

utility, the Commission summarized its position. The Commission:

* * * allows market-based rates if the seller (and each of its affiliates) does not have, or has adequately mitigated, market power in generation and transmission and cannot erect barriers to entry. In addition, the Commission considers whether there is evidence of affiliate abuse or reciprocal dealing.³⁷

Applicants for whom the Commission approved market-based rates are required to file periodic reports or studies to demonstrate their continuing lack of market power and the absence of abusive affiliate practices.

The first step in evaluating market power in generation is to identify the relevant product and geographic markets.³⁸ In those markets, suppliers' market shares are calculated. Low market shares demonstrate that the seller is unlikely to be able to assert market power in that market.³⁹ An applicant with a high market share would be subject to further scrutiny.

For example, in *Enron Power Enterprises Corporation*,⁴⁰ the Commission looked at the market for generating services bid to New England Power Company (NEPCO). In that market, Enron's market share was 4 percent. Furthermore, there were 18 projects out of 22 finalists that were not selected. Thus, NEPCO had numerous additional alternatives to choose from other than Enron. In addition, NEPCO negotiated several favorable provisions in its agreement with Enron suggesting that Enron was not a dominant supplier at the time of the solicitation.

There have been two additional factors of concern to the Commission in electricity cases: Affiliate abuse and the ability to erect barriers to entry. With respect to affiliate abuse, in recent cases, the Commission has required the affiliated parties to file separately for any sales or purchases of electric power between the marketer and its affiliated utility. In addition, the Commission requires the affiliated marketer to purchase any transmission services it may receive from its affiliated utility under a generally applicable, open-access, comparable tariff.

With respect to an applicant's ability to erect barriers to entry, only a few electric cases have raised this issue. Some affiliates of natural gas pipelines

have sought market rate approval for sales of electricity.⁴¹ However, the Commission has looked to Order No. 636 procedures mandating open access transportation on jurisdictional pipelines to preclude pipelines from erecting barriers to entry.

As a result of *Enron* and other cases, the Commission has developed considerable experience in analyzing generation markets. Recently, in *Kansas City Power and Light*,⁴² the Commission concluded that new generating facilities were being built by many different parties and that there was no evidence that any party could assert market power in markets being served by new facilities. Consequently, as did the Commission in its series of GIC decisions, market power analysis is no longer required when the applicant is proposing sales from new facilities.

The Commission's treatment of transmission market power does not parallel its treatment of market power in generation. The Commission has basically equated applicant ownership or control of transmission facilities with the applicant having market power in transmission in that region.⁴³ The Commission therefore requires transmission owners to file generally applicable open-access, comparable transmission tariffs before the Commission will permit them to charge market rates.⁴⁴

III. Proposed Criteria for Evaluating Market-Based Transportation Rate Proposals

A. General Framework and Criteria

To date, in all cases where the Commission has considered market-based rates, the applicant has been required to show that it lacks significant market power in the relevant markets. Market power is defined as the ability of a pipeline to profitably maintain prices above competitive levels for a significant period of time.

While the Commission has not adopted a mechanistic approach to assessing market power, it has consistently used the same general framework to evaluate requests for market-based rates.

Using this general framework, Commission staff proposes criteria to evaluate the competitiveness of transportation services. To show a lack of market power over firm transportation, for example, staff

anticipates that a pipeline would need, initially, to show that its customers have four to five good alternatives to the applicant's firm transportation service. This is the equivalent of an HHI of .18, which the Commission has used as an initial screen in previous cases.⁴⁵ Staff suggests that only capacity that the applicant shows will be available on other pipelines when the applicant institutes market-based rates could be considered as an alternative.

One necessary element of showing that customers have alternatives would be the pipeline's agreement to give existing firm transportation customers the right to renominate their contract demand levels if a pipeline is allowed to charge market-based rates under existing contracts. Otherwise, the applicant clearly has market power over its customers if existing contracts prevent its customers from freely choosing alternative service or renegotiating their contracts at the time market forces are permitted to control the rates for services. This situation did not exist in the storage cases where the Commission permitted market-based pricing. In those cases, the applicants were either new entrants or existing entities offering new services. There were no existing contracts in effect that the Commission needed to address. This condition is consistent with the Commission's practice in the GIC proceedings where it allowed customers to renominate their sales contract demand levels if a pipeline instituted a GIC.

The framework proposed would be the same for all types of services. It consists of three major steps:

1. *Define Relevant Markets*
 - a. Product market: identify good alternatives to the applicant's product; and
 - b. Geographic market: identify sellers of good alternatives.
2. *Measure Firm Size and Market Concentration*
 - a. Measure the size of the market, calculate each seller's market share, and evaluate applicant's market share;
 - b. Estimate market concentration using the Herfindahl-Hirschman Index (HHI); and
 - c. Evaluate market concentration by using an initial HHI screen of 0.18; a finding in that range is equivalent to finding that customers have at least four or five equal-sized alternatives to the applicant's service.
3. *Evaluate Other Factors*
 - a. If the applicant's market share is large or the market concentration is high (*i.e.*, HHI exceeds 0.18), examine other factors that might prevent or limit the exercise of market power;

³⁷ Heartland Energy Services, 69 FERC ¶ 61,223 (1994).

³⁸ See, *e.g.*, *Kansas City Power & Light*, 67 FERC ¶ 61,183 (1994).

³⁹ In *PSI*, 51 FERC ¶61,367 (1990), *order on reh'g* 52 FERC ¶61,963 (1990), the Commission determined that a seller with a market share of less than 20 percent did not dominate the market.

⁴⁰ 52 FERC ¶ 61,193 at 61,708-61,709 (1990).

⁴¹ See, *e.g.*, *Hartwell*, 60 FERC ¶ 61,143 (1992).

⁴² 67 FERC ¶ 61,183 (1994).

⁴³ See *Enron Power Marketing*, 65 FERC ¶ 61,305 (1993), *order on reh'g*, 66 FERC ¶ 61,244.

⁴⁴ The current policy was announced in *Hermiston Generating*, 69 FERC ¶ 61,035 (1994).

⁴⁵ *E.g.*, *Transco*, 55 FERC at 62,393.