UNITED STATES OF AMERICA

The NOI highlights the 2010 Guidelines' HHI threshold revisions and asks specifically whether FERC should adopt the revised thresholds contained in the 2010 Guidelines.[4] We are concerned that by focusing on changes in the HHI thresholds, FERC is missing a critical thrust of the 2010 Guidelines, *viz*., that merger analysis should examine all dimensions of a transaction's likely competitive effects and should not focus unduly on market concentration. Concentration analysis in the 2010 Guidelines is just one of numerous tools used to determine whether a proposed horizontal merger threatens to lessen competition and harm consumers.[5]

We do not intend by this comment to advise FERC on the procedures for conducting its own merger reviews. As we discuss below, however, excessive reliance on HHIs – especially in electricity markets – can lead to conclusions that are too lenient or too restrictive in an assessment of market power. Given the characteristics of these markets, if FERC adopted the 2010 Guidelines' updated concentration thresholds but did not also revise its approach to place more emphasis on competitive effects – including examination of such effects even when the merger does not exceed the concentration screen – then it could potentially approve mergers that pose serious threats to competition, with significant harmful effects on consumers.

We recognize that, in order to apply the full Guidelines analysis, FERC may need access to information that is different from (or in addition to) that which it typically receives or requests. For example, in a 1998 comment on FERC's then-proposed Appendix A requirements, the FTC staff identified various types of information that the FTC finds useful in reviewing proposed horizontal mergers.[6]

II. Interest of the Federal Trade Commission

The FTC is an independent agency of the United States Government responsible for maintaining competition and safeguarding the interests of consumers, both through enforcement

The FTC and its staff have filed numerous competition advocacy comments with FERC – including comments closely related to the present inquiry – and have participated in FERC technical conferences on market power issues. For example, in March 2007, the Deputy Director for Antitrust in the FTC's Bureau of Economics served as a panelist for a technical conference on FERC's merger and acquisition review standards under Federal Power Act Section 203 (Docket No. AD07-2-000). In March 2010, the FTC submitted comments on FERC's proposed rule concerning FERC's competitive assessments of acquisitions of minority interests in other firms (Docket No. RM09-16-000), which is an issue addressed by the 2010 Guidelines.[13]

Similarly, the FTC submitted comments in December 2009 in FERC's proceedings on possible elements of a National Action Plan on Demand Response (Docket No. AD09-10-000)[14] and on transmission planning processes (Docket No. AD09-8-000).[15] In March 2010, the FTC filed a comment on performance metrics for RTOs and ISOs (Docket No. AD10-5-000),[16] and more recently the FTC staff commented in response to FERC's Notice of Proposed Rulemaking concerning integration of variable en

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indicator of market power or the potential for its exercise. Experience has taught the Agencies that merger analysis should not rely on a single measurement. "The measurement of market shares and market concentration is not an end in itself, but is useful to the extent it illuminates the merger's likely competitive effects."[19] Relying on concentration alone (under either the 1992 or the 2010 concentration thresholds) to determine whether a transaction is likely to substantially lessen competition is an insufficient approach that is prone to error. Merger analysis should be a fact-specific process in which analysts use a variety of tools and forms of evidence to determine whether a merger may substantially lessen competition. Accordingly, "[t]he Agencies consider any reasonably available and reliable evidence to address the central question of whether a merger may substantially lessen competition."[20]

The Agencies often calculate an HHI to measure market concentration, which is derived by summing the squares of individual firms' market shares. Both the post-merger HHI and the HHI increase resulting from the merger are considered. The HHI thresholds, however, do not "provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns."[21] Rather, the Guidelines' thresholds "provide *one way* to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration."[22]

Overreliance on HHIs, particularly in electricity markets, can yield conclusions that are too lenient or too restrictive in an assessment of market power. Among the distinguishing characteristics of electricity markets are the prevalence of relatively inelastic demand, capacity-constrained firms, transmission congestion, and long-term supply contracts. For example, inelastic demand tends to make supply restrictions more profitable, thereby increasing the risk of substantial consumer harm associated with any given HHI level. Although demand can be expected to be somewhat more responsive to wholesale price changes in the future – as demand response technologies and dynamic prices at the retail level are implemented – that alone is unlikely to make HHIs so robust a predictor of competitive effects that other indicators can be neglected. In addition, when suppliers are capacity-constrained, a decision by one or more sellers to restrict supply is less likely to be undermined by increased output on the part of rival suppliers. This also increases sellers' incentives to restrict supply beyond what a given HHI level would lead one to expect. Transmission congestion is a particular form of capacity constraint with the same increased risk of substantial anticompetitive effects and harm to consumers. Conversely, the presence of existing supply contracts with long durations tends to lessen the risk of substantial consumer harm from high HHIs by reducing the profitability of efforts to restrict supply in spot markets. The profitability is reduced because the higher spot

[19] 2010 Guidelines, § 4.

[20] *Id*. § 2.

[21] *Id*. § 5.3.

[22] *Id*. (emphasis added).

market price applies to less output when some of the output has already been committed at a lower price.[23]

The Guidelines also focus on alternatives available to customers as the basis for the use of the "hypothetical monopolist" test that the Agencies employ to define a relevant market. Section 4 of the 2010 Guidelines presents the hypothetical monopolist test, offers several examples, and identifies significant alternative ways to apply this test in different circumstances. Strict market definition, however, is not the only appropriate starting point for merger analysis, and in some situations it may not even be a required element of the analysis. Some transactions may present evidence of anticompetitive effects that is itself useful in identifying relevant markets.[24] Some of the analytical tools used by the Agencies to determine competitive effects do not rely on market definition, although they do focus on competitive alternatives to which customers can turn.[25]

IV. Evidence and Theory of Competitive Effects

To emphasize the insights developed since the 1992 Guidelines were issued, the 2010 Guidelines contain a new Section 2 on evidence of adverse competitive effects. The Agencies have found this type of evidence useful in predicting the likely competitive effects of mergers. The new section discusses market shares and concentration as one of several indicators of a merger's potential competitive effects. The 2010 Guidelines include the observation that presumptions of market power based on concentration measures can be "rebutted by persuasive evidence showing that the merger is unlikely to enhance market power."[26] Other types of evidence listed in new Section 2 include the actual effects observed in a consummated merger, direct comparison based on experience, substantial head-to-head competition, and the potentially disruptive role of a merging party.[27] We believe that consideration of these types of evidence would enrich FERC's competition analysis of mergers. FERC also may identify additional types of evidence of competitive effects that have special significance in electricity mergers.

A thorough assessment of a merger's competitive effects requires consideration of the probable unilateral and coordinated effects of the transaction. The elim

between two firms (unilateral effects) may by itself constitute a substantial lessening of competition. Section 6 of the 2010 Guidelines discusses several common types of unilateral effects. One such effect, "unilateral output suppression strategy," exemplifies a type of concern that can arise in electricity markets:

> A unilateral output suppression strategy is more likely to be profitable when (1) the merged firm's market share is relatively high; (2) the share of the merged firm's output already committed for sale at prices unaffected by the output suppression is relatively low; (3) the margin on the suppressed output is relatively low; (4) the supply responses of rivals are relatively small; and (5) the market elasticity of demand is relatively low.[28]

Although FERC has recognized that a merger could give the merged firm the incentive and ability to undertake a unilateral output suppression strategy, FERC has stated that it would examine the potential for such a strategy only if concentration thresholds were exceeded.[29] Under the 2010 Guidelines, however, the Agencies may consider the risks of such a strategy, even if the merger does not exceed the market concentration screens. Thus, as we said above, if FERC adopted the 2010 Guidelines' updated concentration thresholds but did not also revise its approach to place more emphasis on competitive effects – including examination of such effects even when the merger does not exceed the concentration screen – then it could potentially approve mergers that pose serious threats to competition. Where the factors raising concerns about unilateral output suppression are present in electricity markets, FERC should be particularly attentive to the anticompetitive effects of mergers – even when post-merger concentration levels are below the thresholds set forth in the 2010 Guidelines.

Coordinated anticompetitive effects also occur when a merger affects the supply decisions of the firms remaining in the post-merger market in ways that harm consumers. Outright collusion is one important kind of coordinated effect, but less explicit forms of coordination can also significantly lessen competition. Section 7 of the 2010 Guidelines discusses coordinated effects.

An important update in the 2010 Guidelines is increased attention to competitive effects on dimensions of competition other than price, including product variety, product quality, and innovation.[30] As electricity markets move beyond the one-product-fits-all model, this aspect of merger analysis will likely become more important to FERC.

V. <u>Other Features of the 2010 Guidelines that Bear on Proper Merger Analysis</u>

We also highlight certain other sections of the 2010 Guidelines that describe important elements of the Agencies' merger review process and should enrich FERC's analysis of mergers.

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[28] 2010 Guidelines, § 6.3.

[29] FPA Section 203 Supplemental Policy Statement, 120 F.E.R.C. ¶ 61,060, P 60 (2007), *order on clarification*, 122 F.E.R.C. ¶ 61,157 (2008).

[30] 2010 Guidelines, § 6.4.

We address several of these topics because the revisions in the 2010 Guidelines also address them. Not all of these sections will be relevant to every merger or acquisition under review, but any of them may be applicable depending on the characteristics of the transaction.

A. Powerful Buyers and Monopsony

The 2010 Guidelines include a new Section 8 on the competitive effects analysis involved when powerful buyers are present. This section points out that powerful buyers may be able to negotiate to avoid some or all anticompetitive effects of a merger. "However, the Agencies do not presume that the presence of powerful buyers alone forestalls adverse competitive effects flowing from the merger."[31] The Agencies examine the choices available to powerful buyers and how those choices would change due to the merger. The Agencies also examine whether the negotiating strengths of some buyers impact the competitive effects of a merger on other buyers.

The 2010 Guidelines also contain a new Section 12 on the competitive effects of mergers of competing buyers. This analysis focuses on alte

C. Partial Acquisitions

The new partial acquisitions section of the 2010 Guidelines identifies significant potential anticompetitive effects due to partial acquisitions, even when the partial acquisition does not necessarily constitute a transfer of control to the acquirer.[34] The Agencies will consider all ways in which a partial acquisition may affect competition. Three aspects of a partial acquisition's competitive impact are of particular concern: (1) the acquirer's influence over the competitive conduct of the target firm, (2) reductions in the incentives of the acquiring and target firms to compete with each other, and (3) access by the acquiring firm to non-public, competitively significant information about the target firm.[35]

D. Information for 2010 Guidelines Analysis of Mergers

The 2010 Guidelines discuss sources of evidence to be obtained from merging parties, customers, and other industry participants and observers. The FTC staff provided a similar list of information sources and types in a 1998 comment to FERC concerning FERC's then-proposed revised filing requirements for merger applications in the electric industry.[36] That earlier discussion remains relevant as FERC undertakes merger analysis pursuant to the 2010 Guidelines. Moreover, given the detailed informn

VI. Market Power Issues in Determining Whether to Authorize Market-Based Rates

The NOI also asks "what impact the 2010 Guidelines should have, if any, on [FERC's] analysis of horizontal market power in its electric market-based rate program."[38] The same sources and types of information that are discussed in the 2010 Guidelines also are useful in the determination of whether a supplier already has market power, although the inquiry is somewhat different. In the evaluation of a merger, the analysis focuses on *changes in competition due to the merger*. By contrast, the market definition exercise in a non-merger matter seeks to identify customer alternatives at the competitive price. (The competitive price is likely to be lower than the current price if the latter includes a market power component.)[39] A failure to ensure that customer alternatives are analyzed at the competitive price can result in a serious error, such as defining the market too broadly if customers are searching more widely for alternatives in response to an already supracompetitive price.[40] Proper application of the Guidelines in the context of market-based rate reviews will help avoid such errors.

[38] NOI P 21.

[39] 2010 Guidelines, footnote 5.

[40] This type of error in market definition is known as the "Cellophane fallacy," after the product sold by defendant du Pont in *United States v. E.I. du Pont de Nemours and Co*., 351 U.S. 377 (1956). The Supreme Court ruled that du Pont did not have market power for food wrapping and, as the primary support for the broad product market that it found, observed that customers were routinely substituting other food wrappings for cellophane. Economists generally find fault with this decision because the Court did not account for du Pont's exiing9dB markeiTAgg lowwhenhat an