UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

COMMENTS OF THE INDEPENDENT MARKET MONITOR FOR PJM

Monitoring Analytics, LLC, acting in its capacity as the Independent Market Monitor for PJM[1] ("Market Monitor") submits these comments in response to the Notice of Inquiry issued in the above referenced docket on March 17, 2011.[2]

A. 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 2010 Guidelines?

The two essential new metrics proposed in the Horizontal Merger Guidelines issued by the U.S. Department of Justice ("DOJ") and the Federal Trade Commission on August 19, 2010 ("2010 Guidelines"), are the definition of the relevant market and the modified limits on HHI thresholds.

The approach for examining horizontal market power concerns in transactions under § 203 of the FPA should be revised to reflect the 2010 Guidelines and to reflect the realities of organized wholesale power markets introduced in 1999 and thereafter.

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1 PJM Interconnection, L.C.C. is a Commission-approved Regional Transmission Organization. Capitalized terms used herein and not otherwise defined have the meaning provided in the PJM Open Access Transmission Tariff ("OATT") or the PJM Reliability Assurance Agreement ("RAA").

2 134 FERC ¶ 61,191.

The current approach to merger analysis does not fully reflect the information available in organized wholesale power markets with locational marginal prices in determining the relevant market(s) of the merging firms. The current approach for determining the relevant market uses approximations of seasonal geographic markets that assume the model of individual utility territories rather than the wholesale power markets that incorporate multiple utilities and other participants. The current approach assumes broadly defined aggregate markets rather than relying on the data now available from organized wholesale power markets on locational markets created by transmission constraints, distribution factors and relative dispatch costs, and reflected in locational marginal prices. The detailed hourly information now available in these markets means that many of the previously required assumptions can be replaced with actual, detailed market data covering actual unit operation, dispatch, prices, offers, imports, exports, and the transmission constraints that create local markets. This new approach would examine repeated sub markets that are created by regional and local constraints that divide the aggregate markets under conditions where the distribution factors and relative costs of supply sources define the relevant markets.

Rather than place less emphasis on market definitions in its analysis of mergers, the methodology for determining the relevant market(s) should be refined and the refined market definitions should be used as the basis of the Commission's analysis. Any analysis of market structure depends on an accurate definition of the relevant markets. Market definitions hinge on properly identifying and properly evaluating potential substitutes for a given product. Within organized markets data is available, and should be used, to define markets based exactly on how the units are evaluated and dispatched to meet demand, based on networked relationships between resources and load, relative costs, availability and operational parameters. Such an approach provides definitions of the relevant markets based on actual operational data related to the participants and the market in which they operate. Evaluated in this manner, the substitutability among supply options in a market is made transparent, along with the relevant market(s), and the relative importance of the merging firms within the market(s). It is on this basis that the use of prescribed formulas regarding market shares, residual suppliers and concentration ratios, as well as other metrics, can be useful tools for evaluating the effects of a proposed merger.

This approach should be applied to all markets in the relevant RTO/ISO including energy markets, capacity markets and ancillary services markets.

1. If so, what elements of this approach should the Commission adopt? And how should the Commission incorporate these elements into its analysis?

The DOJ continues to focus on whether a proposed merger will cause adverse competitive impacts on customers and consumers as a result of diminished competitive constraints or incentives.[3]

The DOJ looks at various types of evidence in determining whether there will be adverse competitive effects of a merger: the actual effects observed in consummated mergers in the same or analogous relevant markets, examinations of the competitiveness of isolated markets for the same or analogous products with varying market concentrations, evidence of whether the merging firms have been or likely will become, in the absence of

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[3] 2010 Guidelines at 2

the merger, substantial head-to-head competitors; the pre and post proposed merger market share and market concentrations in the merging firm's relevant market(s).[4]

The DOJ notes that "these Guidelines describe the principle analytical techniques and the main types of evidence on which the Agencies usually rely to predict whether a horizontal merger may substantially lessen competition."[5] However, the DOJ notes that the "Guidelines should be read with an awareness that merger analysis does not consist of uniform application of a single methodology."[6]

In evaluating the effects of a proposed merger, the DOJ's determinations are based on analysis that requires careful determination of the affected relevant market(s). The DOJ recognizes that, in many cases, defining the relevant markets is not straightforward due to subtleties in the substitutability among suppliers based on product characteristics (the lack of homogeneity in products), as well as search and transaction costs.[7] Given the difficulty of defining the market in some cases, the DOJ has added modeling potential market outcomes measured in probable effects on and responses of customer to changes in price and product characteristics, to their analytical metrics to be used to define the relevant market and to examine the potential effects of a proposed merger.[8] Given the variety of markets that DOJ has under its purview, the addition of more subjective market structure analysis, as well as the use of formulaic calculations of HHI and market share, is prudent.

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4 2010 Guidelines at 2–4.

5 *Id*. at 1.

6 *Id*. at 1

7 *Id*. at 8–15.

8 *Id*. at 11–12.

However, in organized wholesale power markets there is detailed data about product substitutability which makes objective market definitions possible and which makes many of the subtleties of the DOJ approach unnecessary.

The Market Monitor recommends that the Commission use market definitions based on actual operational substitutability and residual supplier analysis to examine the relative importance of the merging firms based on pre and post merger market positions in every relevant market.

The Commission should also consider using additional forms of merger analysis, including some of the subjective ones outlined in the 2010 Guidelines, when examining the possible effects of mergers. For example, the Commission should look at the actual effects observed in wholesale electricity markets where mergers have been consummated, it should examine the competitiveness of isolated wholesale electricity markets with varying market concentrations, it should look at evidence of whether the merging firms have been or likely will become, in the absence of the merger, substantial head-to-head competitors in regional and locational wholesale electricity markets; and the Commission should continue to examine, with refined market definitions based on actual operational data, the pre and post proposed merger market share and market concentrations in all of the merging firms' relevant markets.[9]

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[9] *Id*. at 2–4.

2. **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?**

The current HHI thresholds should not change to match the revised HHI levels found in the 2010 Guidelines. The Commission's current HHI thresholds continue to be appropriate for wholesale electricity markets. Underlying fundamentals of the wholesale electricity markets have not changed since the Commission first determined that a conservative approach to the determination of structural market power is still appropriate. The wholesale electricity markets are still subject to significant barriers to entry, limited substitutes, lack of storage and inelastic demand.

As the Commission has previously noted, the price elasticity of demand is a critical variable in determining whether a particular market structure is likely to result in a competitive outcome.[10] A market with a specific set of market structure features may have a competitive outcome under one range of demand elasticity conditions and a noncompetitive outcome under another set of elasticity conditions. It is essential that market power tests account for elasticity conditions and that evaluation of market power tests neither ignore elasticity nor make counterfactual elasticity assumptions. As the Commission stated, "In markets with very little demand elasticity, a pivotal supplier could extract significant monopoly rents during peak periods because customers have few, if any, alternatives."[11]

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[10] 107 FERC ¶61,018 (2004).

[11] *Id*.

The Market Monitor agrees with the Commission that given the relative inelasticity of demand for wholesale electricity, there is a need to be conservative in defining and measuring the existence of market power among wholesale electric market participants. The Commission's current HHI thresholds provide appropriate thresholds for defining and measuring the existence of market power among wholesale electric participants when applied using the market definitions that emerge from the actual operation of the wholesale power market.

B. 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?

1. **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.**

2. **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.**

The official forms of analysis accepted by the Commission in its assessment of the possible effects of mergers in the wholesale electricity markets should expand beyond those found in Appendix A. Specifically, as outlined in the 2010 Guidelines, analysis that studies the actual effects observed in wholesale electricity markets where mergers have been consummated, analysis of the competitiveness of isolated wholesale electricity markets with varying market concentrations, and analysis that weighs whether the merging firms have been or likely will become, in the absence of the merger, substantial head-to-head competitors in regional and locational wholesale electricity markets should be accepted.

The Commission should also continue to encourage and accept analysis designed to look at the potential of the merger to improve opportunities for unilateral and coordinated interaction.[12] To this end, the Commission should continue to examine, with refined market definitions based on actual operational data, the pre and post proposed merger market share and market concentrations in all the merging firms' relevant markets.[13] As an important addition to unilateral and coordinated interaction analyses, the Commission should encourage residual supplier analysis to examine the relative importance of the merging firms based on pre and post merger market positions in every relevant market.

C. 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.

The thresholds for examining horizontal and screening for market power in its electric market-based rate program should be retained. The Commission's current application of the wholesale market share indicative screen and the pivotal supplier screen, with the currently associated thresholds, where the failure of either screen results in a rebuttable hypothesis of market power are an appropriate and powerful set of tools for detecting structural market power.[14]

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12 2010 Guidelines at 24–25.

13 *Id*. at 2–4.

14 134 FERC ¶ 61,191 at 8.

More specifically, the Market Monitor believes that, using properly defined markets, the 20 percent market share threshold wholesale market share indicative screen, the 2500 HHI threshold and pivotal supplier are appropriately conservative thresholds for determining the existence of market power for purposes of the Commission's market-based rate program. The Market Monitor agrees with the Commission conclusion 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."[15] A conservative screen continues to be appropriate because the wholesale electricity markets are still subject to the significant barriers to entry, limited substitutes, lack of storage and inelastic demand that the Commission originally cited as the rationale for a conservative set of screens.[16]

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15 *Id*. at 9.

16 *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).

II. CONCLUSION

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

Respectfully submitted,

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