

contained in the DOJ/FTC Merger Guidelines are appropriate to assess existing market power. Section IV discusses the use of market concentration measurements as a screen for determining whether more detailed analysis is warranted. The comment suggests that also examining market concentration among subsets of generation assets based on their dispatch order may provide a more accurate picture of existing market power. Section V discusses how computer simulation analysis is likely to be the most effective and direct method of assessing existing market power in a strategic analysis if certain market power thresholds are met. Because of the complexities of electric power transmission and the large number of separate market conditions that are of competitive concern, computer simulation analysis also is likely to be the most practicable method of examining existing market power. Finally, the APSC may wish to allow electric utilities to present an efficiencies analysis based on the principles in the DOJ/FTC Merger Guidelines.

II. Addressing Existing Market Power Is Critical to Enjoying the Benefits of Competition

The FTC recently addressed the importance of addressing existing market power in generation and transmission prior to the start of retail electricity competition when it provided views to Chairman Thomas E. Bliley, United States House of Representatives Committee on Commerce, on H.R. 2944, The Electricity Competition and Reliability Act. The Commission noted that:

[T]he starting point for competition in the electric power industry is not the level playing field characteristic of a newly developing market. Instead, vertically integrated, regulated monopolies have controlled the generation, transmission, and distribution of electric power in state-authorized geographic territories. In this context, as regulation is reduced and competition is encouraged, there is a significant potential that these utilities will use their existing market power in generation, transmission and distribution services to deter competition that could benefit consumers. For example, one or a few generating firms might obtain and be able to exploit their market dominance in areas of the country where transmission congestion occasionally creates restricted geographic markets for electric energy (load pockets). This concern is heightened because generation and transmission services often are substitutes: market power in generation services often can be remedied by additional transmission capacity and vice-versa (i.e., a transmission constraint often can be alleviated by securing generation services closer to the ultimate destination). In addition, consumers have not previously had choices of electric power suppliers, and thus consumer protection issues need particular attention. . . .

[M]arket power at the transmission level is likely to give a vertically integrated firm the incentive to exercise that market power. Indeed, the Federal Energy Regulatory Commission (FERC) very recently concluded that, even when vertically integrated utilities have functionally unbundled their generation assets from their transmission assets, they have a continuing opportunity to engage in undue discrimination in access to their transmission facilities and thus to impede competitive markets.⁽⁷⁾ In addition to discrimination against competitors seeking access to their transmission facilities, vertically integrated firms may exercise their market power through cross-subsidization in favor of their unregulated affiliates. Both forms of behavior will likely reduce the degree of competition facing the integrated firm's generation assets, although continued regulation of the firm's transmission assets may well prevent the full exercise of transmission market power. These two forms of anticompetitive behavior, plus the costs of regulation, may be significant enough in some circumstances that separating the operation (and/or ownership) of the transmission grid

generation and retail trades of electricity, however, existing market power in generation may prevent consumers from realizing the full benefits of competition.

Current antitrust laws are not designed to address the mere possession of market power or the legitimate acquisition of or increase in market power through lawful regulatory processes. Instead, the antitrust laws are designed to address increases in market power brought about by mergers or unfair methods of competition, such as predation, discrimination, and raising rivals' costs.

In light of this potential for harm to consumers due to existing market power at both the generation and transmission level, proceedings designed to assess and address market power prior to the implementation of retail electricity competition are critical to ensure that the benefits of competition enure to consumers.

III. Market Structure Measures Are Appropriate Screens for Additional Analysis

The APSC staff proposes a two-step analysis to assess existing horizontal market power. The first step is a structural analysis using market concentration and market share statistics to determine if a utility possesses market power in various product and service markets. Under the second step, if certain market concentration or market share thresholds are met for any relevant market, the utility is required to submit a more extensive strategic behavior analysis. In addition, each electric utility is required to submit information regarding entry conditions as well as an assessment of what APSC staff refers to as thresholds

The APSC may wish explicitly to require market share and concentration statistics for subsets of generation assets as well. In particular, statistics analyzing concentration of generation plants at the margin may provide a more accurate picture of an electric utility's existing market power in specific time periods (or product markets).(10) For example, when the United Kingdom sought to remedy existing market power, it focused on concentration among mid-merit (or mid-cost) plants because these plants were the price-setting plants under most load conditions.(11) Thus, if the two major U.K. utilities controlled a preponderance of the mid-merit plants, they were able to exercise market power, regardless of their ownership of peaking plants or base load plants.(12)

V. Strategic Analyses Could Include a Range of Likely Scenarios

The staff proposal requires a utility to submit a strategic analysis in a particular product market, if the HHI index for the relevant market exceeds 1000 and the utility's market share for that product exceeds 15 percent. These analyses are required to demonstrate whether any supplier can increase profits by strategic pricing of supplies or strategic withholding of supplies or capacity from the market.

; HHI thresholds are
precision than is
concentrated
share of the merged

del

(ea

)13en (or)4()r)17nTC



In light of the many possible combinations and permutations of conditions that are potentially of interest and the costs associated with running multiple simulations, the APSC may wish to provide guidance to affected parties concerning which scenarios it regards as the most important. One approach is to focus on worst, middle, and best scenarios. For example, the worst scenario might include a peak demand period in Arkansas when demand is also high in neighboring areas, pancaked transmission rates remain in place, natural gas prices are higher than expected and new environmental restrictions on coal burning have been issued. Each of these conditions can be relaxed somewhat for a middle case scenario and relaxed further for a best case scenario.

Within each of the scenarios it is appropriate to examine both unilateral and coordinated interaction theories of market power. This is particularly true where the additional analysis is triggered by high HHIs. Because the HHI is itself based on a concern about coordinated interaction, it is logical to examine possible coordinated interaction in markets with high HHIs. In computer simulation modeling, coordinated interaction can be incorporated most simply by assuming that when the leading firm increases prices, one or more other firms also increase their prices.⁽¹⁵⁾ The APSC may wish to include a coordinated interaction theory requirement in the strategic analyses.

effects. These are termed *merger-specific efficiencies*. Only alternatives that are practical in the business situation faced by the merging firms will be considered in making this determination; the Agency will not insist upon a less restrictive alternative that is merely theoretical.

Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is uniquely in the possession of the merging firms. Moreover, efficiencies projected reasonably and in good faith by merging firms may not be realized. Therefore, the merging firms must substantiate efficiency claims so that the Agency can verify by reasonable means the likelihood and magnitude of each asserted efficiency, how and when each would be achieved (and any costs of doing so), how each would enhance the merged firm's ability and incentive to compete, and why each would be merger-specific. Efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means. . . .

The Agency will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market. To make the requisite determination, the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market.⁽¹⁸⁾

The APSC may wish to use this analytical framework as the basis for evaluating efficiency claims that an electric utility may make regarding existing market power.

VII. Concpeconit 1 scn 70.56 473.28 4(o)13()Tj ET EMC /H4 <</4 <</4the

April 13, 2000

Endnotes:

1.

2. This comment represents the views of the staff of the Bureaus of Economics and Competition and of Policy Planning of the Federal Trade Commission. They are not necessarily the views of the Federal Trade Commission or any individual Commissioner. Inquiries regarding this comment should be directed to John C. Hilke (303-844-3565).

3. The staff of the FTC has commented to FERC on electric power regulation in Docket No. RM99-2-000 (regional

detailed statistical analyses used to establish the nature and extent of market power in the U.K. system. In July 1993,