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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

FERC Sheds Light On The Delivered Price Test

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David Hunger


Edo Macan

In a pair of orders issued recently, the Federal Energy Regulatory Commission clarified what it does (and does not) want to see in a market power study for market-based rates or an application for approval of a transaction under Federal Power Act (FPA) Section 203.[1] The FERC's methodology, the delivered price test (DPT), has been used in practice since the issuance of its merger policy statement[2] in 1996, but many of the details of the methodology have been open to interpretation and not clearly articulated by the commission. In these orders, the commission clarified the ambiguities around specifics of the DPT. In particular, the FERC clarified seven key points in the DPT methodology: (1) data transparency/integrity; (2) use of historical transaction data to corroborate results; (3) calculation of available economic capacity; (4) calculating variable costs; (5) transmission rates; (6) identification of potential supply; and (7) inclusion of long-term purchases and sales contracts.

A Nontrivial Exercise: Corroborating Historical Trade and Transmission Data

Regarding data transparency, the commission simply pointed out that there should be workable links to data sources used in the analysis so that it can verify the accuracy of the data sources and to ensure the accuracy of the submitted DPT.[3] A less obvious, but very important clarification was a reference to the commission's regulations that states that the results of the DPT need to be corroborated with actual energy trade and transmission data.[4]

As economists like to say, this is a nontrivial exercise. The reasoning makes sense. If suppliers are to be considered competitors in a given destination market (DPT speak for relevant geographic market), then there should be some evidence that they have actually sold in that market. The commission suggests using e-tag data for evidence of transmission service into the destination market and trade data, for example through its electronic quarterly reports. The commission does provide some wiggle room — "remind[ing] DPT filers that they should provide historical trade and transmission data and explain significant discrepancies between modeling results and such data."[5]

Could Corroboration Work in Favor of Merging Entities?

One potential explanation for "discrepancies" between DPT results and trade data could be that the sellers could, but haven't, sold in the destination market, and thus help maintain competitive outcomes by their presence as a potential competitor, but the commission has not explicitly endorsed that

argument.[6] The partial equilibrium nature of the DPT itself also leads to differences between who could sell into a particular market and who did sell into that market. The FERC methodology requires analyzing multiple destination markets using the same resources. In reality, those resources can't be in more than one place at a time, so historical sales data shows where they chose to sell, and for commercial reasons, they may never sell into a market that they could have sold into. Again, you can only be in one place at a time.

Another potentially interesting result of the requirement to corroborate DPT results with trade data is that it could work in the favor of merging entities. For example, two merging sellers that are geographically (or electrically) close to each other may have screen failures in their respective destination markets, but if they have not traditionally competed in those markets, then the applicants could argue that the DPT screen failures are not showing harm to competition. The commission has repeatedly stated that it looks beyond the screens to the actual competitive effect of a proposed transaction.[7] This argument could be an example of the actual competitive effects of the merger, rather than the screen results.

More Complete Modeling Methodology to Calculate Available Economic Capacity

The commission also revisited its stated methodology for calculating available economic capacity (AEC), which deduct a seller's native load obligations from its economic capacity (EC). As stated in the merger policy statement, a seller's native load obligation needs to be modeled as being served by its lowest-cost units, effectively taking them out of the stack of generation available to compete in wholesale markets. The commission made it clear that any future DPT analysis that does not model AEC in this manner will be deemed deficient.[8] This requirement demands more complex modeling methodology, which maintains the ranking of the units' delivered cost with respect to each destination market for each seller rather than simply subtracting native load once the EC calculation has been made.

The commission also renewed its emphasis on accurate cost calculations in the DPT. At its core, the DPT asks which sellers can compete, given their variable costs and transmission costs, in a given set of season/load conditions. If the costs are not accurate, the results of the DPT are rendered meaningless. Just as the commission has focused on the other side of the equation — the assumed market price for a given season/load level by requiring sensitivity studies using +/- 10 percent prices, here it is simply enforcing the requirements of the merger policy statement and its progeny. As input costs fall and prices become flatter across seasons and load levels, this degree of accuracy becomes increasingly important. Transmission rates can vary from less than $2 megawatt-hours to over $8 MWh.[9] In a market with very little separation of marginal costs and flat prices, transmission costs can be the difference between being in or out of the money in a given destination market.

More Clarity Around DPT Analysis

The commission brought up the importance of the identification of potential supply in a DPT analysis. Here, as with the other issues, it made the point that the DPT needs to have accurate and complete data on plants that have shut down or recently come on line. In discussing the need to account for purchase contracts, the commission first focused on the straightforward need for accuracy and completeness when determining whether a seller's capacity should be reduced to account for long-term contracts. From there, the commission went on to take on one of the thornier issues in any DPT analysis: which factors determine whether a long-term contract should be added (or subtracted in the case of a long-term sale).

The determination of whether a supplier with purchase contracts has EC or AEC depends on a number of factors specific to that supplier, such as the supplier's native load (if any), the amount of generation the supplier has to meet that load, including any contracts the supplier has to buy or sell energy or capacity, and the prevailing market price.[10]

The commission cited examples of units whose output is fully contracted being assigned to the owners in the EC and AEC calculations and noted that both types of errors can adversely affect the accuracy of the DPT results.

Overall, the commission did the industry a favor by clearly articulating what it is looking for in a DPT analysis, much of which is simply accuracy and adequate data sourcing. Moreover, the commission went beyond the obvious and addressed some of the difficult issues that arise in a merger or market-based rates case by adhering to the language of the merger policy statement and providing clarity to some of the more ambiguous issues that have arisen over the years since its issuance in 1996.

—By David Hunger and Edo Macan, Charles River Associates

David Hunger is a vice president with the energy practice of Charles River Associates. Formerly a senior economist at the FERC, Hunger is an expert in energy market merger analysis and market rate matters, as well as energy and capacity market rules in FERC-regulated regional transmission organizations. He has testified in multiple FERC proceedings involving organized markets administered by independent system operators (ISOs) and RTOs, and merger and acquisition cases at the FERC and state commissions.

Edo Macan is a principal with the energy practice of Charles River Associates. His practice is focused on M&A and quantitative analytics in the energy markets. In addition to market power issues, he advises clients on a variety of quantitative topics, including asset valuation, risk management, derivatives pricing, asset optimization, hedging strategies, demand-side management, price forecasting, renewable resources, energy market structure issues and contract disputes.

[1] Public Service Company of New Mexico, 153 FERC ¶ 61,060 (PNM) and Refinements to Policies and Procedures for Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities 153 FERC ¶ 61,065 (Order No. 816).

[2] Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996) (Merger Policy Statement), reconsideration denied, Order No. 592-A, 79 FERC ¶ 61,321 (1997).

[3] PNM at p. 31.

[4] PNM at p. 63, citing 18 C.F.R. § 33.3(c)(6) (2015).

[5] PNM at p. 65.

[6] There is significant literature on potential competition in antitrust analysis, but the FERC has focused on actual sales rather than potential competitors.

[7] See, e.g., Supplemental Policy Statement, FERC Stats. & Regs. ¶ 31,253 at p. 60

[8] PNM at p. 62.

[9] See e.g., MISO Schedule 8 FERC Electric Tariff Non-Firm Point-To-Point Transmission Service SCHEDULES 45.0.0
https://www.misoenergy.org/Library/Repository/Tariff%20Documents/Schedule%2008.pdf

[10] PNM at p. 48.