UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Exelon Corporation and Pepco Holdings, Inc.	))))	Docket No. EC14-96-000

COMMENTS OF
THE INDEPENDENT MARKET MONITOR FOR PJM

Pursuant to Rule 211 of the Commission's Rules and Regulations,[1] Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM ("Market Monitor"),[2] submits these comments on the joint application of Exelon Corporation ("Exelon") and Pepco Holdings, Inc. ("PHI") (collectively, the "Companies") for approval of a transaction whereby Exelon would acquire substantially all of the assets of PHI. The proposed merger would combine the assets of Exelon, a large generation owner and a large transmission owner in PJM with the assets of PHI, a large transmission owner in PJM. The merger would eliminate a large independent transmission owner in PJM and make its assets again part of a vertically integrated company. The proposed merger raises potential vertical and horizontal market power issues.[3] To address these concerns, the Companies rely on assertions that regulation by state commissions and membership in an RTO remove

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1 18 CFR § 385.211 (2011).

2 Capitalized terms used herein (including the attached report) and not otherwise defined have the meaning used in the PJM Open Access Transmission Tariff ("OATT").

3 *See Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*, Order No. 1000 ("Order No. 1000"), FERC Stats. & Regs. ¶ 31,323 (2011), *order on reh'g*, Order No. 1000-A, 139 FERC ¶ 61,132 (2012).

opportunity and/or incentive to exercise such market power. Assertions about the effectiveness of state regulation and RTO membership are not adequate to address the vertical and horizontal market power issues. The Companies should be required to provide more information about how the merger would affect vertical market power and provide for any appropriate behavioral mitigation measures. The Market Monitor recommends consideration of specific behavioral mitigation measures, which, if adopted, could address vertical market power issues.

I. COMMENTS

A. The Incremental Increase in the Concentration of Ownership of Generation Assets Does Not Raise Concerns About Market Power; The Companies Have Not Analyzed the Effects of Combining Their Demand-Side Resources Portfolios.

The Companies claim (at 15–19) that the increase in concentration of the ownership of supply assets in the PJM region is very small and does not raise market power concerns. The Market Monitor has performed an analysis consistent with its practice in prior section 203 proceedings.[4] The Market Monitor agrees that the proposed merger does not raise concerns about horizontal market power in generation, and it does not believe that any additional analysis of increased concentration of generation ownership resulting from the proposed merger is necessary.

Horizontal competition in PJM markets extends beyond consideration of generation assets. Demand-side resources ("DSR") participate in PJM energy markets and capacity markets. Both Exelon and PHI have substantial portfolios of DSR, and the proposed merger

[4] *See*, *e.g.*, Comments of the Independent Market Monitor for PJM, Docket No. EC14-14 (December 9, 2013); Comments of the Independent Market Monitor for PJM and Motion to File Comment Three Days Out-of-Time, Docket No. EC11-83 (July 21, 2011); *see also Exelon Corporation, Constellation Energy Group, Inc.*, 138 FERC ¶ 61,167 (2012); *Analysis of Horizontal Market Power under the Federal Power Act*, 138 FERC ¶ 61,109 (2012).

would significantly increase the combined company's market share among DSR providers, but the Companies do not provide an analysis showing the effects of combining them.

B. The Proposed Merger Presents Transmission-Related Market Power Issues That Require Further Investigation and Potentially Mitigation.

The combination of Exelon and PHI raises questions about vertical market power that the Companies should be required to address in detail.[5] The Companies do not adequately address these issues in their filing. The identified concerns about vertical market power issues could be addressed with appropriate conditions to approval of the merger.[6]

Vertical market power is control or influence over the means of competition in, and/or access to, an upstream or downstream market.[7] An entity with vertical market power can leverage a position in upstream or downstream markets where the entity in question would otherwise not have an advantage. Examples of vertical market power are control of transmission and/or gas pipelines that can be used to control access to the

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5 *See* 18 CFR § 33.4; *see also Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000) ("Order No. 642"); *Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006); *Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, 61 Fed. Reg. 68,595, 77 FERC ¶ 61,263 (*mimeo*), FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) ("Merger Policy Statement"); *FPA Section 203 Supplemental Policy Statement*, FERC Stats. & Regs. ¶ 31,253 (2007).

6 *See* 18 CFR § 33.4(d).

7 *See* 18 CFR § 33.4(a)(1) ("The applicant must file the vertical Competitive Analysis described in paragraphs (b) through (e) of this section if, as a result of the proposed transaction, a single corporate entity has ownership or control over one or more merging entities that provides inputs to electricity products and one or more merging entities that provides electric generation products (for purposes of this section, merging entities means any party to the proposed transaction or its parent companies, energy subsidiaries or energy affiliates).")

wholesale electricity market or affect the competitiveness in the wholesale electricity market.[8]

The Companies note that in Order No. 642, the Commission emphasized its concern about three primary types of mergers: "(1) 'convergence mergers' between electric utilities and natural gas pipelines that 'may create or enhance the incentive and/or ability for the merged firm to adversely affect prices and output in the downstream electricity market and to discourage entry by new generators;'[footnote omitted] (2) mergers involving owners of electric transmission facilities that may use those facilities to benefit their electric generation facilities; and (3) mergers involving the ownership of other inputs to the generation of electricity" [footnote omitted].[9] The Market Monitor has concerns about the first two types of mergers.

The combination of Exelon and PHI also raises horizontal market power issues in transmission. In Order No. 1000, the Commission implemented a new policy encouraging competition in the development of transmission projects.[10] Competition to build

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8 *See* Order No. 642 mimeo at 94 ("We also note that a number of important considerations in evaluating downstream markets have arisen in recent merger cases. For example, in [*American Electric Power Company*, 90 FERC ¶ 61,242] we found that applicants had not properly modeled the possible vertical foreclosure scenarios in which AEP or CSW could use its transmission system to frustrate competition. We agreed with intervenors that, by looking only at suppliers that were "first-tier" to one applicant and buyers that were "first-tier" to the other applicant, the applicants excluded many foreclosure scenarios. Moreover, by looking only at the least-cost contract path, applicants ignored foreclosure scenarios. Their analysis focused solely on whether the merger created the incentive to increase prices, thus ignoring cases where the merger *enhanced* that incentive and cases where the merger created or enhanced the *ability* to raise prices. Applicants concluded that because the change in market concentration under a particular foreclosure scenario did not exceed the horizontal merger standard, the merger did not create or enhance vertical market power. However, as we explained in *Dominion*, the market concentration level, as opposed to the change in market concentration, is the relevant measure, since highly concentrated upstream and downstream markets are necessary, but not sufficient, conditions for a vertical foreclosure strategy to be effective." [Emphasis in original.]).

9 Companies at 19, citing Order No. 642, FERC Stats. & Regs. ¶ 31,111 at 31,904.

10 *See* Order No. 1000 at PP 225–344.

transmission projects was not a merger type identified in Order No. 642, but after the change to the regulatory approach to competition in transmission specified in Order No. 1000, the effect on competition in transmission should be considered. This may also be considered as an exacerbating factor for mergers involving owners of electric transmission facilities.

1. The Incremental Increase in the Concentration of Ownership of Natural Gas Distribution Assets Raises Concerns About Vertical Market Power That Require Further Investigation and Mitigation Should Be Considered.

PECO, BGE, and Delmarva operate intrastate natural gas distribution systems, and the concentration of ownership will increase as a result of the merger. The Companies address this issue (at 20–21), stating "Each of these utilities is highly regulated by the respective state public utility commissions, each of which imposes open access distribution requirements that ensure service to new customers, including gas-fired generators seeking to interconnect with the respective distribution systems." The Companies Witness Solomon claims (at 20) that "new generation can, and likely will, be sited to connect directly to an interstate transmission pipeline system and thus bypass the PECO, BGE or Delmarva local gas distribution systems." The Companies do not discuss the rules for bypass in each state affected by the proposed merger, including whether and how a distribution company can impose charges or other conditions on a gas customer seeking to bypass the local gas distribution company and take service directly from an interstate pipeline. A discussion of these rules is necessary to evaluate the Companies' assertion that opportunity for bypass fully addresses vertical market power concerns.

2. The Incremental Increase in the Concentration of Ownership of the Transmission System Raises Concerns About Vertical and Horizontal Market Power That Requires Further Investigation and That Could Be Addressed With Mitigation.

The Companies address the increased potential for market power in the electric transmission market stating (at 21): "All of the transmission facilities owned by the

Applicants are under the control of PJM, and will continue to be under PJM's control after the consummation of the Transaction. As a result, the Transaction does not increase in any respect the ability of the Applicants to use their ownership or control of transmission facilities to give themselves a competitive advantage in energy markets."

This is overstated. Section 4.1 of the PJM Consolidated Transmission Owners Agreement ("TOA") specifies PJM's "control" over a transmission owner's transmission facilities. PJM can direct the operation of transmission facilities (with no right to assume physical control), prepare the Regional Transmission Expansion Plan and obtain data and other information in order to comply with NERC standards.[11] This transfer of responsibility is significant, but it is also limited. It is not enough for the Companies to avoid explanation of the potential effects on competition from vertical market power for the combination of assets of a major supplier and transmission owner in PJM with the assets of a major transmission owner in PJM.

Transmission owners' participation in PJM, or in any other RTO, is voluntary.[12] Transmission owners have significant leverage over the RTO in which they are a member. Like any organization, RTOs are concerned with protecting their size, scope and importance.[13] The exit of a transmission member would be a very significant negative for an RTO.[14] The greater the proportion of the RTO's assets represented by the transmission owner, the greater the threat of exit to the RTO and the greater the potential influence of the transmission owner over the RTO governance and processes.

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11 TOA § 4.1.

12 *See* Order No. 2000 *mimeo* at 115–117; *see also*, *Louisville Gas and Electric Company, et al.*, 114 FERC ¶61,282 (2006).

13 *See*, *e.g.*, Duke Energy Answer and Motion for Leave to Answer in Docket No ER10-1562 (August 10, 2010) Attachment A (Letter from John R Bear, President & CEO, Midwest Independent System Operator, to Keith Trent, Duke Energy, dated May 4, 2010).

14 *See id.*; *see also*, *e.g.*, *Duquesne Light Company*, 122 FERC ¶61,039 (2008).

The combination of Exelon and PHI will combine under a single owner a substantial portion of the transmission system. Exelon's transmission assets currently account for 16.8 percent of transmission service credits collected from the PJM market and Pepco Holdings assets currently account for 6.6 percent of transmission service credits collected from the PJM market. The combined company would account for 23.4 percent of transmission service credits collected from the PJM market. The combined owner will have substantial and increased influence over decisions that directly relate to competition in PJM among developers of transmission projects. Although the RTO has responsibility for the interconnection process, transmission owners perform interconnection studies for generation.[15, 16]

Having a transmission owner involved in the study process creates a conflict of interest if they are also the developer or potential developer of a project or own competing generation.

The incentive and opportunity exist for transmissions owners to exert vertical market power and influence the interconnection process of potential wholesale competitors, from determining the timeliness, the technical requirements for and the costs of the interconnection.

Transmission owners are responsible for setting the line limits used by the RTO in their network models. It is evident from a recent PJM study of operational and market

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15 The conflict of interest has created controversy. *See*, *e.g.*, *Primary Power v. PJM Interconnection, L.L.C.*, 140 FERC ¶ 61,054 (2012), *reh'g denied*; 143 FERC ¶ 61,204 (2013); Letter from Atlantic Grid Holdings LLC to PJM Board, dated June 24, 2014 re "Artificial Island Decision," which can be accessed at: <*http://www.pjm.com/~/media/about-pjm/who-we-are/public-disclosures/20140630-atlantic-wind-letter-regarding-artificial-island.ashx*>; Letter from Pepco Holding, Inc. and Exelon to the PJM Board re "PJM Process for Evaluating Competitive Artificial Island Proposals" dated July 14, 2014 at <*http://www.pjm.com/~/media/about-pjm/who-we-are/public-disclosures/20140714-exelon-letter-regarding-the-pjm-process-for-evaluating-competitive-artificial-island-proposals.ashx*>.

16 Such studies include Feasibility Studies, System Impact Studies and Facilities Studies. OATT Parts IV & VI.

impacts during a heat wave event, that incorrect or incomplete information on line limits can have significant market impacts.[17]

The concentration of ownership in transmission assets creates a concern about horizontal in addition vertical, market power. A consolidation of transmission companies reduces the pool of companies that have the expertise to compete to build competitive transmission projects, as defined in Order No. 1000. Consolidation will reduce the competition to build competitive transmission projects. A reduction in competition will likely result in higher costs for customers.

The Market Monitor believes that behavioral mitigation could address these concerns. Examples of behavioral mitigation that would address vertical market power issues include securing the Companies' agreement (i) to commit to remain in PJM; (ii) to permit third party independent interconnection studies; and (iii) to commit to a thorough review of ratings of all elements of the combined transmission systems and provide supporting analyses to PJM and the Market Monitor for review and to establish an ongoing regular process for reviewing and updating transmission limits.

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17 PJM Interconnection, Technical Analysis of Operational Events and Market Impacts During the September 2013 Heat Wave (December 23, 2013).

II. CONCLUSION

The Market Monitor respectfully requests that the Commission afford due consideration to these comments as the Commission resolves the issues raised in this proceeding.

Respectfully submitted,

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Dated: July 21, 2014

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Eagleville, Pennsylvania,
this 21st day of July, 2014.

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