

134 FERC ¶ 61,191
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

[Docket No. RM11-14-000]

Analysis of Horizontal Market Power under the Federal Power Act

(March 17, 2011)

AGENCY: Federal Energy Regulatory Commission.

ACTION: Notice of Inquiry.

SUMMARY: In this Notice of Inquiry, the Federal Energy Regulatory Commission seeks comment on whether, and if so, how, the Commission should revise its approach for examining horizontal market power concerns in transactions under § 203 of the Federal Power Act to reflect the Horizontal Merger Guidelines issued by the Department of Justice and Federal Trade Commission on August 19, 2010 (2010 Guidelines), and what impact the 2010 Guidelines should have, if any, on the Commission's analysis of horizontal market power in its electric market-based rate program.

DATES: Comments are due [Insert date that is 60 days after publication in the **FEDERAL REGISTER**].

ADDRESSES: You may submit comments, identified by docket number by any of the following methods:

- Agency Web Site: <http://ferc.gov>. Documents created electronically using word processing software should be filed in native applications or print-to-PDF format and not in a scanned format.

- Mail/Hand Delivery: Commenters unable to file comments electronically must mail or hand deliver an original copy of their comments to: Federal Energy Regulatory Commission, Secretary of the Commission, 888 First Street, NE, Washington, DC 20426.

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SUPPLEMENTARY INFORMATION:

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Analysis of Horizontal Market Power under the Federal Power Act Docket No. RM11-14-000

NOTICE OF INQUIRY

(March 17, 2011)

1. In this Notice of Inquiry, the Federal Energy Regulatory Commission (Commission) seeks comment on whether, and if so, how, the Commission should revise its approach for examining horizontal market power concerns in transactions under § 203 of the Federal Power Act (FPA)¹ to reflect the Horizontal Merger Guidelines issued by the Department of Justice (DOJ) and Federal Trade Commission (FTC) (together, the Antitrust Agencies) on August 19, 2010 (2010 Guidelines), and what impact the 2010 Guidelines should have, if any, on the Commission's analysis of horizontal market power in its electric market-based rate program under § 205 of the FPA.²

I. Background

A. Section 203

2. Section 203(a)(4) of the FPA requires the Commission to approve a proposed disposition, consolidation, acquisition, or change in control if it finds that the proposed

¹ 16 U.S.C. 824b.

² 16 U.S.C. 824d.

transaction will be consistent with the public interest. In the 1996 Merger Policy Statement, the Commission set out the three factors it generally considers when analyzing whether a proposed § 203 transaction is consistent with the public interest: effect on competition, effect on rates, and effect on regulation.³ In analyzing whether a proposed transaction will have an adverse effect on competition, the Merger Policy Statement adopted the Antitrust Agencies' 1992 Horizontal Merger Guidelines (1992 Guidelines)⁴ and its five-step framework,⁵ as well as the Appendix A analytic screen, based on the 1992 Guidelines, to identify transactions that would not harm competition. The components to a screen analysis are as follows: (1) identify the relevant products; (2) for the purpose of determining the size of the geographic market, identify customers who may be affected by the merger; (3) for the purpose of determining the size of the geographic market, identify potential suppliers to each identified customer (includes a

³ *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044, at 30,111 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) (Merger Policy Statement). The Energy Policy Act of 2005 added the requirement that the Commission find that the transaction will not result in inappropriate cross-subsidization, unless the Commission determines that such cross-subsidization will be consistent with the public interest. Energy Policy Act of 2005, Pub. L. No. 109-58, 1289, 119 Stat. 594, 982-83 (2005), *codified*, 16 U.S.C. 824b(a)(4).

⁴ U.S. Dept. of Justice & Federal Trade Commission, "Horizontal Merger Guidelines" (1992), as revised (1997) (1992 Guidelines).

⁵ Merger Policy Statement, FERC Stats. & Regs. at 30,118. The five steps are: (1) defining the markets; (2) evaluating whether the extent of concentration of the market raise concerns about potential adverse competitive effects; (3) assessing whether entry could counteract such concerns; (4) assessing any efficiency gains that cannot otherwise be gauged; and (5) assessing whether either party to the merger would fail without the merger, causing its assets to exit the market.

delivered price test (DPT) analysis, consideration of transmission capability, and a check against actual trade data); and (4) analyze market concentration using the Herfindahl-Hirschman Index (HHI)⁶ thresholds from the 1992 Guidelines.⁷

3. The Commission adopted the HHI thresholds set forth in the 1992 Guidelines to classify a market as unconcentrated, moderately concentrated, and highly concentrated, and to assess the competitive significance of the change in HHI resulting from a proposed transaction. The Commission, based on the 1992 Guidelines, classifies a market as unconcentrated if the post-merger HHI in the market is below 1,000 points and considers mergers that result in an unconcentrated market as unlikely to have adverse competitive effects, regardless of the change in HHI resulting from the merger.

4. The Commission classifies a market as moderately concentrated if the post-merger HHI ranges from 1,000 to 1,800. Under the Commission's standards, a merger in a moderately concentrated market that involves an increase in HHI of more than 100 points is considered to potentially raise significant competitive concerns. The Commission currently classifies a market as highly concentrated if the post-merger market's HHI exceeds 1,800 and considers mergers that result in a change in HHI that is greater than

⁶ The HHI is a widely accepted measure of market concentration, calculated by squaring the market share of each firm competing in the market and summing the results. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases. Both the Antitrust Agencies and the Commission use HHI to assess market concentration. *See infra* P 10, 12.

⁷ Merger Policy Statement, FERC Stats. & Regs. at 30,119-20, 30,128-37.

50 points as potentially raising significant competitive concerns. If the change in HHI exceeds 100 points, the merger is presumed to create or enhance market power.

5. The Commission revised its regulations to reflect the adoption of the 1992 Guidelines in the analysis of horizontal market power in § 203 transactions. Section 2.26 of the Commission's regulations states:

(a) The Commission has adopted a Policy Statement on its policies for reviewing transactions subject to section 203.

That Policy Statement can be found at 77 FERC 61,263 (1996). The Policy Statement is a complete description of the relevant guidelines. Paragraphs (b)-(e) of this section are only a brief summary of the Policy Statement.

...

(c) Effect on competition. Applicants should provide data adequate to allow analysis under the Department of Justice/Federal Trade Commission Merger Guidelines, as described in the Policy Statement and Appendix A to the Policy Statement.⁸

6. The Commission described the 1992 Guidelines as a well-accepted standard approach for evaluating the competitive effects of mergers but noted that the 1992

⁸ 18 CFR 2.26.

Guidelines “are just that – guidelines. They provide analytical guidance but do not provide a specific recipe to follow.”⁹ In addition, the Commission noted analytic challenges in applying the 1992 Guidelines to the electric power industry, “because the industry is evolving very rapidly and because the industry has some unique features.”

The Commission explained that an analysis that follows the 1992 Guidelines still requires many assumptions and judgments to fit specific fact situations.¹⁰ In the Supplemental Policy Statement, the Commission noted that the Antitrust Agencies use “informal and non-public processes for reviewing transactions,” in contrast to the public process used by the Commission.¹¹ The courts have also acknowledged that the Commission’s standard of review is whether a transaction is “consistent with the public interest,” and that the Commission was not intended to enforce antitrust policy in conjunction with the Antitrust Agencies.¹²

7. The Commission subsequently issued Order No. 642, which stated that, consistent with the 1992 Guidelines, applicants that failed the competitive screen could submit evidence to assist the Commission in evaluating the following factors to show that the proposed transaction would not have an adverse effect on competition: (1) the potential adverse competitive effects of the merger; (2) whether entry by competitors can deter

⁹ Merger Policy Statement, FERC Stats. & Regs. at 30,118.

¹⁰ *Id.*

¹¹ *FPA Section 203 Supplemental Policy Statement*, FERC Stats. & Regs. ¶ 31,253, at P 69-70 (2007), *order on clarification*, 122 FERC ¶ 61,157, at P 15 (2008).

¹² *Northeast Utilities Service Co.*, 993 F.2d 937, 947 (1st Cir. 1993).

anticompetitive behavior or counteract adverse competitive effects; (3) the effects of efficiencies that could not be realized absent the merger; and (4) whether one or both of the merging firms is failing and, absent the merger, the failing firm's assets would exit the market.¹³

B. Market-Based Rates

8. With respect to the Commission's analysis of horizontal market power in its market-based rate program, the Commission employs two preliminary screens – the wholesale market share indicative screen and the pivotal supplier indicative screen – and failure of either screen results in a rebuttable presumption of horizontal market power. The intent of the indicative screens is to identify those sellers that raise no horizontal market power concerns and can otherwise be considered for market-based rate authority.¹⁴

9. The Commission has traditionally employed a 20 percent threshold for the wholesale market share screen (a seller with a market share of less than 20 percent passes

¹³ *Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111, at 31,898 (2000) (1992 Guidelines sec. 0.2 Overview). These factors are codified at 18 CFR 33.3(f). The 2010 Guidelines retain these steps, but place less emphasis on them.

¹⁴ *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order No. 697, FERC Stats. & Regs. ¶ 31,252, at P 62, *clarified*, 121 FERC ¶ 61,260 (2007), *order on reh'g*, Order No. 697-A, FERC Stats. & Regs. ¶ 31,268, *clarified*, 124 FERC ¶ 61,055, *order on reh'g*, Order No. 697-B, FERC Stats. & Regs. ¶ 31,285 (2008), *order on reh'g*, Order No. 697-C, FERC Stats. & Regs. ¶ 31,291 (2009), *order on reh'g*, Order No. 697-D, FERC Stats. & Regs. ¶ 31,305 (2010).

the screen).¹⁵ The Commission stated that the use of such conservative thresholds at the indicative screen stage of a proceeding is warranted because the indicative screens are meant to identify those sellers that raise no horizontal market power concerns, as well as those that require further examination.¹⁶ The Commission reasoned that a 20 percent threshold for the wholesale market share screen struck the proper balance between identifying sellers that may present market power concerns, while avoiding the risk of “false negatives” and imposing undue regulatory burdens on sellers. Several protesters argued that the 20 percent threshold was too low in light of the 1992 Guidelines’ statement that firms with 35 percent or more market share have market power. The Commission rejected these arguments, stating that a market with five equal-sized firms with 20 percent market shares will have an HHI of 2,000, which is above the HHI threshold used in the 1992 Guidelines for a highly-concentrated market,¹⁷ and that market power is more likely to be present at lower market shares in markets for commodities with low demand price-responsiveness, like electricity, than in markets with high demand elasticity.¹⁸

¹⁵ *AEP Power Marketing, Inc.*, 97 FERC ¶ 61,219, at 61,969 (2001); *AEP Power Marketing, Inc.*, 107 FERC ¶ 61,018, at P 8, 102 (April 14 Order), *order on reh’g*, 108 FERC ¶ 61,026 (2004).

¹⁶ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 62.

¹⁷ As explained further below, the Antitrust Agencies use HHI as a method of classifying a market based on its level of concentration. *See infra* P 12. Under the 1992 Guidelines, a market with an HHI above 1,800 is considered to be highly concentrated. 1992 Guidelines sec. 1.5.

¹⁸ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 80, 89-93.

10. Sellers that fail either indicative screen may rebut the presumption of market power in one of several ways, including by submitting a DPT analysis. 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 and load condition. The results of the DPT can be used for pivotal supplier, market share, and market concentration analyses. In analyzing market concentration in this context, the Commission uses an HHI threshold of 2,500.¹⁹ In rejecting arguments that it should, consistent with the 1992 Guidelines, adopt an HHI threshold of 1,800, the Commission noted that the Department of Justice had previously advocated an HHI threshold of 2,500 for analyzing whether to grant market-based pricing for oil pipelines and that the Department of Justice had further stated that the Commission could reasonably conclude that an entity participating in a market with an HHI threshold of less than 2,500 had a rebuttable presumption that it did not have market power.²⁰

II. The 2010 Guidelines

11. The 2010 Guidelines set forth how the Antitrust Agencies will evaluate the competitive impact of mergers, focusing on whether a merger results in anticompetitive effects such as “encouraging one or more firms to raise price, reduce output, diminish

¹⁹ *Id.* P 110-111; April 14 Order, 107 FERC ¶ 61,018 at P 110-11.

²⁰ Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 110 (citing Comments of the U.S. Department of Justice in response to *Notice of Inquiry Regarding Market-Based Ratemaking for Oil Pipelines*, Docket No. RM94-1-000 (Jan. 18 1994)).

innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives.”²¹ The 2010 Guidelines replace the 1992 Guidelines and explain several changes to the analysis set forth in the 1992 Guidelines.

12. Specifically, the 2010 Guidelines raise the HHI thresholds used by the Antitrust Agencies to classify a market as unconcentrated, moderately concentrated, or highly concentrated. The 2010 Guidelines modify the thresholds adopted in the 1992 Guidelines for the purpose of classifying a particular market and assessing the significance of a post-merger change in HHI, as summarized in the table below.

HHI (Market Concentration) Thresholds		
Market	1992 Guidelines	2010 Guidelines
Unconcentrated	<1000	<1500
Moderately Concentrated	1000-1800	1500-2500
Highly Concentrated	>1800	>2500
HHI Changes Potentially Raising Significant Competitive Concerns		
Moderately Concentrated Markets	>100	>100
Concentrated Markets	>50	>100, <200
HHI Changes Presumed Likely to Enhance Market Power		
Concentrated Markets	>100	>200

13. In addition, the 2010 Guidelines place less emphasis on market definition and the use of a prescribed formula for considering the effects of a merger than the 1992 Guidelines. Instead, the 2010 Guidelines state that the Antitrust Agencies will engage in a fact-specific inquiry using a variety of analytical tools, including direct evidence of competition between the parties and economic models that are designed to quantify the

²¹ 2010 Guidelines sec. 1.

extent to which the merged firm can raise prices as a result of the merger.²² Section 6.3 of the 2010 Guidelines provides additional guidance as to how the methods in the 2010 Guidelines can be tailored to analyze markets involving relatively undifferentiated products. In particular, § 6.3 of the 2010 Guidelines identifies factors that may indicate that a merged firm may find it profitable to unilaterally suppress output in a market involving relatively undifferentiated products.²³

14. The 2010 Guidelines also address the potential competitive effects arising from partial acquisitions and minority ownership.²⁴ The proposed analysis of a partial acquisition focuses on three principal effects: (1) whether the acquiring company will be able to influence the competitive conduct of the target firm;²⁵ (2) whether the partial acquisition will reduce the financial incentive to compete because losses from one owned firm are offset by gains at the other;²⁶ and (3) whether the partial acquisition enables companies to access non-public competitive information that can lead to coordinated activity by the firms.²⁷

²² *Id.*

²³ *Id.* sec. 6.3.

²⁴ *Id.* sec. 13.

²⁵ The 2010 Guidelines state that a voting interest in the target firm or specific governance rights, such as the right to appoint members to the board of directors, can permit such influence. *Id.*

²⁶ The 2010 Guidelines state that acquiring a minority position in a rival might significantly blunt the incentive of the acquiring firm to compete aggressively because it shares in the losses inflicted on the rival. *Id.*

²⁷ Issues relating to partial acquisitions are among the issues before the Commission in Docket No. RM09-16-000. *Control and Affiliation for Purposes of*
(continued...)

III. Request for Comments

15. The Commission seeks comment on whether, and if so, how, the Commission should revise its approach for examining horizontal market power concerns in transactions under § 203 of the FPA to reflect the 2010 Guidelines. As discussed above, the 2010 Guidelines place less emphasis on market definition and the use of a prescribed formula for considering the effects of a merger than the 1992 Guidelines. Should the Commission adopt this approach? If so, what elements of this approach should the Commission adopt? And how should the Commission incorporate these elements into its analysis? The 2010 Guidelines' reduced emphasis on market definition and prescribed formulas aside, should the Commission adopt the revised HHI levels in the 2010 Guidelines in its analysis of whether a proposed transaction will adversely affect competition under § 203 of the FPA?

16. For example, the 2010 Guidelines raise the HHI threshold for an unconcentrated market and classify a market where the post-merger HHI is below 1,500 as unconcentrated. Should the Commission adopt the 2010 Guidelines' classification? Or should the Commission continue to classify a market as unconcentrated if the post-merger HHI in the market is below 1,000 points?

17. While the 2010 Guidelines continue to retain a threshold of 100 points for the purpose of assessing the significance of a post-merger change in HHI in a moderately

Market-Based Rate Requirements under Section 205 of the Federal Power Act and the Requirements of Section 203 of the Federal Power Act, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,650 (2010).

concentrated market, the 2010 Guidelines classify a market with a post-merger HHI of between 1,500 and 2,500 as moderately concentrated. Should the Commission adopt the 2010 Guidelines' classification of a moderately concentrated market, or should the Commission continue to classify a market as moderately concentrated if the post-merger HHI ranges from 1,000 to 1,800?

18. Under the 2010 Guidelines, a market is classified as highly concentrated if the post-merger HHI exceeds 2,500, and mergers that involve an increase in HHI of between 100 and 200 points are considered to potentially raise significant competitive concerns, with mergers resulting in a change of greater than 200 points presumed to be likely to enhance market power. Should the Commission adopt the 2010 Guidelines' thresholds for the purpose of identifying a market as highly concentrated and assessing the competitive significance of a change in HHI resulting from a merger? Or should the Commission continue to classify a market as highly concentrated if the post-merger market's HHI exceeds 1,800? Also, should the Commission continue to consider mergers that result in a change in HHI that is greater than 50 points as potentially raising significant competitive concerns, and that mergers resulting in a change in HHI exceeding 100 points are presumed to create or enhance market power?

19. Should the Commission adopt any of the other aspects of the 2010 Guidelines? If so, which ones, and how would the Commission incorporate these aspects into its market power analysis?

20. In this regard, we note that there are fundamental differences between the Commission's process and that of the Antitrust Agencies. The Commission's review

process is public and parties can intervene and submit comments, while the review process at the Antitrust Agencies is nonpublic and closed. The Commission's merger decision is based on a factual record shaped not only by the applicant, but by intervenors and subject to analysis by Commission staff. The merger decisions by the Antitrust Agencies are based on information submitted by the applicant, non-public information gathered by the agency staff, as well as the economic analysis performed by agency staff. The Commission seeks comment on whether the differences between the Commission's process for considering applications under §§ 203 and 205 of the FPA and the process used by the Antitrust Agencies for considering mergers affect the extent to which the Commission should adopt the 2010 Guidelines.

21. Finally, the Commission also seeks comment on what impact the 2010 Guidelines should have, if any, on the Commission's analysis of horizontal market power in its electric market-based rate program.

IV. Comment Procedures

22. The Commission invites interested persons to submit comments, and other information on the matters and issues identified in this notice. Comments are due [Insert date that is 60 days after publication in the **FEDERAL REGISTER**]. Comments must refer to Docket No. RM11-14-000, and must include the commenter's name, the organization they represent, if applicable, and their address in their comments.

23. The Commission encourages comments to be filed electronically via the eFiling link on the Commission's web site at <http://www.ferc.gov>. The Commission accepts most standard word processing formats. Documents created electronically using word

processing software should be filed in native applications or print-to-PDF format and not in a scanned format. Commenters filing electronically do not need to make a paper filing.

24. Commenters that are not able to file comments electronically must send an original copy of their comments to: Federal Energy Regulatory Commission, Secretary of the Commission, 888 First Street NE, Washington, DC 20426.

25. All comments will be placed in the Commission's public files and may be viewed, printed, or downloaded remotely as described in the Document Availability section below. Commenters on this proposal are not required to serve copies of their comments on other commenters.

V. Document Availability

26. In addition to publishing the full text of this document in the *Federal Register*, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page (<http://www.ferc.gov>) and in FERC's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, NE, Room 2A, Washington DC 20426.

27. From FERC's Home Page on the Internet, this information is available on eLibrary. The full text of this document is available on eLibrary in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number excluding the last three digits of this document in the docket number field.

28. User assistance is available for eLibrary and the FERC's website during normal business hours from FERC Online Support at (202) 502-6652 (toll free at 1-866-208-3676) or email at ferconlinesupport@ferc.gov, or the Public Reference Room at (202) 502-8371, TTY (202)502-8659. E-mail the Public Reference Room at public.referenceroom@ferc.gov.

By direction of the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.