UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Technical Conference on Public Utility Holding Company Act of 2005 and Federal Power Act Section 203 Issues	Docket No. AD07-2-001

Opening Remarks of Darren Bush[*]

Introduction

I want to thank the Commission for giving me the opportunity today to speak about merger policy in the context of the electricity industry. But more importantly, I would like to thank the Commission for asking the hard questions about the direction of FERC Merger Review in light of the experiences in merger enforcement over the past decade. My remarks here today are my own, as I do not represent anyone. I speak today based upon my experience as an Antitrust Division trial attorney who focused upon matters involving the electricity sector, as an economist, and as a law professor whose research and writing has focused on antitrust issues arising in the context of regulated/deregulated industries.[1]

The basic underlying purpose of any merger analysis is to determine whether, under a theory of harm, the merger could injure competition in general and consumers in particular.[2] This theory of harm, and any eventual discovery of the theory's validity,

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[1] The term "deregulation" is a bit of a misnomer. See Harry First, Regulated Deregulation: The New York Experience in Electric Utility Deregulation, 33 LOY. U. CHI. L. J. 911 (2002)(noting that New York's electricity market was not deregulated, but in fact replaced "one regulatory system with another.").

[2] See Department of Justice/Federal Trade Commission, Commentary on the Horizontal Merger Guidelines, *reprinted in* JOHN J. FLYNN, HARRY FIRST & DARREN BUSH, ANTITRUST: STATUTES, TREATIES, REGULATIONS, GUIDELINES, POLICIES 2007-2008 (2007)(hereafter "Guidelines Commentary" or "Commentary"), noting that "at the center of the Agencies' application of the Guidelines, therefore, is competitive effects analysis." Id. at 301. This of course includes but is not limited to the relevant product

unifies merger analysis. Absent a theory of harm,[3] any merger analysis is without any guiding force, potentially causing disconnect between the merger analysis and the proposed remedy, and potentially creating both Type I and Type II errors by requiring remedy in instances where no harm arises and by missing harms that do not fit into pre-ordained relevant markets and concentration statistics.[4]

Appendix A Analysis is Inadequate as a General Rule Because it Does not Link Theory of Harm, Market Analysis, and Remedy

Appendix A Analysis fails to consider this relationship between consumer injury, the relevant market, and remedy.[5] As an example, compare the DOJ's analysis in Exelon with the Commission's analysis. DOJ espoused a "fuel curve" theory of harm. Namely,

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and geographic markets, market concentration, competitive effects such as coordinated or unilateral behavior, whether entry mitigates anticompetitive harm, and efficiencies arising from the transaction.

[3] Guidelines Commentary, at 301. ("Merger analysis depends heavily on the specific facts of each case. At the outset of an investigation, when Agency staff may know relatively little about the merging firms, their products, their rivals, or the applicable relevant markets, staff typically contemplates several broad hypotheses of possible harm.")

[4] See generally, U.S. Dept. of Justice, Policy Guide to Merger Remedies (2004)(hereafter Horizontal Merger Guidelines), available at http://www.usdoj.gov/atr/public/guidelines/205108.htm, noting that:

> Structural remedies are preferred to conduct remedies in merger cases because they are relatively clean and certain, and generally avoid costly government entanglement in the market. A carefully crafted divestiture decree is "simple, relatively easy to administer, and sure" to preserve competition.10 A conduct remedy, on the other hand, typically is more difficult to craft, more cumbersome and costly to administer, and easier than a structural remedy to circumvent.

Id. Moreover, the Policy Guide continues, there are costs associated with monitoring compliance with the remedy. The merged firm may attempt to evade regulation, leading to indirect costs associated with such evasion. Conduct remedies may also restrain procompetitive behavior and may also paralyze the subject of the conduct remedy such that it cannot respond to changing market conditions.

[5] Cf. Guidelines Commentary:

> The Agencies therefore examine all plausible markets to determine whether an adverse competitive effect is likely to occur in any of them. The market definition process is not isolated from the other analytic components in the Guidelines. The Agencies do not settle on a relevant market definition before proceeding to address other issues. Rather, market definition is part of the integrated process by which the Agencies apply Guidelines principles, iterated as new facts are learned, to reach an understanding of the merger's likely effect on competition.

Id. at 303.

that the combination of marginal generation assets and inframarginal units created an incentive and ability to raise prices in wholesale energy markets in PJM-East and PJM-Central-East.[6] DOJ's remedy was designed to eliminate the ability of the firm to increase wholesale prices by requiring the divestiture of specific marginal units.

In contrast, FERC posited the harm to be violation of the merger screen itself, without further analysis.[7] The imposed remedy was deconcentration by virtual and actual divestiture of unspecified assets. The question arises as to what harm FERC was seeking to eliminate, apart for increased market power. Certainly the fuel curve theory of harm was not considered, as the divestiture order did not specify particular assets.[8]

This leads me to my second point:

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[6] See U.S. v. Exelon Corp., Case No. 1:06CV01138 (D.D.C. 2006), available at http://www.usdoj.gov/atr/cases/f216700/216785.htm (Complaint) and http://www.usdoj.gov/atr/cases/f217700/217717.htm (Competitive Impact Statement). The competitive impact statement noted that "[t]he combination of PSEG and Exelon's generating units would increase the merged firm's ability and incentive to withhold selected output, forcing PJM to turn to more expensive units to meet demand, resulting in higher clearing prices in PJM East and PJM Central/East." Competitive Impact Statement, at 10. While the proposed acquisition did indeed trip market shares under traditional HHI analysis, this is a fortuitous accident, as fuel-curve injuries to competition do not require extraordinarily high HHI levels.

[7] Cf. Guidelines Commentary:

> Indeed, market concentration may be unimportant under a unilateral effects theory of competitive harm. As discussed in more detail in Chapter 2's discussion of Unilateral Effects, the question in a unilateral effects analysis is whether the merged firm likely would exercise market power absent any coordinated response from rival market incumbents. The concentration of the remainder of the market often has little impact on the answer to that question.

Id. at 320. See also Id. at 318 ("[T]he Agencies do not make enforcement decisions solely on the basis of market shares and concentration . . . .")

[8] Also note that generation units entering the relevant market might have a deconcentrating effect according to FERC merger analysis but utterly fail to remedy the harm espoused by the DOJ, depending upon the location of the entrant generation along the supply curve.

Appendix A Analysis Cannot Address Certain Theories of Harm That Arise in Electricity Markets Due to the Idiosyncratic Nature of Generation Assets or Vertical Issues That Plague Electricity Markets.

Appendix A Analysis, by focusing on traditional horizontal concentration in a non-traditional market, may miss serious competitive effects in particular relevant markets.

For example, several potential harms spanning energy markets are not readily susceptible to Appendix A analysis. As mentioned above, fuel curve theories of harm are not easily identified by Appendix A. Vertical considerations such as those encountered in PE/Enova[9] concerning pipeline transportation and issues concerning transmission manipulation are not addressable using Appendix A analysis.

Moreover, harms related to mergers of noncontiguous entities may not be addressable. The largest theory of harm related to noncontiguous mergers is perhaps potential competition doctrine. The Horizontal Merger Guidelines here refer to the DOJ's 1984 Guidelines as an authority on "non-horizontal" mergers and thus include potential competition in non-horizontal analysis.[10] While the Horizontal Merger Guidelines view what some courts might consider to be potential competitors as either in the market or entry that mitigates anticompetitive harm,[11] they treat others potential

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[9] U.S. v. Enova Corp., Case No. 98-CV-583 (TFH) (D.D.C. 1998), available at http://www.usdoj.gov/atr/cases/f1700/1790.htm (Complaint) and http://www.usdoj.gov/atr/cases/f1700/1789.htm (Competitive Impact Statement).

[10] In affirmative cases asserting the potential competitor doctrine, the 1984 Guidelines remain in force. As the DOJ and FTC explained upon the release of the 1992 Guidelines: "guidance on non-horizontal mergers is provided in Section 4 of the Department's *1984 Merger Guidelines*, read in the context of today's revisions to the treatment of horizontal mergers." U.S. DEP'T OF JUSTICE & FTC, STATEMENT ACCOMPANYING RELEASE OF REVISED MERGER GUIDELINES (Apr. 2, 1992), *reprinted in* ABA ANTITRUST SECTION, THE 1992 HORIZONTAL MERGER GUIDELINES: COMMENTARY AND TEXT 21, 22 (1992).

[11] See Horizontal Merger Guidelines §§ 1.31, 1.33, and 3,

entrants under an entirely different framework. Such determinations are highly fact intensive. Regardless of whether one is speaking of "actual potential competition" or "perceived potential competition," more than rudimentary market share analysis is necessary. Indeed, often the subjective views of the parties regarding perceived potential competitors are necessarily obtained through documentary evidence. However, it is possible to devise a decent test for determining whether merging parties are potential competitors—as has been done in a 2004 Wisconsin Law Review article by two Department of Justice alums.[12] However, any such analysis is deeply document intensive by necessity and thus ill-suited for inclusion in Appendix A analysis.

My final point concerning Appendix A analysis arises from the starting point of merger analysis, namely defining the relevant market.

Appendix A Analysis Creates Difficulties in Defining the Relevant Market Because Appendix A assumes a relevant market and parties follow those market definitions

HHIs hinge entirely on how one defines the market, and the modeling techniques of the merging parties. I will leave for others to discuss the latter issue, but I wish to address my deep concern about defining relevant markets in a vacuum.[13]

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[12] Darren Bush and Salvatore Massa, *Rethinking the Potential Competition Doctrine*, 2004 WIS. L. REV. 1035 (discussing application of potential competition doctrine in numerous deregulated industries and proposing test unifying the doctrine in the context of Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act). See also John E. Kwoka, *Non-Incumbent Competition: Mergers Involving Constraining and Prospective Competitors*, 52 CASE W. RES. L. REV. 173 (2001). Joseph F. Brodley, *Potential Competition Under the Merger Guidelines*, 71 CAL. L. REV. 376 (1983) (discussing arguments against limit pricing).

[13] See Guidelines Commentary at 314 ("The process of defining the relevant market is directly linked to competitive effects analysis. In analyzing mergers, the Agencies identify specific risks of potential anticompetitive harm, and delineate the appropriate markets within which to evaluate the likelihood of such potential harm. This process could lead to different conclusions about the relevant markets likely to experience competitive harm for two similar mergers within the same industry.")

First, geographic markets play a crucial role in this industry, perhaps greater than those in the general economy. Geographic constraints are not continuous. They could vary by hour, day, or season. As such, geographic market determinations are much more difficult in this industry than in others. The basis of such geographic market issues are often transmission constraints. To the extent that certain regions are isolated due to transmission constraints, they may be relevant markets for competition policy purposes such that the merging party may exercise market power in a relevant geographic market smaller than the RTO/ISO. Thus, the Commission cannot assume that the relevant market is the RTO/ISO. As was the case in Exelon and in NRG/Wisvest,[14] the laws of nature (transmission constraints) ignore the laws of humans (markets defined by law or industry convention). However, the determination of a relevant market for purposes of determining consumer injury should not ignore such constraints. Thus, geographic market definitions can cause difficulties for any merger review. Facts must be obtained to support any relevant market determination. This is easier in RTO markets as the facts already exist in the form of RTO data. Geographic markets are more difficult to determine in non-RTO markets. In such markets, reliance upon standard tools of information gathering is important.

Fourth, it may not be the case that the Commission can assume a single relevant product market. In addition to the capacity and energy markets that may be defined by the independent system operator/regional transmission organization, there are potentially

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[14] Wisvest-Connecticut, LLC, 96 F.E.R.C. ¶ 61,101 (2001).

products which certain customers seek in a bundle. Thus, an examination of the industry-recognized markets may be insufficient.[15]

Fifth, determining whether entry will mitigate anticompetitive conduct cannot strictly be based upon the deconcentrating effect of such entry "in the market." The geographical location of the generation unit entering the market might be critical, as will its cost of providing energy.

The Merging Parties Should Not in The First Instance Be Identifying The Theory of Harm and the Relevant Market, Although They Should Be Required to Provide Information That Enables The Commission to Do So.

I hope I have communicated that merger review is fraught with peril. It is highly subject to determinations as to relevant market. Often, traditional market screens[16] will completely miss the harm caused by the merger. Thus, I fear that the search for a merger screen is a quest for the Holy Grail. And by relying on the economic analysis of applicants with an obvious interest in enhancing the procompetitive effects of a

[15] See Guidelines Commentary at 313 (noting industry usage of the word "market" is not controlling). The Guidelines initial starting point is based upon consumer preferences. Specifically,

> Product market definition depends critically upon demand-side substitution--i.e., consumers' willingness to switch from one product to another in reaction to price changes. The Guidelines' approach to market definition reflects the separation of demand substitutability from supply substitutability--i.e., the ability and willingness, given existing capacity, of firms to substitute from making one product to producing another in reaction to a price change. Under this approach, demand substitutability is the concern of market delineation, while supply substitutability and entry are concerned with current and future market participants.

Guidelines Commentary, at 304.

[16] I have commented previously on the difficulties of other types of market screens. See, e.g., http://www.tapsgroup.org/sitebuildercontent/sitebuilderfiles/050314_appataps_comments.pdf. For corroboration of my position regarding Contestable Load analysis, see Federal Trade Commission Comments to the Federal Energy Regulatory Commission, available at http://www.ftc.gov/be/V060004.pdf.

transaction while minimizing anticompetitive harms, the Commission has relied on analysis that is biased (in the strict academic sense of the term) from the outset.

Instead, I believe the Commission should focus its efforts upon what authority it has to investigate mergers, how it might be able to obtain competitively sensitive information from the parties without that information being shared with others to the detriment of the market. It should also focus the filings of the parties to provide the Commission with the raw information necessary to examine the theories of harms I have outlined above. And, it should require from the applicants information and analysis demonstrating that the proposed transaction does not raise any of the described competitive concerns.[17]

Conclusion

The detection of market power is not for the faint hearted. It requires rigorous analysis, large amounts of information, and serious thinking about the boundaries of the market (including consumer preferences, available supply, transmission constraints, the multitude of electricity products offered, etc.). It also requires an examination of entry, potential entry, potential exercises in conduct, and the like.[18]

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[17] It is important to add that in markets that change over time, new theories of harms might emerge. Thus, the Commission should afford itself flexibility in addressing and identifying new theories of harm and not assume that the theories of harm outlined here are the only ways to engage in exercises of market power.

[18] The analysis of market power or the potential for market power in electricity markets should not hinge upon whether or not the analysis is undertaken in the merger context. As an analogy, the Department of Justice's examination of conduct in the context of Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act are not dramatically different, with certain caveats in market definition arising from current market power exercise in the cases of Sections 1 and 2 (e.g., the "Cellophane fallacy"). Compare FTC & U.S. DEP'T OF JUSTICE, ANTITRUST GUIDELINES FOR COLLABORATIONS AMONG COMPETITORS (2000) with the Horizontal Merger Guidelines.

A market power screen, if properly applied, may determine in some instances the boundaries of the market and market shares within that market. However, it will not capture certain types of conduct, particularly if the screen is slavishly applied[19] such that facts indicating different market analysis ought to be undertaken are ignored.

In sum, screens are not the Holy Grail of market power detection. The beacon of market power screens is only Grail-shaped, and barely are that. The screens fail to heed the caution implicit in the Guidelines that markets are complex and that rigid application of the Guidelines may not lead to the right answer. Worse, they ignore the fundamental purpose of the exercise in question—the determination of whether the merger yields anticompetitive conduct that injures consumers. The Guidelines' caution regarding rigid application rings particularly true in electricity markets, and FERC should be wary of using screens that will be unable to detect many instances of exercises of market power.

Thank you.

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[19] See U.S. DEP'T OF JUSTICE & FTC, HORIZONTAL MERGER GUIDELINES § 0 (1992) ("Because the specific standards set forth in the Guidelines must be applied to a broad range of possible factual circumstances, mechanical application of those standards may provide misleading answers to the economic questions raised under the antitrust laws. Moreover, information is often incomplete and the picture of competitive conditions that develops from historical evidence may provide an incomplete answer to the forward-looking inquiry of the Guidelines.")