BEFORE THE
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Reporting Requirement for Changes	)	
in Status for Public Utilities with	)	Docket No. RM04-14-000
Market-Based Rate Authority	)	

COMMENTS OF THE U.S. DEPARTMENT OF JUSTICE

I. INTRODUCTION

In a Notice of Proposed Rulemaking in this Docket issued October 6, 2004 ("NOPR"), the Federal Energy Regulatory Commission ("Commission") called for comments on a proposal to establish guidelines concerning the types of events that trigger reporting obligations of wholesale electricity sellers authorized to make sales at market-based rates. Among other things, the proposal provides for more timely reporting by sellers with market-based rate authority of changes in ownership or control of generating assets.[1] In previous orders authorizing market-based rates, the Commission gave sellers the option of reporting changes in ownership or control of generating assets every three years in lieu of reporting changes on an ongoing basis.[2] The NOPR calls for elimination of that option and a requirement that sellers with market-based rates file notice of changes in status no later than 30 days after the change in status occurs.[3] As the Commission has recognized, sellers may exercise control and market power through contract as well as through ownership.[4] Thus, "control" of generating assets would, under the proposed

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[1] See NOPR ¶ 8.

[2] See id. ¶¶ 1, 4.

[3] See id. ¶ 2.

[4] See id. ¶ 9.

rule, include control exercised through contractual arrangements.[5] The Commission proposes the change

> [i]n order to facilitate our oversight of public utilities with market-based rate authority, to ensure that the rates being charged continue to be just and reasonable and to give guidance to market participants . . . .[6]

II. POSITION OF THE DEPARTMENT

The Department of Justice ("Department") is responsible for enforcement of the antitrust laws in the electric power industry. Electric power mergers are subject to Section 7 of the Clayton Act, which prohibits mergers likely to lessen substantially competition in any relevant market. Other agreements between electric power market participants are subject to Section 1 of the Sherman Act, which prohibits contracts or agreements that restrain trade unreasonably. The Department analyzes electric power mergers under the Horizontal Merger Guidelines ("Merger Guidelines");[7] it analyzes agreements between competitors under the Antitrust Guidelines for Collaborations Among Competitors ("Collaboration Guidelines").[8] Analyses under the Merger Guidelines and Collaboration Guidelines seek to determine whether consumer welfare is enhanced or diminished by the merger, acquisition or collaboration at issue.

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[5] See id.

[6] Id. ¶ 1.

[7] U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104 (April 2, 1992). The Department previously has urged the Commission to adopt the Merger Guidelines in its own analysis of electricity mergers. See Comments of the U.S. Department of Justice, In the Matter of Merger Policy Under the Federal Power Act, FERC Docket No. RM 96-6-000, filed May 7, 1996.

[8] U.S. Department of Justice and Federal Trade Commission, Antitrust Guidelines for Collaborations Among Competitors, reprinted in 4 Trade Reg. Rep. ¶ 13,160 (April 7, 2000). The Collaboration Guidelines note that the Department will, if appropriate, analyze an agreement between competitors under the Merger Guidelines. See id. § 1.3.

The Department's inquiry into consumer welfare under the Merger Guidelines and the Collaboration Guidelines is closely related to the Commission's inquiry into market conditions suitable for market-based rates. Both agencies focus on how certain agreements change the structure and competitive conditions of a market. The Department has substantial experience collecting information relevant to this inquiry. Based on this experience and on the close relationship between the Department's and the Commission's analyses, the Department offers these comments.

The Department urges the Commission to consider carefully the costs and benefits of any new reporting requirements. Unduly burdensome reporting requirements, such as a "transmittal letter"[9] requiring a full-blown market analysis, may discourage agreements that are beneficial to electricity consumers. Should the Commission determine that new reporting requirements are necessary, we urge the Commission to consider a simple requirement calling for utilities to file (1) a copy of the contract concerned and (2) a summary of its key attributes that have an effect on the parties' incentive or ability to exercise market power. This information would allow the Commission to quickly distinguish contracts unlikely to give rise to anticompetitive effects from those likely to give rise to such effects and the provision of such information would not be unduly burdensome for reporting utilities. This approach might thus yield the greatest net benefit for electricity consumers.

[9] See NOPR ¶ 15.

III. THE COMPETITIVE EFFECTS OF CONTRACTUAL CONTROL OF GENERATING PLANTS AND IMPLICATIONS FOR THE COMMISSION'S PROPOSED REPORTING REQUIREMENTS

Because control of an asset can be conferred through ownership or contract, in whole or in part, any contract that transfers control over any substantive decision about an asset or effectively reallocates some portion of the revenue stream associated with an asset might yield anticompetitive harm.[10] Thus, any reporting requirement should be made broad enough to cover all such types of contractual arrangements.[11] In electricity markets, these arrangements include, but are not limited to, tolling agreements and power sales agreements.[12]

Under a typical tolling agreement, a power marketer supplies gas to a generator, the generator converts the gas to electricity, and the power marketer sells the electricity at wholesale. Under a typical power sales agreement, a power marketer simply buys some or all of

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[10] Although there is no theoretical basis for defining a threshold degree of control or share of revenue that yields anticompetitive harm, the Department understands that the Commission may wish to establish some reporting threshold as a matter of practical enforcement.

[11] Imposing a broad reporting requirement tends to ensure completeness. It may be the case that only a limited set of rights needs to be transferred for a significant anticompetitive effect. Or, revenues might be shared only in the limited circumstances under which the parties otherwise would have been significant competitors. Or, an agreement might raise concerns only because it is part of a set of agreements, any one of which would not raise concerns in isolation. A broad reporting requirement ensures that the Commission gets notice in such circumstances. It also minimizes incentives to restructure agreements merely to get a more favorable reporting requirement.

[12] Another example of contracts that may cause anticompetitive harm are joint bidding or agency agreements whereby a single agent submits bids for several generators or generating units into an auction market for wholesale electricity. Analytically, the Department typically would treat such agreements as it would treat a series of tolling or power sales agreements entered into by a single firm with several generators in a geographic market. Such agreements may concentrate in a single market participant control over a substantial share of electricity sold in the market.

the electricity produced by a generator and sells it at wholesale. Under either contractual arrangement the marketer will have de facto control over all or some share of generation at the plant. Such arrangements can have competitive effects similar to those arising from mergers: both may give a single market participant control over generating assets that enhance its ability or incentive to exercise market power unilaterally or in coordination with other market participants. In other words, both contractual arrangements and mergers may alter the structure of a market and thereby give rise to potential anticompetitive effects. As with mergers, however, contractual arrangements also may give rise to efficiencies.[13]

The Department typically treats contractual arrangements under the Collaboration Guidelines. Those Guidelines call for a "rule of reason" analysis weighing of the potential anticompetitive effects against the efficiencies of such arrangements. As discussed in more detail below, the key information required for an analysis under the Collaboration Guidelines includes the identity of the parties to the agreement, the amount of generation subject to the agreement, and the ownership or control of other generation by the parties.

A. Potential efficiencies of contractual arrangements

Contractual arrangements can benefit consumers in a variety of ways. Such agreements may allow firms to combine complementary know-how or other assets to produce and market electricity at lower cost than otherwise.[14] Three categories of efficiencies that may arise from such agreements relate to (1) combining complementary skills, (2) allocating risk efficiently and

[13] The Collaboration Guidelines note that the Department will, if appropriate, analyze certain collaborative agreements under the Merger Guidelines. See Collaboration Guidelines § 1.3.

[14] Cf. id. § 3.31(a) (discussing the effects of production collaborations in general).

(3) reducing financing costs. An agreement may, for example, permit a firm expert in operating a generating plant to join forces with a firm expert in marketing. Although each firm may be capable on its own of operating a generating plant and marketing its output, an agreement may permit two firms, each with relative expertise in generating and marketing, to combine their expertise to produce and market more efficiently. Moreover, each firm typically bears the risk it is best equipped to handle: the generator usually bears the risk of operating the plant, including the risk of outages; the marketer usually bears at least part, if not all, of the risk of marketing output, including the risk of market price fluctuations. Finally, agreements often are used as collateral to finance the purchase or construction of a power plant thereby lowering financing costs and facilitating entry. The Collaboration Guidelines call for the Department to weigh these potential efficiencies against the potential anticompetitive effects of such contractual arrangements.

B. Potential anticompetitive effects of contractual arrangements

Contractual arrangements between competitors[15] may give rise to anticompetitive effects in at least two ways. First, by giving a single firm control of assets that formerly were independently controlled, a contractual arrangement may reduce competition.[16] Consider a simple example: a tolling agreement that gave control of the only two independently owned and operated generating plants in a market to one of the plants' owners would give that owner the incentive and ability to maintain monopoly pricing by reducing the combined output of the

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[15] The Collaboration Guidelines use the term "competitors" to refer to actual and potential competitors. See id. § 1.1.

[16] See id. § 3.31(a).

plants. Second, a contractual arrangement between competing firms may alter their financial incentives in a way that encourages the exercise of market power. For example, an agreement -- whether a tolling, power sales or some other agreement -- that allows a generator to share in the profits of a competitor will increase the generator's incentive to exercise market power even if the agreement gives it no additional control over generation in a market.[17]

Certain contractual arrangements between firms that are not competitors also give rise to anticompetitive effects. In the extreme case, a series of vertical agreements between one marketer and several generators might give the marketer control over all generating assets in a market, thus allowing the marketer to exercise market power. Of course, a marketer may be able to exercise market power with control over less than all output in a market; indeed, one of the hallmarks of electricity markets is that it may take only a very small market share comprising the right mix of assets to exercise market power.[18]

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[17] Cf. id. § 3.34(c) (discussing effects of financial interest in collaboration generally).

[18] For example, in a real-time auction market with a market-clearing price set by the bid of the marginal generating unit, a firm owning or controlling generating units may find it profitable to physically or economically withhold one or more of its units, reducing the supply of electricity to the market and thereby increasing the market-clearing price. Although the firm will lose revenue on the units it withholds, it may more than make up for that loss through gains in revenue on its units still supplying electricity to the market. If withholding a small quantity of supply yields a very large price increase, it may be profitable for the firm to withhold even though it has a very small total share of electricity supplied to the market. Thus, a contractual arrangement giving a single firm control over generating units that would allow it to (1) affect market prices substantially by withholding supply and (2) recover on other units the losses associated with the withheld units would increase the likelihood that the firm would exercise market power even if the firm had a relatively small share of electricity supply or generating capacity.

C. Information necessary to determine whether a contractual arrangement is likely to harm competition

Certain basic information, summarized in Appendix A, would allow the Commission to quickly determine if a specific contractual arrangement is unlikely to increase market power or reduce incentives to compete.[19] As noted above, there are two situations in which contractual control might cause concern: when competitors enter into contractual arrangements that reduce the incentive or ability of the firms to compete and when contractual arrangements concentrate important assets in the hands of a single firm. Thus, the most important data are the names of the parties to the contract, the location of the generating assets under contract, and the location of any other generating assets owned or otherwise controlled by either counterparty.[20] This information would allow the Commission to quickly determine whether there is any geographic overlap among generating assets controlled by the parties. Absent a geographic overlap, the agreement generally should not present any substantial anticompetitive concern.[21]

Even if the parties control assets located in the same geographic market, additional

[19] The items in Appendix A concern only the terms of a single contract between two parties. To fully analyze the effects of a single contract on a market, the Commission would, of course, need similar information regarding third parties in the market. We assume that the Commission would have or could obtain such third-party information.

[20] Items (a), (b), (f), (j) in Appendix A.

[21] Information regarding transmission constraints is, of course, important for determining the scope of the geographic market for electricity markets. In its NOPR, the Commission requested comments on the need for transmission providers to report long-term transmission outages. Generally, regional transmission organizations ("RTOs") collect information regarding long-term transmission outages for long-term planning purposes. If a jurisdictional entity is a member of an RTO, there is no need for the Commission to collect transmission outage information from the member as the Commission can simply collect this information from the RTO directly. However, to the extent that an entity is not a member of an RTO, the Commission may wish to require that the entity report any long-term transmission outages.

information may allow the Commission to determine quickly whether the agreement would give the firms, individually or jointly, the incentive or the ability to exercise market power. For example, information regarding the identity, number and capacity of generators under contract or otherwise owned or controlled by the parties may indicate whether it would be profitable for either party to withhold generating capacity to raise market price.[22] Similarly, information regarding any ownership interests the parties have in common and the compensation scheme established between them may help determine whether the agreement diminishes the financial incentive of the parties to compete against one another.[23] As noted above, if a generator has a financial interest in one of its competitors, the generator will be less inclined to compete. Finally, agreement execution and start dates would be of value in assessing the time period in which any anticompetitive harm would occur.[24]

IV. WEIGHING THE COSTS AND BENEFITS OF A NEW REPORTING REQUIREMENT

The Commission seeks comments on the type of information that needs to be reported, the materiality of transactions to be reported and the frequency of reporting. The efficiency of a new reporting requirement can only be determined by examining its costs and benefits. If a new reporting requirement imposes undue costs on reporting utilities, it may discourage contractual arrangements that benefit consumers. The Commission should thus ensure that the additional costs are balanced by additional benefits. The costs of a new reporting requirement largely relate to the administrative costs to reporting utilities, including compiling, preparing and submitting

[22] Items (g), (h) and (k) in Appendix A.

[23] Items (c) and (I) in Appendix A.

[24] Items (d) and (e) in Appendix A.

the required information and the costs to the Commission of processing and analyzing that information. The benefits of a new reporting requirement likely relate to reducing the costs of making an incorrect determination about market-based rate authority for a utility.

A. A new reporting requirement may reduce error costs arising from an incorrect grant of market-based rate authority

The Commission currently faces an information gap that a new reporting requirement might fill. Under its current practice, the Commission grants a utility market-based rate authority only after determining the utility cannot exercise market power. Once market-based rate authority is granted, it typically is three years before the Commission reconsiders whether the utility can exercise market power. In the intervening three years, however, a utility may enter into unreported contractual arrangements that alter market structure in ways that enhance the utility's ability or incentive to exercise market power.

A new reporting requirement capturing information the Commission currently does not have may enhance the Commission's ability to determine whether a utility should continue to have market-based rate authority. This, in turn, may reduce the costs associated with incorrectly allowing market-based rates to be charged: higher electricity prices for consumers. For example, a reporting requirement that captured an agreement tending to enhance market power would reduce the likelihood of error arising from maintaining market-based rate authority when it should be withdrawn.

The costs of errors associated with an incorrect determination regarding market-based rate authority -- the costs to consumers of higher electricity prices -- may influence the type, materiality and frequency of any reporting requirement. For example, if the costs of improperly allowing market-based rate authority to continue are very high, then a more comprehensive reporting requirement may be needed. Alternatively, if such costs are low, a less comprehensive reporting requirement may be needed. Of course, the appropriate reporting requirement will depend not only on error costs, but also on the administrative costs of reporting.

B. A new reporting requirement may impose significant administrative costs on utilities

Although the Commission attempts to estimate the direct costs to utilities of complying with its proposed reporting requirement, it may have underestimated such costs. The NOPR states that it would take a utility approximately six hours to meet the Commission's proposed reporting requirement but provides no basis for the estimate.[25] The Commission's proposed rule calls for market-based rate applicants to file a "transmittal letter" with an analysis demonstrating the effect the reported agreement has on competition.[26] Such a letter may take substantially more than six hours to prepare and may impose significant costs on applicants. The competitive analysis the Commission requires from a public utility for an initial application for market-based rates can be very costly. If the Commission's proposal for a transmittal letter becomes a de facto requirement for a full-blown competitive analysis every time a utility enters into a reportable transaction, the Commission may end up imposing substantial costs and yet likely end up with little more than self-serving analyses containing little of use beyond any reported objective facts.

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[25] See NOPR ¶ 19.

[26] See id. ¶ 15.

C. A simple reporting requirement may produce the greatest net benefit to consumers

Instead of a reporting requirement that might call for a full-blown competitive analysis, the Department suggests that the Commission consider a relatively simple requirement, one that merely requires a utility file any reportable agreement with a simple form identifying key objective facts about the agreement. The form would ask utilities to identify those attributes of the agreement that would, like those attributes identified in Appendix A, have an effect on the ability or incentive of the parties to exercise market power. With a summary of these attributes in hand, the Commission could quickly identify key terms of the agreement and analyze whether the agreement significantly changes the basis for market-based rate authority. If the key terms of the agreement raise suspicion, the Commission can then further review the agreement and those terms that may give rise to anticompetitive effects. The Commission could reasonably require such a filing to be made virtually contemporaneously with any reportable transaction, allowing almost real-time monitoring of markets.

V. THE POTENTIAL COSTS OF DISCLOSING REPORTED INFORMATION TO THE PUBLIC

Another potential cost associated with a new filing requirement relates to disclosing reported information to the public. Unnecessarily disclosing to the public information regarding agreements, like those that might trigger reporting as discussed in the NOPR, may harm consumers. First, a utility typically treats such "business sensitive" information confidentially for a variety of reasons; for example, the information may reveal the utility's marketing strategy or the terms on which the utility deals with suppliers and customers. To the extent that disclosure discourages utilities from entering into otherwise efficient agreements, customers will be harmed.

Second, in certain circumstances, disclosure of information regarding customer-specific transactions may diminish competition by facilitating collusion among competitors.[27] In particular, disclosure of customer-specific information regarding prices and quantities may make it easier for competitors to communicate with one another regarding the terms of a tacit or express collusive agreement. In markets that are susceptible to oligopoly pricing, like many electricity markets, an exchange of customer-specific information may make it easier for competitors to collude tacitly. Moreover, an exchange of customer-specific information may make it easier for parties to a collusive agreement to monitor the behavior of their co-conspirators, increasing the likelihood that such an agreement will be formed and will persist. In sum, extensive disclosure of customer-specific information will allow utilities to observe the terms on which their competitors do business, increasing the likelihood of collusion and higher prices for electricity consumers.

The Department urges the Commission to keep confidential any information it collects pursuant to a new reporting requirement. However, if the Commission determines that disclosure is necessary, it should consider alternatives to complete and immediate disclosure of customer- or contract-specific information so as to prevent harm to competition. For example, if the Commission adopts a reporting requirement like that suggested by the Department, it should consider disclosing only a summary of the key attributes of the reported contract rather than the

[27] Cf., U.S. Department of Justice and Federal Trade Commission, Statements of Antitrust Enforcement Policy in Healthcare, reprinted in 4 Trade Reg. Rep. ¶ 13,150 at 20,762 (August 28, 1996) (discussing hospital participation in exchanges of price and cost information). See generally, Andrew R. Dick, Knowing Your Rival's Price: Some Guideposts for Evaluating Communications Between Competitors (U.S. Department of Justice, Econ. Analysis Group Working Paper No. EAG02-10, August 2002).

contract itself. Harm to consumers might also be reduced by disclosing any collected information only after a substantial time lag or by disclosing it in aggregated form.

VI. CONCLUSION

The Department urges the Commission to carefully consider the costs and benefits of a new reporting requirement concerning contractual arrangements. Any such requirement should balance the administrative costs of obtaining information against the benefits of more accurate determinations regarding market-based rates authority for wholesale electricity sellers. A simple requirement calling for filing of the contract concerned and a summary of its key attributes may yield the greatest net benefit to electricity consumers.

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APPENDIX A:
KEY INFORMATION ABOUT TOLLING AND POWER SALES AGREEMENTS RELATED TO ANTICOMPETITIVE EFFECTS

(a) Names of parties to agreement

(b) Names of affiliates (parents, subsidiaries or other affiliates) of parties to agreement

(c) Ownership interest each party (including parents, subsidiaries or other affiliates) has in the other

(d) Agreement execution date

(e) Agreement start and end dates

(f) Identity and location of generating plants subject to agreement

(g) Capacity (MW), fuel used (coal, gas, oil, other) and type (combustion turbine, gas turbine, combined cycle, other) of generating units subject to agreement

(h) Capacity (MW) subject to agreement, by generating unit

(i) Compensation scheme: whether party controlling generation pays fixed reservation charges, operating expenses, fixed fee per unit output, other

(j) Identity and location of other generating plants owned or controlled by parties (including parents, subsidiaries or other affiliates) to agreement

(k) Capacity (MW), fuel used (coal, gas, oil, other) and type (combustion turbine, gas turbine, combined cycle, other) of other generating plants owned or controlled by parties to agreement