

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Entergy Services, Inc.

Docket Nos. ER91-569-008
ER91-569-023
ER91-569-024
EL04-123-000

ORDER ESTABLISHING HEARING PROCEDURES

(Issued June 30, 2005)

1. Entergy Services, Inc. (Entergy) submitted a Delivered Price Test (DPT) to rebut the presumption that Entergy has market power in the Entergy control area; that presumption resulted from Entergy's failure of the wholesale market share screen for generation market power. In this order, the Commission establishes a trial-type, evidentiary hearing to examine Entergy's DPT, in order to determine whether Entergy should be allowed market-based rate authority for transactions in the Entergy control area.
2. The trial-type, 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. Pending the outcome of this evidentiary hearing, Entergy's sales at market-based rates in the Entergy control area will remain subject to the refund effective date established in the December Order.¹

¹ *Entergy Services, Inc.*, 109 FERC ¶ 61,282 (2004) (December Order), *order on reh'g*, 111 FERC ¶ 61,145 (2005) (May Order), *reh'g pending*.

Background

3. In the April 14 Order, as clarified by the July 8 Order,² the Commission adopted two indicative screens for assessing generation market power: a pivotal supplier screen and wholesale market share screen. The Commission stated that passage of both screens establishes a presumption that the applicant does not possess generation market power, while failure of either screen creates a rebuttable presumption that the applicant has generation market power. The Commission further stated that applicants and intervenors may, however, rebut the presumption established by the results of the initial screens by submitting a DPT.

4. On August 9, 2004, as supplemented on November 19, 2004, Entergy submitted for filing the generation market power screens in compliance with the Commission's April 14 and July 8 Orders. Entergy's filing indicated that it passed the generation market power screens in its first-tier markets. However, the filing indicated that Entergy's share of uncommitted capacity in the Entergy control area exceeded 20 percent for each of the four seasons during the time period considered. Consequently, Entergy's filing indicated that Entergy failed the wholesale market share screen in the Entergy control area. To rebut the presumption of market power created by its failure of the wholesale market share screen, Entergy chose to submit a DPT.³ Entergy's DPT results showed it failed the DPT using the economic capacity measure, one of the measures

² *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018 (April 14 Order), *order on reh'g*, 108 FERC ¶ 61,026 (2004) (July 8 Order).

³ As stated in the April 14 Order, an applicant that fails the initial screens has 60 days from the date of issuance of an order finding a screen failure to: (1) file a DPT analysis (if it so chooses); (2) file a mitigation proposal tailored to its particular circumstances that would eliminate the ability to exercise market power; and/or (3) inform the Commission that it will adopt the April 14 Order's default cost-based rates and submit cost support for such rates. April 14 Order, 107 FERC ¶ 61,018 at P 208. In addition, as the Commission stated in the April 14 Order, the applicant or intervenors may present evidence such as historical sales data to support whether the applicant does or does not possess market power. April 14 Order, 107 FERC ¶ 61,018 at P 37. In this case, Entergy chose to submit the DPT with its initial filing.

prescribed in the April 14 and July 8 Orders.⁴ However, Entergy's DPT results further showed that it passed the DPT using the available economic capacity measure, another measure prescribed in the April 14 and July 8 Orders.⁵

5. In the December Order, the Commission stated that Entergy's failure of the wholesale market share screen provided the basis for the Commission to institute a section 206 proceeding in Docket No. EL04-123-000, which was limited to Entergy's control area, to examine whether Entergy may continue to charge market-based rates, and established a rebuttable presumption of market power. The Commission stated that the section 206 proceeding would review Entergy's DPT.

Discussion

6. As discussed more fully below, after reviewing Entergy's DPT and the comments and analyses of intervenors, the Commission finds that Entergy's DPT raises issues of material fact that we cannot resolve based on the record before us, and are more appropriately addressed in the hearing ordered below.

Delivered Price Test

7. 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.⁶ The DPT is used to analyze the effect on competition for transfers of jurisdictional facilities in section 203 proceedings,⁷ using the framework described in Appendix A of the Merger Policy Statement and revised in Order

⁴ April 14 Order, 107 FERC ¶ 61,018 at P 106-109; July 8 Order, 108 FERC ¶ 61,029 at P 26.

⁵ *Id.*

⁶ April 14 Order, 107 FERC ¶ 61,018 at P 105-12.

⁷ 16 U.S.C. § 824b (2000).

No. 642.⁸ The DPT is well established: it has been used routinely by the Commission to analyze market power in the merger context for many years, and it has been affirmed by the courts.⁹

8. 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.¹⁰ The results of the DPT can be used for 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 which refers to Appendix A of the Merger Policy Statement and Order No. 642 for a complete description of the DPT and its requirements.

9. 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.¹¹

10. 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

⁸ 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. 70,984 (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).

⁹ *See, e.g., Wabash Valley Power Associates, Inc. v. FERC*, 268 F. 3d 1105 (D.C. Cir. 2001).

¹⁰ Super-peak, peak, and off-peak, for Winter, Shoulder and Summer periods and an additional highest super-peak for the Summer.

¹¹ April 14 Order, 107 FERC ¶ 61,018 at P 107-108.

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.

11. 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.

12. Under the DPT, applicants must also calculate the market concentration using the Herfindahl-Hirschman Index (HHI) based on market shares. HHIs are usually used in the context of assessing the impact of a merger or acquisition on competition. However, as noted by the 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.¹²

13. 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

¹² 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.")

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).

14. As with our initial screens, applicants and intervenors may present evidence such as historical wholesale sales. Those data could be used to calculate market shares and market concentration and could be used to refute or support the results of the DPT. 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.¹³

Entergy’s Delivered Price Test

15. Entergy’s DPT analysis shows that it passes the DPT in the Entergy control area using the available economic capacity measure because its market share is always below 20 percent (in all but the summer 1 period, Entergy’s market shares are below 2.5 percent and is about 14 percent for the summer 1 period), its HHIs are always below 2500 (ranging from 574 to 1367 and below 1000 in all but three periods, which indicates an unconcentrated market), and it is not a pivotal supplier in any season or load period.

16. On the other hand, Entergy’s DPT analysis shows that it does not meet the criteria for a showing of a lack of market power in the Entergy control area using the economic capacity measure. When the economic capacity measure is used, Entergy’s market shares and HHIs increase. Using the economic capacity measure, Entergy’s market shares are above 20 percent in all periods and are highest at the summer extreme peak and in the off-peak periods. Further, its market shares are around 30 percent in the peak and super-peak periods, slightly above 45 percent in all off-peak periods and 51 percent in the summer 1 period (the extreme peak). In addition, using the economic capacity measure, Entergy’s HHIs increase, although they are below 2500 in all but two periods.

¹³ Order No. 642 at n. 41.

Specifically, Entergy's HHIs exceed 2500 in the summer extreme peak and off-peak periods, and are very close to 2500 in the winter off-peak and shoulder off-peak periods, but otherwise are well below 2500. In addition, Entergy's study indicates that Entergy is a pivotal supplier in all but two periods (winter peak and shoulder peak).

17. Entergy argues that the Commission should give greater weight to the available economic capacity results for several reasons. Using the economic capacity measure, Entergy argues, results in a failure of the DPT because the economic capacity measure fails to account for its native load obligations and its position as the vertically-integrated utility in its own control area. According to Entergy, an economic analysis that fails to take into account a utility's native load obligations significantly overstates the utility's generation capacity available to serve the wholesale market. Further, Entergy states that as a franchised utility, pursuant to state laws, it must own or have under contract sufficient resources to cover its native load obligations during both peak and off-peak conditions. Entergy also argues that, given the Commission's conservative approach in formulating the market share screens, it would be appropriate for the Commission to give the greatest consideration of the available economic capacity measure of the DPT because it is the indicator that provides the additional review of the native load issue.

18. In contrast, Occidental Chemical Corporation (Occidental) and the L-M Municipals¹⁴ argue that the economic capacity measure deserves greater weight. Occidental asserts that the Commission should give the economic capacity measure greater weight for the following reasons: (1) Entergy meets its native load and other sales from a single portfolio of generating resources; (2) the available economic capacity's assignment of the lowest cost resources to native load results in an understatement of capacity that is economic in the market thereby biasing market shares downward and does not reflect the way Entergy prices its wholesale power; (3) independent power producers' (IPPs) market share does not reflect a native load deduction and thus IPPs appear relatively larger when in fact the dominant utility may have foreclosed the IPPs from the serving the utility's native load; (4) the larger economic capacity measure indicates an increased incentive to dispatch units with higher costs than competitors as a means to ensure those units' continued inclusion in rate base; and (5) the larger economic capacity measure shows the size of the utility relative to its competitors and thus its incentive to foreclose competitors from gaining access to the market. In addition, the L-M Municipals argue that economic capacity is the more

¹⁴ Lafayette Utilities System, the Louisiana Energy and Power Authority and the Municipal Energy Agency of Mississippi (collectively, L-M Municipals).

appropriate measure because the ability to rely on rate-based assets to back up wholesale sales gives Entergy a substantial competitive edge over suppliers without such a broad portfolio.

19. Moreover, several intervenors assert that Entergy's DPT is flawed because it fails to take into account internal transmission constraints in the Entergy control area, which materially impacts the market power analysis by reducing the amount of competing supply.¹⁵ Intervenors assert that the Commission's market power analysis presumes that non-Entergy generation has transmission access and can actually compete with Entergy. However, NRG argues, this assumption is not accurate given the inability of generation, other than generation designated as a network resource serving its own network load, to obtain firm transmission service in the Entergy region. According to NRG, this lack of transmission availability significantly diminishes the ability of such generators actually to compete with Entergy's generation. APPA states that the Commission's regulations make clear that a DPT must include an evaluation of available transmission capability to deliver the product to the relevant market.

Occidental/Calpine Delivered Price Test

20. On August 30, 2004, as supplemented on December 7, 2004, Occidental and Calpine filed a DPT analysis,¹⁶ which attempts to replicate Entergy's DPT (using Entergy's assumptions regarding its native load commitments and operating reserves and adjusted total capacity values, first-tier imports, planned outages and the capacity available from cogeneration units to more accurate levels) and contends that Entergy has substantially greater market power than demonstrated in Entergy's DPT.

¹⁵ See, e.g., protests of American Public Power Association (APPA); L-M Municipals; Occidental; the Mississippi Delta Energy Agency, the Clarksdale Public Utilities Commission and the Public Service Commission of Yazoo City; NRG Power Marketing, Inc., Louisiana Generating LLC, Bayou Cove Peaking Power LLC, Big Cajun I Peaking Power LLC, LSP Energy Limited Partnership, and NRG Sterlington Power LLC (collectively, NRG); and Union Power Partners filings.

¹⁶ The August 30, 2004 DPT was performed by Dr. DeRamus on behalf on Occidental. However, the updated study was submitted on behalf of both Occidental and Calpine Corporation (Calpine).

21. The DPT submitted by Occidental and Calpine further asserts that Entergy's DPT results are based on flawed assumptions and data (such as using an incorrect amount of available rival capacity, an erroneous simultaneous import capability number and also assuming that there are no internal transmission constraints) and therefore, are unreliable. In addition, it asserts that Entergy's analysis fails to demonstrate the sensitivity of its DPT results to changes in several key assumptions such as wholesale market prices, native load, the volume of existing wholesale transactions and internal transmission constraints.

Hearing Procedures

22. Several intervenors argue that Entergy's DPT is flawed because it fails to take into account internal transmission constraints in the Entergy control area, which materially impact the market power analysis by reducing the amount of competing supply. Intervenors point to portions of the transcript of a Technical Conference held on July 29-30, 2004 that addressed several proceedings that raise issues of transmission access to the Entergy system (including Entergy's Independent Coordinator of Transmission proposal).¹⁷ They note that the transcript contains statements made by various individuals (including an Entergy official) that indicate that transmission constraints on the Entergy system do interfere with the economic dispatch due to the inability of relatively efficient units to be scheduled. We also note that there were 55 instances of transmission denials and curtailments in the Entergy control area due to local constraints for 2002-2003 in the Entergy control area.¹⁸

23. The principal issue in this case is whether Entergy 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 Entergy 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.

24. 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

¹⁷ Clarksdale protest at 6-7 and L-M Cities protest at 9-11.

¹⁸ Entergy response to staff deficiency letter filed November 19, 2004, Appendix B, Request 11.

available to them.”¹⁹ Entergy’s DPT analysis uses the Entergy control area as the relevant geographic market, but, according to intervenors, does not take into account transmission limitations within the Entergy control area. As discussed above, intervenors submit evidence of how transmission constraints within the Entergy control area prevent customers’ access to generators located within the Entergy control area. In addition, Entergy submitted data that show numerous instances of transmission service denials or curtailments within its control area due to local constraints.²⁰

25. We find that important questions exist concerning whether the entire Entergy 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 geographic market within the Entergy 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.²¹ 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.²² Accordingly, we will require an evidentiary hearing. We instruct the parties at hearing to limit the scope of their inquiry to the impact of any transmission constraints on the appropriate scope of the relevant market.²³

¹⁹ Merger Policy Statement at 30,132.

²⁰ This is consistent with the Commission’s approach to internal transmission constraints in the generation market power indicative screens where we stated “Applicants and intervenors may also provide evidence that because of internal transmission limitations (*e.g.*, load pockets) the relevant market (or markets) is smaller than the control area.” April 14 Order, 107 FERC ¶ 61,018 at P 75.

²¹ 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), and *CP&L Holdings, Inc and Florida Progress Corporation*, 92 FERC & 61,023 (2000).

²² See Merger Policy Statement at 30,118-119.

²³ *Wisconsin Public Service Corporation*, 75 FERC ¶ 61,057 (1996).

26. The presiding judge in this proceeding is directed to make 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. In this regard, issues to be addressed at hearing include, but are not limited to: (1) the location in the Entergy control area of transmission constraints that bind; (2) the time (load conditions) at which those constraints bind and the duration of those binding conditions; (3) the identity and ownership of generators affected, particularly generators dispatched out of economic merit order; (4) the impact of such binding constraints on the DPT results; and (5) the procedures used by Entergy to address constraints in dispatching its own generators and whether those procedures differ with respect to non-Entergy generators. The parties are directed to provide the presiding judge with any and all assistance needed to fully develop the record to ensure a properly-constructed DPT. Once the presiding judge submits a decision regarding a properly-constructed DPT, and once the parties have filed briefs on and opposing exceptions, the Commission will address the issue of whether Entergy has generation market power in the Entergy control area. In particular, the Commission does not set for hearing the issue of *how* the DPT results should be interpreted and whether Entergy does or does not have generation market power in the Entergy control area. We note that parties have raised other issues concerning Entergy's DPT, however we will address those arguments in the subsequent order that addresses the issue of whether Entergy has generation market power in the Entergy control area.

27. Entergy's sales at market-based rates in the Entergy control area will remain subject to refund for the statutory refund period commencing with the refund effective date established in the December Order, pending the outcome of the hearing procedures ordered below.

Mitigation

28. Several intervenors assert that since Entergy states that it fails one of the indicative screens and its own DPT, the proceeding should shift immediately into developing mitigation measures to address Entergy's market power. NRG asserts that the mitigation measures must address the totality of Entergy's market power, not solely generation market shares. Intervenors recommend that the Commission adopt a variety of near-term mitigation measures to address Entergy's market power, including: (1) requiring competitive solicitations for supply procurement; (2) requiring security constrained, economic dispatch; (3) requiring an independent Open Access Same-Time Information System (OASIS) administrator; (4) requiring independent market monitoring; (5) requiring Entergy to hire an independent consultant to investigate the lack of available transmission capacity on the Entergy system; and (6) assigning Commission enforcement

staff for on-site monitoring of Entergy's transmission operations.²⁴ Moreover, L-M Municipals argue, Entergy should not be permitted to expand its generation fleet through the purchase of IPP assets without first offering participation to other load-serving entities in the region on terms no worse than those offered to Entergy itself.

29. Entergy responds that the Commission should reject the various mitigation measures proposed by the intervenors. Entergy asserts that these mitigation measures are premature at this point in the proceeding since the Commission must first make a finding that Entergy has market power before mitigation measures can be imposed. Furthermore, Entergy states that under the process established in the April 14 and July 8 orders, if these proceedings do reach a stage where mitigation measures are required, the Commission has given the applicant, not the intervenors, the initial opportunity to propose tailored mitigation.

30. The Commission finds that the issue of mitigation is premature at this time and therefore, will not address the arguments raised by intervenors concerning mitigation at this time. In the April 14 Order, the Commission stated that no mitigation will be imposed until there has been a Commission order making a definitive finding that the applicant has market power or, where the applicant accepts a presumption of market power, an order is issued addressing whether default cost-based rates or case-specific cost-based rates are to be applied. The Commission has not determined in this order that Entergy has market power. Further, Entergy's updated market power analysis is still under review and is subject to the ongoing investigation established in Docket No. EL05-105-000, which is being held in abeyance pending the outcome of further proceedings. If the outcome of the proceeding in Docket No. EL05-105-000 results in a Commission order that makes a definitive finding that Entergy has market power, the Commission will respond to the intervenors' arguments and address mitigation measures at that time.

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

²⁴ See protests and comments of EPSA and NRG.

public hearing shall be held in Docket No. EL04-123 to resolve the issues of material fact regarding Entergy's DPT for the Entergy control area, as discussed in the body of this order.

(B) Upon commencement of the hearing discussed above in Ordering Paragraph (A), 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) Entergy's sales at market-based rates in the Entergy control area will remain subject to the refund effective date established in the December Order, as discussed in the body of this order.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Linda Mitry,
Deputy Secretary.