UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Enhanced Natural Gas)
Market Transparency) Docket No. RM13-1-000

COMMENT OF THE U.S. DEPARTMENT OF JUSTICE

February 1, 2013

I. INTRODUCTION

In a Notice of Inquiry in this Docket issued November 15, 2012 (NOI), the Federal Energy Regulatory Commission called for comments on possible changes to its regulations under the natural gas market transparency provisions of section 23 of the Natural Gas Act (NGA), as adopted in the Energy Policy Act of 2005.[1] The Commission is considering whether market participants should be required to report detailed transaction-specific information regarding every natural gas transaction that entails physical delivery for the next day or the next month. The Commission seeks comments on several related issues, including the scope of the reporting requirement, the type of information to be reported, the burden on reporting companies, and possible public dissemination of reported information. The Department of Justice's comment focuses on the competitive effects of the public dissemination of reported information.[2]

[1] Notice of Inquiry, *Enhanced Natural Gas Market Transparency*, 141 FERC ¶ 61,124 (2012), 77 Fed. Reg. 69,781 (2012).

[2] This comment reiterates and expands on a comment the Department submitted in a prior proceeding concerning transparency in natural gas and electricity markets. *See* Comments of the Department of Justice, Antitrust Division, Transparency Provisions of the Energy Policy Act, FERC Docket No. AD06-11-000 (Jan. 25, 2007), *available at* http://www.justice.gov/atr/public/comments/223049.pdf.

The Department urges the Commission to carefully consider the potential adverse effect of transparency on competition, as required by the NGA.[3] It is widely understood that transparency can have pro- and anticompetitive effects. Transparency can increase efficiency in production, consumption, and investment, thereby lowering prices for consumers. Transparency also can facilitate market monitoring by the Commission and the public. However, transparency can increase the likelihood of an exercise of market power by facilitating coordination among suppliers, thereby raising prices for consumers. In general, the risks of coordination are greater when transparency involves the dissemination of detailed transaction-specific information, as is contemplated by the Commission in this proceeding.

If the Commission chooses to issue new rules requiring that market participants report information concerning natural gas transactions, it can reduce the likelihood of anticompetitive effects by maintaining the confidentiality of any reported firm- or transaction-specific information. Alternatively, the Commission may be able to achieve some of the benefits of transparency while reducing the likelihood of anticompetitive effects by releasing firm- or transaction-specific information only in limited circumstances, or by aggregating, masking, or lagging the release of such information.

[3] "In determining the information to be made available under this section and the time to make the information available, the Commission shall seek to ensure that consumers and competitive markets are protected from the adverse effects of potential collusion or other anticompetitive behaviors that can be facilitated by untimely public disclosure of transaction-specific information." Natural Gas Act § 23(b)(2), 15 U.S.C. 717t-2 (2006).

II. BENEFITS OF TRANSPARENCY: MONITORING & EFFICIENCY

Market transparency can benefit the public by facilitating market monitoring and by promoting efficient production and investment decisions.

Transparency can facilitate market monitoring by the Commission or the public. The collection of market information, including firm- and transaction-specific information, clearly can help the Commission identify, remedy, and deter violations of the Commission's regulations, including its market manipulation regulations. Moreover, public dissemination of such information can help the public identify such violations and bring them to the attention of the Commission.

Transparency also can increase short-run efficiency by providing appropriate signals to suppliers about how much to produce. Information about actual or expected prices are necessary for suppliers to make economically rational decisions about how much to produce and sell. Better information about market prices and the factors that affect prices allow suppliers to assess the profitability of production, making it less likely that "too much" or "too little" production will take place and that production will take place only when it covers costs.

Finally, transparency can increase long-run efficiency by providing appropriate signals to suppliers and potential suppliers about how much to invest. Information about future market prices allows suppliers to better assess the profitability of investing in productive capacity. Similarly, information concerning the conditions that affect future prices (e.g., expected supply and demand conditions) permits suppliers to better forecast expected prices and assess likely investment profitability. Such price signals help reduce the risk that “too much” or “too little” investment takes place and that investment will take place only when it is expected to cover its costs.

III. COSTS OF TRANSPARENCY: COORDINATION

Although transparency clearly has benefits, it also can have costs. In particular, public disclosure of firm- or transaction-specific information may reduce competition by facilitating coordination among suppliers that can increase prices, thereby harming consumers. Such coordination can involve the formation of an agreement, which almost certainly would violate the antitrust laws, or mutual interdependence, which may not violate the antitrust laws.

Successful coordination – whether through an agreement or mutual interdependence – entails three critical tasks: (1) reaching terms of coordination that are profitable to the suppliers involved; (2) detecting deviations from the terms that would undermine the coordination; and (3) punishing such deviations. Certain market conditions – such as transparency, high concentration, impediments to entry, a homogeneous product, a low elasticity of demand, and small and frequent sales – may render a market vulnerable to coordination, making it easier for suppliers to perform the three critical tasks.[4] Each of these market conditions is discussed briefly below:

- *Transparency*. Transparency may increase the amount of information available to suppliers about actions taken by other sellers. The more detailed this information, the better suppliers will be able to determine whether their rivals are adhering to the terms of coordination. When such information is made available quickly to suppliers, they will be

[4] These are among the most commonly cited factors affecting the likelihood of coordination. Other such factors are discussed in U.S. Dep’t of Justice & Fed. Trade Comm’n, Horizontal Merger Guidelines § 7 (Aug. 19, 2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf.

able to more quickly punish deviations from terms of coordination. And anticipating that it will be easier to detect and punish deviations from the terms of coordination, suppliers may find it easier to coordinate their actions.

- *High Concentration*. Fewer suppliers in a market may make it easier for suppliers to reach, and detect deviations from, terms of coordination, increasing the likelihood that terms will be reached. For example, in more concentrated markets the market share of a given supplier will, on average, tend to be larger; and the larger its share, the more a supplier will gain from an increase in price and the greater will be the incentive to reach terms of coordination. Moreover, if a supplier with a relatively large market share deviates from the terms of coordination by underpricing, the greater the effect on price and the more noticeable is the deviation.

- *Impediments to Entry*. The greater are impediments to entry, the less likely it is that coordination among existing suppliers will be disrupted by the prospect of competition from new suppliers, increasing the likelihood of coordination.

- *Homogeneous Products*. If suppliers offer products that are differentiated by quality, it can be difficult for them to reach terms of coordination; additionally, a supplier may deviate from terms of coordination by offering a higher quality product. By contrast, suppliers of a homogeneous product need to agree on only one price; and because they compete primarily on price, it is easier for suppliers to reach, and detect deviations from, terms of coordination.

- *Low Elasticity of Demand*. The less elastic is demand for a product, the higher the price that coordinating suppliers can profitably set, the greater the gains to coordination, and the more likely it is that suppliers will coordinate their actions.

• *Small and Frequent Sales.* The smaller are sales, the smaller the gains to a supplier from deviating from terms of agreement on any given sale. The more frequent are sales, the more quickly will other suppliers detect such a deviation. Hence, smaller and more frequent sales increase the likelihood of coordination.

IV. MARGINAL EFFECTS OF TRANSPARENCY

The costs and benefits of any new regulation that increases transparency likely will depend on the extent to which gas markets are vulnerable to coordination, as well as the degree to which the markets already are transparent to suppliers, consumers, and the Commission. To determine whether a new regulation is desirable, the Commission may wish to consider the *marginal* effect of the regulation on transparency; that is, the *change* in transparency, and the associated benefits and costs, brought about by the regulation. If the marginal costs (i.e., the increased risk of coordination) outweigh the marginal benefits (i.e., enhanced efficiency and market monitoring) of the additional transparency resulting from the regulation, then the regulation should not be implemented. If the marginal benefits outweigh the marginal costs, then it may be desirable to implement the regulation.

V. SAFEGUARDS AGAINST COORDINATION

The Commission may be able to reduce the costs of increased transparency arising from the dissemination of firm- or transaction-specific information by adopting certain practical safeguards. There are three types of safeguards that the Commission may wish to consider. First, and most obviously, the risks of coordination can be reduced by maintaining the confidentiality of any firm- or transaction-specific information reported to the Commission. This would eliminate the ability of suppliers to use such information for purposes of coordination. Moreover, it still would permit the Commission to monitor markets. However, it would eliminate the benefits that transparency can have on efficiency, and on the ability of the public to monitor markets.

Alternatively, the Commission may be able to achieve some of the benefits of transparency while reducing the likelihood of coordination by releasing firm- or transaction-specific information only in limited circumstances. For example, rather than release all firm- and transaction-specific information it collects, the Commission could release such information only if it has reason to believe that market participants have violated its market manipulation rules. Or the Commission could release transaction-specific information if market prices exceed a threshold level that might indicate potential market manipulation concerns. Such limited release of transaction-specific information might deter suppliers from violating the Commission's rules and help the public better understand the market, while at the same time reducing the likelihood of coordination.

Finally, the Commission may be able to more fully realize the benefits of transparency while reducing, at least in part, its potential anticompetitive consequences through three practical safeguards: aggregation, masking, and lagging. First, appropriately aggregated information makes it difficult for suppliers to determine whether others are abiding by terms of coordination; knowing that it is difficult to detect deviation from those terms, suppliers will be less likely to reach terms of coordination. Second, and for the same reason, appropriately masking firm- or transaction-specific information would hinder suppliers from using the information to reach terms or from detecting and punishing a deviation from terms of coordination. Even if it is deemed appropriate to disseminate firm- or transaction-specific information, masking the identity of the parties to the transaction may deter coordination by undermining the usefulness of the information to reach terms of coordination.[5] Finally, releasing information with a time lag will keep suppliers from immediately knowing whether others have abided by or deviated from terms of coordination, increasing the likelihood that deviations will occur, and thereby undercutting the likelihood and likely effectiveness of coordination.

Whether any of these safeguards are appropriate will depend on the relative marginal benefits and costs of the dissemination of firm- or transaction-specific information as contemplated by the Commission. The greater the marginal costs, in terms of an increased risk of coordination, the stronger the case for limited or no release of transaction-specific information. The greater the marginal benefits, in terms of increased efficiency or more effective market monitoring, the stronger the case for a broader release of transaction-specific information. However, such costs and benefits cannot be evaluated in the abstract; rather, their evaluation requires a close consideration of the structure and characteristics of natural gas markets, and of the marginal effect on transparency of the specific regulation under consideration.

[5] However, in a market with a small number of suppliers, aggregating and masking may not be sufficient to prevent suppliers from learning enough about their rivals to substantially diminish the likelihood of coordination. In the extreme case of two suppliers, masking and aggregating would not prevent each supplier from unmasking or disaggregating the information to reveal the other supplier's information. Hence, aggregation or masking is effective only when there are a sufficient number of market participants. In the case of a market with few suppliers, when aggregation or masking may not be effective, it may be desirable to maintain the confidentiality of collected information or increase the lag with which information is released to the public.

VI. CONCLUSION

As the Commission decides whether to issue new regulations regarding transparency, the Department urges it to consider carefully the characteristics of, and the existing degree of transparency in, natural gas markets to avoid unnecessarily increasing the likelihood of coordination among gas suppliers. It is particularly important that the Commission do so in the present proceeding. Unlike the Commission's existing natural gas transparency regulations, which call for the collection and dissemination of *aggregated* information,[6] the NOI contemplates the dissemination of *disaggregated*, transaction-specific information, which may increase substantially the risk of coordination.

If the Commission decides to issue rules calling for the collection of highly detailed information about these markets, it may be able to eliminate or reduce the likelihood that the rules will facilitate collusion by maintaining the confidentiality of any firm- or transaction-specific information it collects, or by disseminating such information only in limited circumstances. Alternatively, the Commission may achieve transparency's benefits to a greater extent, while limiting its potential harm, by aggregating, masking, and/or lagging the release of such information.

[6] Neither Order 704 nor Order 720 calls for the public dissemination of detailed, transaction-specific information as contemplated in the NOI. *See Transparency Provisions of Section 23 of the Natural Gas Act*, Order No. 704, FERC Stats. & Regs. ¶ 31,260 (2007), *order on reh'g*, Order No. 704-A, 73 Fed. Reg. 55,276 (Sept. 26, 2008), *order dismissing reh'g and clarification*, Order No. 704-B, 125 FERC ¶ 61,302 (2008); and *Pipeline Posting Requirements under Section 23 of the Natural Gas Act,* Order No. 720, 73 Fed. Reg. 73,494 (Dec. 2, 2008), FERC Stats. & Regs. ¶ 31,283, at P 3 (2008), *order on reh'g*, Order No. 720-A, 130 FERC ¶ 61,040 (2010).

Respectfully submitted,

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