Federal Energy Regulatory Commission
May 18, 2006 Commission Meeting
Statement of
Chairman Joseph T. Kelliher

E-2: MBR NOPR (RM04-7-000)

"The Commission has granted market-based rates for power sales by public utilities since 1988. However, it has always acted on market-based rate orders on a case-by-case basis, and the Commission's policies represent an evolution of decisions in a host of individual cases.

Over time, the Commission developed a four prong analysis to measure market power, focusing on (1) generation market power, (2) transmission market power, (3) other barriers to entry, and (4) affiliate abuse. The proposed rules would change this four prong analysis. It modifies the interim generation market power test.

With respect to the transmission market power prong, we learned at a December 2004 technical conference held in this proceeding that that the proper inquiry relates to vertical market power exercise, since comprehensive rate regulation of transmission service eliminates the ability to exercise transmission market power. This issue is the use of transmission to advantage wholesale power sales, not transmission market power per se. That has implications for our analysis under the transmission market power prong. In a related order we issue today, the Commission proposes reforms to its open access rules to eliminate the opportunity for undue discrimination and preference in transmission service that exists under the current rules.

Most market-based rates cases have revolved around the generation market power prong. In recent years, some have focused on transmission market power. The third and fourth prongs of our market power test remain largely undefined or ill-defined.

The proposed rules adjust the four prong test into a two prong test: (1) horizontal market power, and (2) vertical market power. The generation market power prong would become the horizontal market power prong, and the transmission market power prong and other barriers to entry prong would become the vertical market power prong. The fourth prong of the existing analysis, affiliate abuse, has effectively operated as a condition of market-based authorization, rather than a discrete measure of market power. In the proposed rule, we call a spade a spade and condition market-based authorization on compliance with our affiliate sales restrictions. These changes would make our market power test more consistent with traditional antitrust analysis.

Perhaps the most important change we are proposing today is codifying our market power test in our regulations, for the first time in nearly 20 years. Currently, there are roughly 1,200 companies with market-based rate authorization. All of those companies are required to submit triennial market analysis, and report changes in status. The universe of companies with market-based rate authorization has grown so large that it is appropriate, perhaps even necessary, that we incorporate our test into our regulations. Doing so will provide greater regulatory certainty to the regulated community and stakeholders, and minimize the prospect of inconsistency in application of our test. We learned during the changes of status rulemaking that the case-by-case approach runs the risk of inconsistent application. We propose to apply that lesson here.

The Commission's authority to approve market-based rates has been tested by the courts, and affirmed. However, it is important to note that we have steadily strengthened our market based rate test in recent years. We strengthened the reporting requirements, in Order No. 2001. We raised the generation market power threshold, in the April and July 2004 orders. We established a changes of status reporting requirement. We began to consistently revoke the market-based rate authorization of companies that do

not submit triennial market analysis or electronic quarterly reports, as required by their authorization. We propose another step today.

The proposed rules do not mark a dramatic departure in the Commission's market-based rate policies. We make some modifications to the interim generation market power test. In particular, we change the native load deduction from minimum peak day in the season to average peak native load, averaged across all days in the season. We retain the default geographic markets, but provide guidance on what applicants have to show to support an alternative geographic market. The interim generation market power test is no longer interim, instead it would be modified and incorporated into our regulations.

Part of our reason for proposing to incorporate our market power test into Commission regulations is to relieve staff of the burden of reviewing triennial market analysis from companies that lack market power, namely unaffiliated power marketers and power producers with 500 megawatts or less of generating capacity that do not own or control transmission facilities and present no other vertical market power issues.

While these companies would be relieved of the requirement to submit triennial market analysis, they are not relieved of their obligation under the changes of status rule. If a company authorized to charge market-based rates because it has less than 500 megawatts of generating capacity were to acquire additional generation, they would be required to seek Commission authorization for the acquisition, or report the change in status, and may become subject to the triennial reporting requirement. Failure to seek authorization or report an acquisition may give rise to disgorgement of profits and imposition of civil penalties. This approach would allow Commission staff to concentrate greater resources on the larger companies that have greater market power.

To me, the primary rationale of this proposed rule is good government. We are proposing to make our market power test more clear, and more consistent with traditional antitrust analysis, incorporating lessons we have learned from nearly 20 years experience, and providing greater regulatory certainty in our policy in a complicated area.

I look forward to the comments on the proposed rule."