for 2004-2013 period in the Southern subregion, which is consistent with historical growth rate of 2.4 percent). Similarly, the Regional Self-Assessments for the Southern subregion submitted for the 2003 and 2002 *NERC Long-Term Reliability Assessment* forecasted average annual peak demand growth of 2.6 percent and 2.77 percent, respectively.

³¹ *See Southern Company 2004 Annual Report* at 12 ("We project long-term average annual... electricity demand growth of 2 percent."); *Southern Company 2003*

Southern Companies' Sensitivity Analysis

55. Southern Companies did not provide adequate sensitivity analyses and the data necessary to corroborate its DPT results, and it provided incomplete information regarding transmission constraints, firm transmission rights, and historical trade and transmission access data. Southern Companies has thus failed to comply with the Commission's regulations requiring applicants to demonstrate that the results of their analysis do not vary significantly in response to small variations in actual or estimated prices.³²

Hearing Procedures

56. The principal issue in this case is whether Southern Companies has generation market power regarding sales in its control area. Thus, if we are to rely on a DPT analysis, the DPT must reflect the actual competitive alternatives available to customers located in the Southern control area. As such, it is important that the geographic market used in the DPT accurately reflect the area over which those customers can effectively access competing suppliers.

57. The DPT was originally developed as part of the Commission's analytic screen for evaluating proposed mergers. In promulgating the DPT, the Commission observed that the "key to incorporating transmission limitations into the merger analysis is to include each supplier in the relevant market only to the extent of the transmission capability available to them."³³ Southern Companies' DPT analysis uses the Southern control area as the relevant geographic market, but, according to intervenors, does not take into account transmission limitations within the Southern control area.

58. We find that important questions exist concerning whether the entire Southern control area is the appropriate relevant geographic market or whether there exist binding transmission constraints such that it is more appropriate to define more than one

Annual Report at 12 ("In our regulated business, we expect average long-term demand growth of about 2 percent a year."); *Southern Company 2002 Annual Report* at 6 ("Demand growth [is] expected to be about 3.5 percent a year."). In addition, based on the figures reported in these three annual reports, the rate of peak demand growth on the Southern Company system during the period 1998 to 2004 averaged 3 percent per year.

³² 18 C.F.R. §33.3(d)(6) (2004).

³³ Merger Policy Statement at 30,132.

geographic market within the Southern control area. This is an issue of material fact that may affect the results of the DPT in this case. The Commission has defined relevant geographic markets that are smaller than a control area in the context of a DPT analysis.³⁴ Where there are genuine issues of material fact that cannot be resolved on the basis of the written record, or where the DPT analysis has overlooked certain competitive effects, the Commission will set such issues for hearing.³⁵ Accordingly, we will require an evidentiary hearing.

Conclusion

59. We find that there are serious deficiencies in Southern Companies' DPT, including: its use of TTC, rather than simultaneous import capability, to account for transmission constraints; its failure to perform the pivotal supplier analysis using the economic capacity measure; its use of projected data, rather than historical data; and the submission of inadequate sensitivity analyses and incomplete supporting data. In addition, we find that the parties' pleadings raise an issue of material fact as to the impact of internal transmission constraints on the relevant geographic market. Due to these deficiencies and issues of material fact, we are unable to rely on or verify the results of Southern Companies' DPT. The errors in Southern Companies' DPT and the parties' pleadings raise issues of material fact that cannot be resolved based on the written record before us, and are more appropriately addressed in a trial-type evidentiary hearing. Accordingly, we will set this matter for a trial-type evidentiary hearing.

60. The presiding judge in this proceeding is directed to make any factual findings necessary to fully develop the record and to provide the Commission with a properly-constructed DPT on whose results the Commission can, in turn, rely. The Commission does not, however, set for hearing the issue of *how* the results of the properly-constructed DPT should be interpreted and whether Southern Companies does or does not have generation market power in the Southern control area.

61. For purposes of developing a properly-constructed DPT, the issues to be addressed include, but are not limited to: (i) the use of simultaneous import capability, rather than TTC, as the measure of transmission constraints; (ii) the performance of the pivotal

³⁴ See *Wisvest-Connecticut, LLC and NRG Connecticut Power Assets, LLC*, 96 FERC ¶ 61,101 at 61,401(2001); *Energy East Corporation and RGS Energy Group, Inc.* 96 FERC ¶ 61, 322 (2001); *CP&L Holdings, Inc and Florida Progress Corporation*, 92 FERC ¶ 61,023 (2000).

³⁵ See Merger Policy Statement at 30,118-19.

supplier analysis under the economic capacity measure; (iii) the use of historical data for prices, loads, and generation, rather than projected data, (iv) the development of sensitivity analyses and the data necessary to corroborate the DPT results in compliance with the Commission's regulations; and (v) the impact of any transmission constraints on the appropriate scope of the relevant market. The parties are directed to provide the presiding judge with any and all assistance needed to fully develop the record and to ensure a properly-constructed DPT. After the presiding judge assigned to these proceedings submits an initial decision regarding a properly-constructed DPT, and the parties have filed briefs on and opposing exceptions, the Commission will address the issue of whether Southern Companies does or does not have generation market power in the Southern control area.

62. In addition, we note that Southern Companies provided data on competitors in an aggregated form and failed to provide in a usable format the disaggregated data components of an HHI calculation, that is, the identity of the rivals and each individual rival's economic capacity, native load, available economic capacity, market share and contribution to market HHI. We expect DPT studies submitted to include disaggregated data components such that all relevant data underlying the HHIs, and in particular, underlying data for each competitor, is clearly specified.

63. Finally, we emphasize that applicants are required to file historical trade and transmission service data that can be used to corroborate the results of the DPT. Applicants must provide actual trade data regarding electricity sales and purchases in which they participated for the most recent two years for which data are available, identifying the seller, the buyer, the characteristics of the product traded and the price. Further, applicants must provide an explanation of any significant differences between the results obtained by the DPT and recent trade patterns. Applicants must also submit a description of all instances in the two years preceding the application in which transmission service on systems owned or operated by the applicants had been denied, curtailed or interrupted.

64. Southern Companies' sales at market-based rates in the Southern control area will remain subject to refund for the statutory refund period commencing with the refund effective date established in the December 17 Order, pending the outcome of the trial-type evidentiary hearing and a subsequent order by the Commission.

Southern Companies' Historical Data

65. The Commission stated in the April 14 and July 8 Orders that applicants may present historical evidence to show that they satisfy the generation market power concerns. However, the evidence that will be considered is historical sales and/or access to transmission to move supplies within, out of, and into a control area.

66. The Commission explained in Order No. 642 that, if the DPT thresholds are exceeded, it will take a closer look at whether the merger would harm competition. The facts of each case (e.g., market conditions, such as demand and supply elasticity, ease of entry and market rules, as well as technical conditions, such as the types of generation involved) determine whether the merger would harm competition. When the DPT results exceed the thresholds, applicants must provide evidence of relevant market conditions that indicate a lack of a competitive problem, or they should propose mitigation.

67. To demonstrate its lack of market power, Southern Companies submitted historical data regarding the conditions in the long, intermediate, and short-term markets in the Southern control area during calendar years 2002, 2003, and 2004. Specifically, Southern Companies examines the resource positions of certain LSEs in the Southern control area relative to their resource requirements, the construction of new generation in the Southern control area, historical purchase and sales data for Southern Companies, and the historical amount of import capability available for use by LSEs in the Southern control area to access out-of-control area supplies. According to Southern Companies, the analyses, data, and other evidentiary submissions demonstrate the competitive nature of the wholesale power markets in the Southern control area and establish that the Southern Companies do not have, and could not exercise, market power in the Southern control area.

Southern Companies' Position in Short-Term Markets

Southern Companies' Filing

68. Southern Companies argues that it is a net purchaser of short-term energy (defined by applicants as hourly and daily transactions). Therefore, according to Southern Companies, its natural interest is lower prices. To support its claim that it is a net purchaser, Southern Companies notes that: (i) the ratio of its short-term energy purchases to sales was 2.7, 3.9, and 7.5 in 2002, 2003, and 2004, respectively, aggregated across the entire year; (ii) the ratio of its short-term energy purchases to sales during the highest priced hours was 8.8, 12.8, and 9.8 in 2002, 2003, and 2004, respectively; (iii) it was a net purchaser in 18,073 hours and a net seller in 6,521 hours in the 2002-2004 time period; (iv) it was a net purchaser during 2,340 hours and a net seller during 121 hours out of the 10 percent of highest priced hours during the 2002-2004 time period; and (v) it was net seller in small portion (3-17 percent) of the highest load hours during this period. Southern Companies contends that, because of its net buyer position, it cannot profitably raise prices in short-term wholesale markets and that this rebuts any suggestion that it has the incentive (let alone the ability) to raise market prices. According to Southern Companies, this is because the practical result would be to raise its own costs, either in the form of higher prices for short-term purchases from others or the use of higher-cost portfolio resources that would not otherwise have been dispatched.

69. Southern Companies argues that, to exercise market power in those hours when it is a net seller, it would have to be able to predict in advance when such sale hours will occur, which it cannot. Secondly, Southern Companies argues that LSEs have alternative supplies available to them, which would prevent the exercise of market power by Southern Companies.

70. Specifically, Southern Companies argues that it would have been difficult for it to exercise market power in 2002, 2003, and 2004 given the historical levels of available transmission capability (ATC). Southern Companies states that in 2002, 2003, and 2004 totaled across all paths, year-ahead ATC amounts average 2,018 MW on an annual basis and 3,845 MW on a summer-only basis. Further, Southern Companies states there was a substantial amount of post-transaction ATC into the Southern control area. Southern Companies claims that there was sufficient ATC available to allow LSEs to access out-of-control area supplies. In particular, Southern Companies claims that historical data regarding import capability into the Southern control area over this three-year period show that, even during periods of higher prices and higher volumes in the short-term markets, entities inside the Southern control area had access to outside sources of supply. In addition, during all hours that the Southern Companies entered into short-term sales transactions in the control area, it claims that import capability in excess of its sales volumes was available in the event that buyers sought access to supplies in external markets.

71. Further, during the two transmission loading relief (TLR) events initiated in the Southern control area during calendar years 2002, 2003, and 2004, Southern Companies states that it was not a net seller in the short-term markets and that it increased purchases during the TLR hours. Southern Companies concludes that, given these circumstances, it lacked the incentive to raise market prices in the Southern control area, and these circumstances contradict any suggestion that it was withholding capacity in an attempt to elevate market prices. Southern Companies also contends that its sales activity in the short-term markets was not affected by the absence of external supplies due to TLR events; it was a purchaser during the vast majority of these hours, and there is no discernable pattern in pricing behavior on the part of the Southern Companies before, during, and after these TLR hours.

Calpine and Shell Trading Comments

72. Calpine and Shell Trading argue that Southern Companies' analysis of competitive conditions in short-term markets within the Southern control area is flawed because it focuses solely on transactions conducted by Southern Companies, thus failing to provide any comparison with the market behavior of competing generators or a measurement of Southern Companies' market share in short-term sales. Calpine and Shell Trading note that this analysis also focuses on transactions of a comparatively small volume (sales

averaging less than 150 MW), which cannot provide significant evidence regarding the market behavior of a utility with over 35,000 MW of installed capacity. Calpine and Shell Trading reject the assertion that Southern Companies' high volume of purchases relative to sales reduces the likelihood that Southern Companies would want to drive up market prices, as it ignores the fact that sales and purchases may take place at different times, enabling Southern Companies to abuse market power in the hours in which it sells power.

73. Calpine and Shell Trading argue that, by failing to study whether alternative supplies could be physically and economically delivered into the Southern control area, Southern Companies cannot claim that buyers had adequate access to alternative suppliers during periods in which Southern Companies sold power at high prices. Regardless, Calpine and Shell Trading contend that the historical data provided by Southern Companies is simply uninformative because the fact that wholesale purchasers may rely on long-term markets provides no information as to whether the long-term markets themselves are competitive. Furthermore, its emphasis on short-term markets and the question of whether Southern Companies has incentives to engage in physical withholding strategies provides no information regarding whether Southern Companies is a dominant market participant.

74. Calpine and Shell Trading provide an analysis of Southern Companies' market position in short-term markets using historical data. This data shows that during the 2002-2003 period Southern purchased an average of 2,188 MW from non-affiliated market participants and that it sold an average of 4,929 MW to non-affiliated customers. Moreover, Southern accounted for 47 percent of wholesale sales to customers in the Southern control area. Calpine and Shell Trading argue that since Southern Companies accounted for 47 percent of the wholesale sales in the control area for 2003, this rebuts Southern Companies' conclusion that its market share is between 0 and 15 percent.

Southern Companies' Response

75. In its motion to strike and response to the comments of Calpine and Shell Trading, Southern Companies states that it did not include "transactions" among Southern Companies because those are not truly transactions; they are instead allocation mechanisms resulting from integrated economic dispatch. Moreover, these "accounting functions" are based on cost, and this is a market-based rate proceeding. Accordingly, to the extent that the functions do entail interaction with competitive markets (such as opportunity sales), they are reflected in the data presented. In addition, Southern Companies states that these purchases and sales among Southern Companies by definition net to zero and have no effect on the analysis.

76. Southern Companies also contends that Calpine and Shell Trading's assertion that there is inadequate transmission capacity is invalid, as Southern Companies' analysis indicates that in all hours in which Southern Companies participated in the short-term market as sellers, post-transaction transmission capability exceeded the volume of their gross sales. Southern Companies also notes that, in contrast with Calpine and Shell Trading's comments, Southern Companies did consider whether transactions could be delivered into the Southern control area because consideration of physical delivery was implicitly part of the analysis of post-transaction ATC.

77. Southern Companies further contends that Calpine and Shell Trading's discussion of issues such as foreclosure are inappropriate for this proceeding as this proceeding only concerns generation market power. According to Southern Companies, Calpine and Shell Trading's allegations regarding the possibility that Southern Companies may refuse to purchase from merchant generators when their generation costs are lower are speculative and unsupported.

78. Southern Companies also asserts that Calpine and Shell Trading's comparison between sales to affiliates and non-affiliates results is an erroneous conclusion. According to Southern Companies, this analysis is flawed because the comparison is of two different products, the calculation of prices uses incompatible data inputs, and the profits assigned to the products fail to account for certain costs and thus are grossly overstated. Southern Companies emphasizes that the sales to affiliates shown include long-term purchased-power agreements, whereas the sales to non-affiliates are primarily short-term energy transactions, and the revenues associated with the former include capacity revenues as well as energy revenues. Southern Companies argues that Calpine and Shell Trading's statement that Southern Companies' analysis wrongly aggregates transactions across hours is inconsistent with the fact that Calpine and Shell Trading rely on data that has been aggregated across a two-year timeframe.

Entry of New Generation

Southern Companies' Filing

79. To depict the actual condition of the intermediate- and long-term markets in the Southern control area, Southern Companies presents information on the entry of new generation resources in the Southern control area, the majority of which has been developed by entities not affiliated with Southern Companies.

80. Southern Companies states that it had approximately 77 percent of the peak load in 2002 and 68 percent of the resources in the Southern control area. Southern Companies states that the overall peak hour reserve margin in the Southern control area is approximately 41 percent for the calendar year 2002. Southern Companies cites the

construction of 23,450 MW of new generating capacity since 2000 (of which only about 8,000 MW or 35 percent was owned by Southern Companies) in the Southern control area. Southern Companies argues that this increase in capacity shows that: (i) there are no real barriers to generation construction in its area; (ii) the long-term generation market is competitive; (iii) there is a surplus of available capacity over resource requirements; and (iv) Southern Companies is not exercising market power by withholding capacity from the market as evidenced by its willingness to build.

81. Further, Southern Companies argues that buyers were also able to access generating resources outside the Southern control area. The Southern Companies' OASIS provides data that enables buyers internal to the control area and sellers external to the control area to identify the amount of ATC to import off-system power into the Southern control area one year in advance of the delivery period. Southern Companies presents the year-ahead postings of ATC for 2002, 2003 and 2004 in support of its contention. Southern Companies argues that, acting on these postings, LSEs may choose to go ahead and arrange transactions for supplies from outside the Southern control area one year before the delivery date and thereby strengthen their long-range supply portfolios. Southern Companies asserts that external sellers also consider this to be critical information because it enables them to more readily determine their future ability to access the Southern control area to market their generation on an extended-term basis. Whether buying or selling, Southern Companies submits that knowing the viability of alternatives outside of the Southern control area serves to enhance the competitiveness of the long- and intermediate-term markets inside the Southern control area.

82. Southern Companies also points to successful self-build activity by AMEA and other non-Southern Companies LSEs as evidence of the absence of any impediments to such entities developing their own generation assets in the Southern control area to meet their obligations.

LSE Resource Portfolios

Southern Companies' Filing

83. To depict the actual condition of the intermediate- and long-term markets in the Southern control area, Southern Companies presents information regarding four LSEs in its control area that, consistent with their long-term load obligations, have secured long-term resources from a variety of sources including generation the LSEs have owned for years, newly constructed generation, and long-term firm purchases. Southern Companies argues that this gives the LSEs protection against attempts to exercise market power in short-term markets and is evidence that long-term purchase agreements with Southern Companies were superior offers.

84. Specifically, Southern Companies describes the long-range planning strategies of the Municipal Electric Authority of Georgia (MEAG Power), Oglethorpe Power Corporation (Oglethorpe), AMEA, and Dalton Utilities (based on the 2003 annual report of each) to show that, through generation ownership and long-term purchase contracts, these entities are effectively insulated from the need to secure supplies from the short-term markets to satisfy their load obligations. Southern Companies claims that the planning efforts of these entities enhance the intermediate- and long-term competitive markets in the Southern control area and that the LSEs in the Southern control area have had ample opportunity to contract with a number of competing suppliers for capacity and energy to meet their supply obligations. Southern Companies presents information on requests for proposals (RFPs) and contracts to support its contention.

Calpine and Shell Comments

85. Calpine and Shell Trading state that this analysis is flawed and rests on erroneous economic assumptions. First, they argue that the lack of short-term purchases in the Southern control area results from a lack of competition in the short-term markets, as LSEs in the area may have decided to make long-term purchases or self-build due to the lack of market choices in the short-term markets. Second, Calpine and Shell Trading argue that market power can be exercised in intermediate- and long-term markets.

86. Third, Calpine and Shell Trading argue that testimony before the Florida Public Service Commission demonstrates that Southern Companies controls all of the uncommitted capacity that is able to obtain firm transmission access from the Southern control area to Florida Power & Light Company (FPL). Consequently, despite the apparently large amount of nominally available capacity in the Southeast, Calpine and Shell Trading argue that there are significant transmission-related barriers that severely limit the ability of wholesale customers to procure capacity and energy from merchant generation and other independent sources of supply.

Southern Companies' Response

87. In its motion to strike, Southern Companies rejects the allegations raised by Calpine and Shell Trading contending that they have not offered any substantive rebuttal arguments. Southern Companies also disputes Calpine and Shell Trading's contention that the small number of short-term purchases by LSEs results from a lack of competition in the short-term markets, arguing that this evidence instead shows that the planning activities of the LSEs are meant to insulate them from the availability and price volatility associated with the reliance on short-term markets.

88. Southern Companies also argues that Calpine and Shell Trading have misrepresented the FPL testimony insofar as they asserted that FPL was motivated by a concern over loss of transmission rights, when in fact FPL cites Order No. 888 to state that existing customers have the right to roll over transmission rights to other sources of energy and capacity. Southern Companies also disagrees with Calpine and Shell Trading's assertion that Southern Companies controls all uncommitted capacity with firm transmission access, asserting that FPL has contractual control over a large portion of the transmission capacity at issue. Southern Companies also notes that, while Calpine and Shell Trading claim there is an absence of alternative suppliers in the Southern control area, the FPL testimony states that there is a glut of merchant generation capacity in the Southeastern Electric Reliability Council (SERC). However, according to Southern Companies, only a small percentage of this generation capacity could be used to meet FPL's loads in a cost-effective manner because this capacity was either uneconomic, committed, in transmission constrained areas, or in areas where FPL's rollover rights would be inapplicable.

Southern Companies Alternative Market Power Studies

Southern Companies' Modified Pivotal Supplier and Capacity Surplus Index

89. In its original filing, Southern Companies provided the Commission with two alternative market power studies: the "modified pivotal supplier screen" and the "capacity surplus index". The modified pivotal supplier screen is a reformulation of the pivotal supplier screen, which replaces the Commission's wholesale load proxy with what Southern Companies describes as an estimate of actual wholesale market demand. Southern Companies asserts that the modified pivotal supplier screen shows that, under a variety of load and seasonal conditions, Southern Companies is not pivotal within the Southern control area. Southern Companies also filed a "surplus capacity index" that appears to use the same data as the modified pivotal supplier screen, but presents that information in a slightly modified form. Specifically, Southern Companies submits that the "surplus capacity index" computes the ratio of total supply available from entities other than Southern Companies by dividing the amount of non-Southern Companies' capacity in the Southern control area by a proxy for the wholesale load in the Southern control area. Under this approach, Southern Companies estimates that there were competing supplies equal to 3.08 times its estimate of wholesale load in the Southern control area on the basis of 2002 data.

Southern Companies' Contestable Load Analysis

90. Southern Companies submits an additional market power study, the “contestable load analysis”, which purports to show that generation not owned or controlled by the Southern Companies can serve the actual competitive wholesale load in the Southern control area many times over and that there is sufficient import capability to allow the wholesale load to access this generation. To calculate contestable load, Southern Companies subtracts: (i) its retail load; (ii) its wholesale load served under long-term contract expiring after 2007; (iii) the amount of generation owned by LSEs; and (iv) the long-term purchases made by LSEs in the Southern control area from the total control area load. Southern Companies compares this contestable load to the total generation capacity in the Southern control area not owned by Southern Companies, to the extent that it was not included in the calculation of contestable load and import capability as used in the initial generation market power screens. Southern Companies concludes that, because its estimate of competing supply is greater than its estimate of wholesale load, it cannot exercise market power.

Calpine, Shell Trading, and AMEA Comments

91. Calpine and Shell Trading maintain that Southern Companies' modified pivotal supplier screen is redundant since it already passes the pivotal supplier screen. Calpine and Shell Trading state that the modified pivotal supplier screen ignores the fact that the pivotal supplier and wholesale market share screens measure different forms of market power. As such, Calpine and Shell Trading contend, eliminating the wholesale market share test in favor of a second pivotal supplier screen would not improve the Commission's ability to detect market power; instead, it would unduly restrict the Commission. Furthermore, they contend that the modified pivotal supplier screen would add nothing to the analysis because an applicant passing the pivotal supplier would also pass the modified pivotal supplier screen.

92. Calpine and Shell Trading also argue that the capacity surplus index is meaningless because Southern Companies seriously underestimates the denominator (i.e., the wholesale market load). Moreover, the capacity surplus index is irrelevant, since it is simply one more attempt to substitute a redundant modified pivotal supplier-type analysis.

93. Calpine and Shell Trading argue that the contestable load analysis deserves no weight. Calpine and Shell Trading state that it takes into account only non-Southern load that is not covered by owned generation or long-term firm contracts and that, as long as there is a nominal amount, no matter how trivial, of competing generation, Southern Companies would pass the analysis. As such, Calpine and Shell Trading assert, it has no analytical value. Calpine and Shell Trading also note that it examines only short-term

markets and excludes affiliate purchases from the definition of contestable load, even though they comprise half of the wholesale transactions. Calpine and Shell Trading argue that the contestable load analysis ignores the ability of Southern Companies to charge wholesale customers a price greater than the price that would prevail under competition by charging a price that is equal to the “shadow price” established by the next lowest-cost generation available. In addition, Calpine and Shell Trading note that Southern Companies explicitly excluded its own load from its analysis, regardless of whether competing generation could service some of the load more cost-effectively. Finally, Calpine and Shell Trading argue that the contestable load analysis does not account for the potential for Southern Companies to exercise market power by foreclosing competitors from the market or to erect barriers to entry, such as insufficient transmission service.

94. AMEA states that Southern Companies’ contestable load approach should be rejected. According to AMEA, this approach is fatally flawed, affords the applicant excessive discretion, and ignores the applicant’s capacity.

Commission Determination

95. With respect to the historical data and alternative market power studies provided by Southern Companies, we will defer action in this regard until we have before us a properly-constructed DPT.

Southern Companies’ Ability to Exercise Transmission Market Power, Erect Barriers to Entry and Engage in Affiliate Abuse

Calpine and Shell Trading Comments

96. Calpine and Shell Trading argue that, to properly analyze Southern Companies’ market power, the Commission must consider the extent to which a vertically-integrated utility can exercise generation market power. Calpine and Shell Trading state that an important factor not considered in the DPT is the structural characteristics of the Southern control area, such as Southern Companies’ control over transmission, the presence of barriers to entry, and affiliate preferences. These include transmission access problems, non-comparability of transmission services offered to competitors and affiliates, potential for interconnection delays, buyer market power, and affiliate preferences, including access to information.

Southern Companies’ Motion to Strike

97. In its motion to strike and response, Southern Companies argues that the allegations made by Calpine and Shell Trading concerning transmission market power, affiliate abuse and barriers to entry should be disregarded because they are unsupported

by evidence and because the Commission has instituted a separate section 206 proceeding to address these parts of the Commission's market-based rate analysis. In addition, Southern Companies contends that it has had no opportunity to present evidence on these issues and that fundamental due process requires that Southern Companies be allowed to present all relevant information and to test through discovery and cross-examination any information offered by parties in opposition to them.

Commission Determination

98. The trial-type evidentiary hearing established herein in Docket No. EL04-124 is intended to resolve the issues of material fact regarding Southern Companies DPT for Southern control area. Calpine and Shell Trading's allegations relating to the other three parts of the Commission's four-part test for market-based rate authority will be addressed in Docket No. EL05-102.

Southern Companies' Request for Establishment of Evidentiary Hearing

Southern Companies' Motion to Strike

99. In its motion to strike and response, Southern Companies argue that if Calpine and Shell Trading's comments are not struck, the errors and omissions made by Calpine and Shell Trading show the existence of genuine issues of material fact. According to Southern Companies, these issues of material fact cannot be resolved in a "paper hearing", and hence require a trial-type evidentiary hearing to resolve these issues that comports with fundamental principles of due process and fair play.

Commission Determination

100. As discussed above, the errors in Southern Companies' DPT and the parties' pleadings raise issues of material fact, and we will establish a trial-type evidentiary hearing for the limited purpose of resolving the issues material fact regarding Southern Companies' DPT for the Southern control area.

Reporting Requirements

101. Southern Companies must timely report to the Commission any change in status that would reflect a departure from the characteristics the Commission relied upon in granting market-based rate authority.³⁶ Order No. 652 requires that the change in status

³⁶ *Reporting Requirement for Changes in Status for Public Utilities with Market-Based Rate Authority*, Order No. 652, 70 Fed. Reg. 8,253 (Feb. 18, 2005), FERC Stats. & Regs. ¶ 31,175 *order on reh'g*, 111 FERC ¶ 61,413 (2005).

reporting requirement be incorporated in the market-based rate tariff of each entity authorized to make sales at market-based rates. Accordingly, Southern Companies is directed, within 30 days of the date of issuance of this order, to revise its market-based rate tariff to incorporate the following provision:

[insert market-based rate seller name] must timely report to the Commission any change in status that would reflect a departure from the characteristics the Commission relied upon in granting market-based rate authority. A change in status includes, but is not limited to, each of the following: (i) ownership or control of generation or transmission facilities or inputs to electric power production other than fuel supplies, or (ii) affiliation with any entity not disclosed in the application for market-based rate authority that owns or controls generation or transmission facilities or inputs to electric power production, or affiliation with any entity that has a franchised service area. Any change in status must be filed no later than 30 days after the change in status occurs.

The Commission orders:

(A) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and by the Federal Power Act, particularly section 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulations under the Federal Power Act (18 C.F.R., Chapter I), a public hearing shall be held in Docket No. EL04-124 to resolve the issues of material fact regarding Southern Companies' DPT for the Southern control area, as discussed in the body of this order.

(B) A presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a prehearing conference in these proceedings in a hearing room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426. The Presiding Judge is authorized to establish procedural dates, and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

(C) Southern Companies' sales at market-based rates in the Southern control area will remain subject to the refund effective date established in the December 17 Order, as discussed in the body of this order.

(D) Southern Companies revised tariff sheet correcting the market behavior rules are accepted for filing, effective December 17, 2003.

(E) Southern Companies is directed, within 30 days of the date of issuance of this order, to revise its market-based rate tariff to incorporate the change in status reporting requirement adopted in Order No. 652.

By the Commission. Commissioner Kelliher dissenting in part with a separate statement attached.

(S E A L) Commissioner Kelly not participating.

Magalie R. Salas
Secretary

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Southern Companies Energy Marketing, Inc. and
Southern Companies Services, Inc.

Docket Nos. ER97-4166-019
ER96-780-007
ER96-780-009
EL04-124-000
EL04-104-002

(Issued July 8, 2005)

Joseph T. KELLIHER, Commissioner *dissenting in part*:

I agree with the Commission's determination that Southern's DPT analysis departs from the Commission's requirements. As a result, I also agree with the Commission's decision to establish a trial-type evidentiary hearing to address the errors in Southern's DPT analysis.

However, I do not agree with the Commission's decision to set for hearing the additional issue of the impact of internal transmission constraints on the relevant geographic market. The issue at hand is Southern's failure to comply with the Commission's methodology for determining the DPT. That methodology establishes a presumption that the applicant's home control area is the relevant geographic market.¹ The Commission's generation market power test permits, but does not require, an applicant to propose a geographic market that is different than the home control area. It also allows intervenors to propose alternative geographic markets. In this instance, neither Southern nor any intervenor proposed an alternative geographic market.

It is well-established that the DPT itself does not consider internal transmission constraints. To the extent the Commission's order introduces the concept of internal transmission constraints into the determination of a properly constructed DPT, I believe the order improperly modifies the DPT analysis in midstream.

Significant internal transmission constraints can suggest the proper geographic market is not the home control area. However, I do not believe that intervenors' allegations and analysis of internal constraints raise issues of material fact that must be

¹ *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,108 at P 74 (2004).

resolved in a trial-type evidentiary hearing.² In my view, the focus of the hearing should be on developing a record to determine a properly constructed DPT that uses Southern's home control area as the relevant geographic market. Because the hearing established by this order goes beyond the issues raised by Southern's flawed DPT analysis, I dissent in part.

Joseph T. Kelliher

² In contrast, in *Entergy Services, Inc.*, 111 FERC ¶ 61,507 (2005), the Commission found that intervenors' evidence of internal transmission constraints and corroborating evidence submitted by Entergy raised issues of material fact concerning whether the entire Entergy control area is the appropriate relevant geographic market for purposes of calculating the DPT. In this instance, however, there is no evidence corroborating intervenors' submissions.