FERC Technical Conference on FPA Section 203

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The following references discuss methods of evaluating the effects of horizontal mergers on competition and prices, and they explain differences in the methods used by the antitrust agencies and FERC's Appendix A.

I. Methods for Analyzing Market Power in the Electric Power Industry

R. J. Binz and M. W. Frankena, *Addressing Market Power: The Next Step in Electric Restructuring*, Competition Policy Institute, 1998, 88 pp.

> "Determining whether market power is likely to be a significant problem is especially complex in electricity markets because of the complicated physical properties of transmission networks, the subtle interplay between generation and transmission, and the temporal nature of markets for electric energy. Nonetheless, the basic framework that is appropriate to analyze market power in electric power is the same as that used in other industries. The most reliable assessments of market power are likely to be based on a combination of traditional antitrust analysis following the DOJ/FTC Merger Guidelines[2] and simulation modeling."

M. W. Frankena, "Analyzing Market Power Using Appendix A of FERC's Merger Policy Statement: Rationale, Reliability, and Results," *CCH Power and Telecom Law*, Jan./Feb. 1998, pp. 29-34.

> "While the Commission has adopted the Merger Guidelines, it has also mandated a detailed methodology that is not consistent with the approach of the Merger Guidelines and, hence, does not provide a sound basis for determining the need for hearings or remedies." "In contrast to the Commission's methodology, which begins with a buyer and uses a delivered price test to determine the scope of the market, the Merger Guidelines methodology begins with the merging utilities' generators and uses a hypothetical monopolist test."

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[2] http://www.ftc.gov/bc/docs/horizmer.htm

M. W. Frankena, "Geographic Market Delineation for Electric Utility Mergers," *The Antitrust Bulletin*, Summer 2001, pp. 357-402.[3]

> "In its Merger Policy Statement, FERC appropriately adopted the DOJ/FTC Merger Guidelines as the analytical framework for use in evaluating the effects of electric utility mergers on market power. Contrary to assertions in the Merger Policy Statement, the methodology set out in appendix A is not consistent with the Merger Guidelines." "By focusing on individual destination markets rather than geographic markets delineated using the hypothetical monopolist test, the appendix A methodology is likely to overstate competitive problems for some mergers and understate them for others. The overstatement and understatement may be so great that for some mergers the appendix A methodology may find what appear to be serious problems when no problems exist at all, while for other mergers the appendix A methodology may entirely overlook a serious competitive problem." "Moreover, where FERC's method identifies a real problem, its method may lead to an inaccurate diagnosis regarding the remedy required to mitigate the concern."

FTC, *Comment*, Market-Based Rates for Public Utilities, FERC Docket No. RM04-7-000, July 16, 2004.[4]

> "An appropriate computer simulation model…can be used to explore a merger's potential to produce certain types of competitive effects—for example, whether the merger would increase the incentives of the acquiring company to withhold output of electric energy in order to raise market prices and its own profits. Computer simulation models are helpful because they allow one to take into consideration whether other firms would have the incentive and ability to expand output sufficiently to make such a price increase unprofitable. They also can be used to evaluate potential remedies for market power."[5]

J. R. Morris, "Finding Market Power in Electric Power Markets," *International Journal of the Economics of Business*, July 2000, pp. 167-78.[6]

> "As part of the regulatory review of electric utility mergers in the United States, the Federal Energy Regulatory Commission requires utilities to submit market power studies. The Commission has specified a detailed method for calculating market concentration in these studies. This paper shows that one can simulate the actual price effects from the merger by using similar data and models. Using the merger between Union Electric and Central Illinois Public Service Company as an

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[3] http://www.accessmylibrary.com/coms2/summary_0286-27051510_ITM
[4] http://www.ftc.gov/os/comments/ferc/v040021.pdf
[5] For a discussion of limits on merger simulation, and the appropriateness of using particular merger simulation models in particular circumstances, see "Whither Merger Simulation," *The Antitrust Source*, May 2004. http://www.abanet.org/antitrust/at-source/04/05/whither.pdf
[6] http://taylorandfrancis.metapress.com/(n25rrj55ut2sr55525aqgkmc)/app/home/contribution.asp?referrer=parent&backto=issue,5,8;journal,20,27;linkingpublicationresults,1:101205,1

example, this paper demonstrates that the Commission's method is unsound and often identifies competitive problems that are not likely to exist."

II. Market Shares and HHIs in Merger Evaluation

FTC and DOJ, *Commentary on the Horizontal Merger Guidelines*, 2006.[7]

"Evidence that the merged firm would have a relatively high share of sales (or of capacity…) or that the market is relatively highly concentrated may be particularly significant to a decision by either of the Agencies to extend a pre-merger investigation…by issuing a request for additional information…. Although the ultimate decision of whether a merger likely will be anticompetitive is based heavily on evidence of potential anticompetitive effects, the Agencies find that only in extraordinary circumstances can they conduct an extensive competitive effects analysis within thirty days. That is why market shares and concentration levels, which have some predictive value, frequently are used as at least a starting point during the initial waiting period." "The Agencies' joint publication of Merger Challenges Data, Fiscal Years 1999-2003,[8] and the Commission's publication of Horizontal Merger Investigation Data, Fiscal Years 1996-2003,[9] document that the Agencies have often not challenged mergers involving market shares and concentration that fall outside the zones set forth in Guidelines section 1.51. This does not mean that the zones are not meaningful, but rather that market shares and concentration are but the 'starting point' for the analysis, and that many mergers falling outside these three zones nevertheless, upon full consideration of the factual and economic evidence, are found unlikely substantially to lessen competition. Application of the Guidelines as an integrated whole to case-specific facts—not undue emphasis on market share and concentration statistics—determine whether the Agency will challenge a particular merger."

III. Nature of Merger Investigations

Staff, Bureau of Economics, FTC, *Comment*, Revised Filing Requirements, FERC Docket No. RM98-4-000, Sept. 11, 1998.[10]

"Merger analysis under the Horizontal Merger Guidelines is by its nature an information-intensive task.... FERC may be better able to protect the public interest as it reviews proposed mergers in the rapidly changing electric industry by revising its information-gathering process to more closely match the information requirements of the Horizontal Merger Guidelines…. Sources used in our merger investigations often include, for example, the following:

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[7] http://www.ftc.gov/os/2006/03/CommentaryontheHorizontalMergerGuidelinesMarch2006.pdf
[8] http://www.ftc.gov/os/2003/12/mdp.pdf; updated to 2005 at http://www.ftc.gov/os/2007/01/P035603horizmergerinvestigationdata1996-2005.pdf
[9] http://www.ftc.gov/os/2004/08/040831horizmergersdata96-03.pdf
[10] http://www.ftc.gov/be/v980022.htm

- internal documents of the merging parties (including, for example, planning and marketing documents; merger assessments;….);
- third-party documents, including documents from industry trade associations;
- depositions of party and third-party executives and consultants;
- history of previous antitrust cases (including collusion cases….);
- financial analysts' reports;
- employee notes concerning contacts with competitors;
- consultants' reports on competitive conditions in the industry;
- documents and interviews with executives of failed entrants, prospective entrants, and fringe firms;
- filings about competitive conditions made with other government agencies;
- documents and interviews with suppliers; and
- documents and interviews with a variety of customers.

> …. FERC may wish to pursue authority, as part of its merger review process, to subpoena (and hold under strong confidentiality provisions) the decision, planning, and marketing documents of the merging parties as well as related documents from competitors, suppliers, customers and trade associations. FERC also may wish to pursue authority to depose pertinent personnel from the merging parties and from third parties under similar confidentiality conditions….."

<u>IV. Direct Evidence from Behavior and Patterns of Prices</u>

R. Willig, "Re: Assessment of U.S. Merger Enforcement Policy," Testimony before the Antitrust Modernization Commission, Nov. 17, 2005.[11]

> "Concentration measures may be useful tools for analysis and do serve as clear foundations for safe harbors. However, clear admonitions against conclusory over-reliance on concentration measures should guide the enforcement agencies and be heard by the courts. For justification of intervention, there must be identification of adverse effects on competition predicted to be caused by the merger." "Critics of the requirement of market definition emphasize situations where direct analysis is likely to be more reliable [than inferences based on market shares and concentration] in predicting the impacts of a merger. An important example is direct analysis by means of what are labeled 'natural experiments.' These have proven to be especially reliable and informative avenues for empirical analysis throughout recent research in many economics fields. Suppose, as an illustration, that some areas have one super-store, other areas have two super-store competitors and still others have three, and that these super-store competitors' sales are local to their areas. Suppose too that whether there are one, two or three super-store competitors is for reasons that have nothing to do with costs or other determinants of prices. Finally, suppose that it is observed that prices are highest where there is only one super-store, significantly

[11] http://www.amc.gov/commission_hearings/pdf/Statement-Willig.pdf

> lower where there are three, and in the middle where there are two super-stores. Then it might be a reliable conclusion that a merger between super-stores would result in elevated prices where the merger would reduce the number of super-stores from three to two or from two to one… In the example…, the analyst would be driven to conclude from the same natural experiment that the relevant product market is confined to super-stores."

D. T. Scheffman and M. Coleman, "Quantitative Analyses of Potential Competitive Effects from a Merger," Bureau of Economics, FTC, June 9, 2003.[12]

> "Merger investigations typically rely on three types of evidence: (1) information from interviews with (or depositions of) industry participants (particularly customers); (2) information from business documents; and (3) quantitative analyses. Each of these sources of information can be important in assessing the current nature of competition and of the potential effects of a merger." [Quantitative analysis of natural experiments has been used extensively to assess competitive effects of mergers.] "For example, if one of the merging parties entered recently (in general or into particular geographic areas), one can assess the reaction of the other merging party to that entry—did it lower prices and/or lose sales (significantly and on a sustained basis)? Alternatively, if the merging parties compete in some areas but not in others, one can assess whether their pricing differs in those areas where they compete. The Office Depot/Staples matter provides an example of such analyses, where the analysis focused on whether prices were lower when the two companies competed head-to-head in a geographic area."

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[12] http://www.ftc.gov/be/quantmergeranalysis.pdf