

Energy Market Manipulation: Case Studies from the United States Experience

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ENERGY MARKET MANIPULATION: CASE STUDIES FROM THE UNITED STATES EXPERIENCE

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This paper discusses historical instances of energy market manipulation in the United States and the application of regulatory laws in preventing such conduct. The first section summarizes the federal antitrust laws that apply to single firm conduct in the United States. The second section profiles two regulatory agencies with jurisdiction to oversee the energy market: the Federal Energy Regulatory Commission and the Commodity Trading Futures Commission. The third section presents three case studies in energy market manipulation. Two of these case studies focus on the manipulation of the supply of natural gas to or within California during the winter of 2000-2001. The third case study focuses on energy market manipulation in the merger context. The final section identifies recent cases in which courts have dismissed civil antitrust suits against energy companies without reaching the merits of market manipulation claims.

I. FRAMEWORK FOR DOMINANT FIRM CONDUCT IN US ENERGY MARKETS

A. Federal antitrust law

In the United States, the primary federal anti-monopoly statute is called the Sherman Act. Section 2 of the Sherman Act provides: “Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty

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of a felony”² Courts interpret this statute to require a two-part test for a finding of illegal monopoly: first, the firm must possess monopoly power; and second, it must engage in exclusionary conduct that harms the competitive process.³

Monopoly power is generally defined as “the power to control prices or exclude competition.”⁴ This is not the *act* of controlling prices and excluding competition; it is merely the *capability* to do so. If, for example, a firm adopts a policy of predatory pricing, but it only controls five percent of the market, then it does not violate Section 2.⁵

Although there is no agreed minimum threshold for monopoly, a market share in the range of seventy percent is likely to support a finding of monopoly power, so long as there are also substantial barriers to entry and evidence that existing competitors are unable to expand if the monopolist increases prices or decreases output.⁶

Monopoly power is a necessary condition, but it is not sufficient to establish a violation of Section 2. A firm with monopoly power does not violate the antitrust laws unless it uses its monopoly power to engage in exclusionary conduct with a sustained impact on price or permanent exclusion of competitors. A firm that has monopoly power, but does not engage in exclusionary conduct, uses its monopoly power lawfully. Indeed, U.S. courts consider legal monopolies to be an essential component of capitalism. As the Supreme Court recently

² 15 U.S.C. § 2.

³ See *Antitrust Law Developments*, 1 A.B.A. SEC. ANTITRUST L. 225 (6th ed. 2007) (hereinafter *ALD*).

⁴ *Id.*

⁵ A firm with a significant but less than monopoly share may, nevertheless, violate Section 2 if it engages in exclusionary conduct in an attempt to gain monopoly power and its attempt to monopolize has a “dangerous probability” of success. See, e.g., *Spectrum Sports v. McQuillan*, 506 U.S. 447 (1993).

⁶ *Id.* at 230-31.

explained: “The mere possession of monopoly power, and the concomitant charging of monopoly prices, is not only not unlawful; it is an important element of the free-market system. The opportunity to charge monopoly prices—at least for a short period—is what attracts ‘business acumen’ in the first place; it induces risk taking that produces innovation and economic growth.”⁷

To put it simply, U.S. antitrust law does not punish lawfully acquired monopolies, but firms that become, maintain, or expand monopolies through anti-competitive means are subject to liability. As one federal court explained in *United States v. Microsoft Corp.*:⁸ “Whether any particular act of a monopolist is exclusionary, rather than merely a form of vigorous competition, can be difficult to discern.” On the one hand, the law is meant to encourage aggressive competition. On the other hand, aggressive conduct by a firm with a potentially dominant market share can harm the competitive process itself. The enforcement dilemma posed by the need to distinguish robust competition from exclusionary monopolistic conduct is particularly acute in regulated energy markets.

Electric power generating and transmission markets as well as natural gas transportation markets are typically characterized by incumbents with dominant market shares, arising from government authorized exclusive franchises that have been the subject of federal and state restructuring efforts over the last two decades. The competitive policy dilemma arises because, in many circumstances, an energy utility can produce the entire output for a region at a cheaper cost than can two or more firms. Since the public’s interest is served by cost-effective energy supplies, government grants of exclusive franchises have been kept in check through multiple

⁷ *Verizon Commc’ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004).

⁸ 253 F.3d 34, 58 (D.C. Cir. 2001).

layers of regulation aimed at preserving competition that apply more or less concurrently with the antitrust laws.⁹

II. FEDERAL AND STATE REGULATION

The Federal Energy Regulatory Commission (“FERC”) and various State Public Service Commissions establish “just and reasonable” rate levels, and they impose a variety of rules that govern market access and market behavior. In addition, with the emergence of natural gas and electric commodity markets, energy companies have come under the purview of the Commodity Futures Trading Commission (“CFTC”).

Both FERC and CFTC are independent federal agencies with large staffs, headed by five-member Commissions. FERC is primarily tasked with regulating the interstate transmission and sale of natural gas and electricity, while CFTC has general jurisdiction over most futures and options contracts in commodities, including trading in energy futures. An overview of the FERC and CFTC regulatory schemes is provided below.

A. FERC

FERC administers provisions from several different statutes. Three of the most important are control over rates, control over transmission companies, and enforcement of market manipulation rules. FERC has had longstanding authority to regulate the wholesale rates charged for electricity transmission and natural gas transportation in order to ensure that the rates are “just and reasonable.”¹⁰ However, FERC generally does not have jurisdiction over purely intrastate sales of electricity or natural gas, which are within the domain of various state

⁹ See *ENERGY ANTITRUST HANDBOOK: A GUIDE TO THE ELECTRIC AND GAS INDUSTRIES*, A.B.A. SEC. ANTITRUST L.41 (2002).

¹⁰ See 15 U.S.C. §§ 717 – 717w (natural gas); 16 U.S.C. §§ 824d, 824e (electricity).

regulatory authorities. It can reach some intrastate activity, where that activity has a discriminatory impact on interstate transactions.¹¹

FERC also has substantial authority over transmission companies established in the Energy Policy Act of 1992 (the “’92 Act”).¹² The ’92 Act was prompted by technological developments that made smaller power plants economically viable, removing some barriers to entry in power production. The ’92 Act gave FERC the ability to order transmission utilities to provide transmission services to various electricity generating companies, rather than just affiliated entities.¹³

The California energy market disaster in 2000 and a perceived inadequate response from FERC prompted Congress to enact the Energy Policy Act of 2005 (the “’05 Act”) which expanded FERC jurisdiction to cover market manipulation.¹⁴ The new law allowed FERC to reach new categories of market behavior and expanded jurisdiction to cover a broader range of participants in energy markets.¹⁵

In January 2006, FERC instituted Order No. 670 (“Prohibition of Energy Market Manipulation”) which implements the expanded regulatory scope of the ’05 Act.¹⁶ The new rule prohibits any material misrepresentation or omission when there is a duty to speak, and any use of a fraudulent device, in connection with a purchase or sale of natural gas or electricity, or the

¹¹ See *Trans Alaska Pipeline System*, 23 FERC P. 61,352, 61,764-61,763 (1983).

¹² Pub. L. No. 102 – 486, 106 Stat. 2776 (1992)

¹³ See ’92 Act §§ 721 – 26 (codified in 16 U.S.C. §§ 796, 824j – m, 825o-1).

¹⁴ Pub. L. No. 109 - 58, 119 Stat. 594 (2005).

¹⁵ The new law was intended to address behavior observed in the Western energy trading markets such as “wash trading”, where a seller sells energy to a buyer and then almost immediately repurchases it, creating an artificially inflated volume of trading, and false reporting of prices to trade publications. The resulting price reports were then used as the basis for certain types of energy contracts.

¹⁶ 71 Fed. Reg. 4244 (2006) (rule codified at 18 C.F.R. 1c (2006)).

transportation/transmission of either, where the underlying transaction is subject to the jurisdiction of FERC. Anyone engaging in such behavior, regardless of legal status or function, could be the target of FERC enforcement action.

The '05 Act and Order 670 are patterned after a regulatory framework used by the Securities and Exchange Commission to govern markets in public securities to avoid fraud and enhance market transparency for the purpose of maintaining the integrity of the market process.¹⁷ For purposes of FERC enforcement actions, the fraudulent activity need not be subject to FERC jurisdiction—as long as the intent behind the fraud is to affect (or else the fraud recklessly does affect in the absence of intent) activity that is subject to FERC jurisdiction, there is a sufficient connection for FERC to act.¹⁸ Under the new law, FERC can assess a civil penalty of up to \$1 million per violation per day, and criminal penalties for violations can include a fine of up to \$1 million and five years in jail.

B. CFTC

The emergence of futures trading in energy markets has become an important feature of restructured markets. This aspect of energy activity is subject to jurisdiction of the CFTC. The CFTC has jurisdiction over most commodities futures trading under the Commodity Exchange Act (“CEA”).¹⁹ The CEA subjects energy futures transactions to a prohibition on manipulation,²⁰ including attempts to manipulate commodities prices, to corner a market, and the filing of materially false information in connection with mandatory filings under the CEA.²¹ The

¹⁷ *Id.* at p. 2449.

¹⁸ *Id.*

¹⁹ Codified at 7 U.S.C. § 1 *et. seq.*

²⁰ *See* 7 U.S.C. § 2(h)(2)(C).

²¹ 7 U.S.C. § 13(a).

CFTC has brought a number of actions against companies for violating the CEA manipulation ban, particularly for the false reporting of natural gas trading information, which have generally ended in consent decrees or other settlements.²²

III. CASE STUDIES IN ENERGY MARKET MANIPULATION

The events in southern California in the winter of 2000-2001 provide interesting examples of market behavior that challenged the various government enforcement officials who administer the laws surveyed above. Two case studies involving investigations of the California natural gas and electric power markets are offered below. A third case study involves investigation of electric power markets in the eastern United States and the potential for a proposed merger to enhance the likelihood of market manipulation.

A. Natural gas supply delivery within Southern California

The first case study involves the conduct of the Southern California Gas Company (“SoCalGas”), which held the dominant position in the natural gas market in southern California in 2000.²³ A subsidiary of Sempra Energy Corporation (“Sempra Energy”), SoCalGas is a public utility licensed in California and regulated by the CPUC.

Pursuant to California Public Utility Commission (“CPUC”) regulations, SoCalGas serves two types of customers. Its “core” customers include residential and small commercial or industrial users. Core customers receive a full bundle of services, including gas procurement, transportation and delivery. The “non-core” customers include gas-fired electric generators and

²² Although the CFTC is the primary agency that monitors futures trading, the Federal Trade Commission has also examined the competitive impact of the information reported by energy traders to energy price reporting services to determine its influence on price and supply.

²³ The following summary of facts is taken in large measure from the exhaustive factual background provided in the [Proposed] Decision of ALJ Terkeurst in *In re Southern California Gas Co.* (Cal. P.U.C. 2004), available at http://www.cpuc.ca.gov/PUBLISHED/COMMENT_DECISION/41366.htm (6/29/07)

large commercial, industrial or wholesale users. Unlike core customers, non-core customers are responsible for purchasing their own gas and arranging for the end user.

Natural gas delivered into southern California originates from producing basins outside the state: (1) as a commodity delivered to the California-Arizona border, where interstate pipelines intersect with the SoCalGas pipeline system; or (2) “directly” from pooling points within the supply basins by holders of “firm,” or reserved, interstate pipeline capacity. SoCalGas traditionally was the largest holder of firm capacity into southern California, although a number of other firms held significant blocks of pipeline capacity to the California border. Once gas crossed the California border, access to the SoCalGas intrastate pipeline system was necessary in order to reach end users within the SoCalGas service territory, and access to the intra-state capacity was available at SoCalGas’s discretion.²⁴

SoCalGas owns the only natural gas storage facilities in southern California, which include four storage facilities with a capacity of 105 billion cubic feet (“Bcf”). Approximately 30 Bcf was available on a merchant basis for use by non-core customers, while 70 Bcf was reserved for core customers. Within southern California, gas suppliers and gas consumers (such as gas-fired power generators) also used storage and “hub” services offered by SoCalGas. These hub services included short-term “parking,”²⁵ wheeling²⁶ and loaning of natural gas to respond to short-term fluctuations in gas demand.

²⁴ *Public Util. Comm’n of the State of Cal. v. Fed. Energy Regulatory Comm’n*, 100 F.3d 1451 (9th Cir 1996).

²⁵ Parking services entail short-term storage of natural gas owned by customers whose intake capacity was temporarily full. This allows customers to purchase more supply at lower prices and to ensure availability of natural gas during peak use and demand periods.

²⁶ Wheeling services offer customers the ability to transport natural gas across the SoCal Gas system for delivery to points beyond the system.

The SoCalGas storage system and hub services together were designed to function as an extension of the interstate transportation system. Their purpose was to maximize the supply of natural gas brought from outside the state during periods of lesser demand and lower prices. Ideally, the total system was meant to protect SoCalGas's customers from price volatility during periods of peak demand and to facilitate customer efforts to minimize gas purchase costs by taking advantage of seasonal variations in gas consumption patterns.

1. Natural gas and the California energy crisis

Two aspects of SoCalGas's operations have been associated with the radical energy price spikes in California during the winter of 2000-2001. First, SoCalGas instituted a "hub loan program" in which it loaned natural gas to non-core customers. Involving more than one hundred transactions, the hub loan program began in June and continued through November, the traditional "storage injection" season. The financial terms of the hub loans encouraged customers to borrow from SoCalGas's storage rather than purchase supplies from outside the state for injection in advance of the winter season.²⁷ An important provision of this program was that the largest share of loans came due in the winter during the historical peak demand period.

Second, SoCalGas made a change to its historic practice by decreasing storage inventories to levels below previously announced targets. Rather than entering the winter season with 70 Bcf of stored natural gas, SoCalGas had approximately 56.4 Bcf physically in storage on November 1, 2000. It decided to rely on repayment of gas borrowed over the summer to meet some of its need to supply gas in the winter, and borrowers were required to repay the gas loaned from storage with gas delivered at the California border.

²⁷ Because spring prices were unusually high, forward price curves indicated that the winter prices would be lower than the spring ones. As a result, the parties receiving loaned gas believed the loans to be commercially reasonable because they anticipated being able to repay the loans from less expensive future supplies.

The combined effect of lower storage inventory and demand for gas at the border to pay loans led to demand for gas to outstrip the capacity for deliveries at the California border. Prices increased several hundred percent over a short period in the winter, and did not return to seasonally-adjusted levels for a number of months thereafter. California's electric power prices, which were set by the price of gas-fired electric power generators, soared as well. Its regulated electric power distribution utilities were pushed to the edge of bankruptcy, and consumers suffered through high prices and black-outs once liquidity in the power market dried up. SoCalGas's affiliated companies accumulated very sizeable profits from the episode, and investigations followed by federal and state competition authorities.

2. Competition issues and antitrust theories

SoCalGas's conduct during the California energy crisis ultimately was resolved as part of a multi-party settlement, so the matter was never presented to a court on the question of antitrust liability. Nevertheless, its behavior might have been brought before a court on a theory of unlawful monopoly maintenance.²⁸ The analysis generally would have been as follows. Since the public record suggests that SoCalGas has monopoly power in the southern California market for natural gas supply services including storage, transportation and hub services,²⁹ the central

²⁸ The U.S. Department of Justice has brought enforcement actions that alleged unlawful monopoly maintenance, including cases against Microsoft and Dentsply. In those instances, behavior was deemed unlawful when (1) a party possesses monopoly power, and (2) has maintained that power by the use of exclusionary or "anticompetitive conduct that reasonably appears to be a significant contribution to maintaining monopoly power." See, e.g. *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 187 (3d Cir. 2005) (holding that artificial tooth manufacturer unlawfully eliminated competitors' viable distribution channels in order to preserve its monopoly).

²⁹ The Department of Justice, FERC, and CPUC all independently concluded that SoCalGas had monopoly power in this market. *United States v. Enova Corp.*, 107 F. Supp. 2d 10, 13 (D.D.C. 2000); *So. Cal. Edison Co. v. San Diego Gas & Elec. Co.*, 83 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,199 (May 27, 1998); *Re Pacific Enterprises*, 79 C.P.U.C.2d 343 (Cal. P.U.C. 1998);

questions would be whether SoCalGas's conduct was a form of market manipulation with exclusionary effects, and whether such exclusionary effects enabled SoCalGas to maintain its monopoly. To decide such a case, it would be necessary for an antitrust court to conclude that SoCalGas acted as something more than an aggressive competitor that successfully executed an acute business strategy. One test a court might apply would be whether SoCalGas "sacrificed" short-term profits (on natural gas storage services) in order to recoup monopoly profits later on winter deliveries of natural gas supplies into southern California.³⁰ If a court determined that SoCalGas did so for the purpose of excluding competing suppliers from the market to sell winter gas supplies to Southern California, Section 2 liability may have been imposed.

B. Natural gas pipeline transportation

The second case study involves the conduct of El Paso Natural Gas Company ("El Paso"), an interstate natural gas pipeline that serves the California market.³¹ Prior to 1990, El Paso was one of only three firm capacity providers that served California. In the early 1990s, as a result of the FERC implementation of its open-access policy, El Paso experienced increased competition in the California natural-gas market due, in part, to the expansion of capacity on existing pipelines and the construction of a new pipeline which served the California market. FERC and the CPUC also enhanced competition by implementing a capacity-release program for firm shippers, which created a secondary market for interstate pipeline transportation.

³⁰ See, e.g., *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 610-11 (1985) (finding that that monopolist ski company's sacrifice of short-term profits in order to harm competitor constituted exclusionary conduct).

³¹ Unless otherwise indicated, the following discussion is derived from Section 5 Complaint, *Pub. Utilities Comm'n of California v. El Paso Natural Gas Co.*, 105 FERC ¶ 61,201 (FERC Apr. 4, 2000) (No. RP00-241-000).

This increased competition caused the supply of transportation capacity to exceed demand significantly. As a result, the pipelines and local distribution companies (“LDCs”) that held firm capacity discounted their transportation rates in the secondary market even during peak times. The LDCs incurred losses when they sold their capacity at a discounted rate in the secondary market because they were liable to the pipeline for the full rate specified in their transportation contract. The LDCs returned their firm capacity rights to the pipelines whenever they were contractually permitted to do so, which left the pipelines with significant amounts of excess capacity for which there was virtually no demand. In an effort to appease the pipeline owners, FERC and CPUC brokered a settlement between the pipelines and the LDCs that returned capacity to the pipeline and required the LDCs to pay “risk-sharing” surcharges to the pipeline for a portion of their turned back capacity. Under the settlement between El Paso and its customers, the LDCs agreed to pay El Paso an estimated \$255 million over eight years to defray El Paso’s costs of holding the three blocks of turned-back capacity created by the settlement.

1. Pipeline capacity contracts

Dynegy. After several attempts to market the turned-back capacity, El Paso entered into three prearranged-capacity contracts with Dynegy, which corresponded with the three blocks of capacity created by the settlement with the LDCs. El Paso then posted the three contracts for competitive bidding, but accepted bids only on the capacity as a whole—El Paso refused to allow bidders to bid on portions of the available capacity or the individual blocks as a whole.³² Immediately after the contracts went into force, capacity prices rose dramatically and stayed at elevated levels for the full term of the contract. The CPUC challenged the contracts before FERC, alleging a variety of competitive concerns.

³² Pub. Utilities Comm’n of California v. El Paso Natural Gas Company, 94 FERC ¶61,338, 4 (No. RP00-241-000) (2001).

Complainants argued that certain provisions of the contracts would restrain competition and that the amount of capacity held gave Dynegy excessive market power in California. The complainants took issue with one contract provision in particular, the Reservation Reduction Mechanism (“RRM”). Under the RRM, El Paso purportedly reduced Dynegy’s incentive to release excess capacity to the secondary market by agreeing to credit a portion of revenues from the sale of interruptible transportation capacity against Dynegy’s monthly payment obligation. Although FERC concluded that the RRM reduced El Paso’s incentives to discount rates in the secondary market and Dynegy’s fiscal obligations under the contracts, it nevertheless concluded that the contract term did not violate existing regulations.³³ FERC also found that the contracts did not permit Dynegy to exercise market power, despite its large holdings of capacity.³⁴ The Dynegy contracts expired at the end of 1999.

Enron. El Paso replaced the Dynegy contracts with three contracts with Enron. Various parties again challenged the contracts, alleging that profit-sharing provisions, which gave El Paso 25% of Enron’s profits above a set threshold level, reduced El Paso’s incentive to sell interruptible capacity at discounted rates in the secondary market. In addition, the complainants objected to the amount of capacity awarded to Enron under the contracts because it would enable El Paso and Enron to increase prices by withholding capacity.³⁵ FERC rejected these challenges and found that neither the profit-sharing provision nor the size of the capacity contract were inconsistent with the public interest.³⁶

³³ *Id.* at 5.

³⁴ *Id.*

³⁵ *Id.* at 5-6.

³⁶ *Id.* at 10.

Affiliate Contracts. After Enron terminated its contracts, El Paso, once again, accepted bids for the three blocks of available capacity. El Paso awarded the contracts to its marketing affiliate, El Paso Merchant, based on a bid that the CPUC and other complainants argued was significantly higher than its market value (taking account of payments made by customers under the previous settlement). Subsequently, during the 2000-2001 season, while California natural gas prices were spiking to unprecedented levels, El Paso pipeline is alleged to have refused to make pipeline capacity available on the secondary capacity market even though it was operationally available. El Paso was alleged to have done so in order to increase the profits of its trading and marketing affiliates. Complainants argued that El Paso Merchant acquired the excess capacity solely for the purpose of withholding it from the market—behavior which the marketing affiliate could afford to engage in because of its relationship to the El Paso.

The marketing affiliate, in addition to being a supplier of natural gas, was also an owner of natural gas electric generating companies in California that could recoup the cost of gas from retail customers no matter the price. Although it was never sued under the federal antitrust laws, El Paso settled all state antitrust and regulatory enforcement claims against it in 2003 with an agreement that included payments of approximately \$1.3 billion over fifteen years to reimburse ratepayers for costs incurred as a result of the allegedly manipulative conduct.³⁷

2. Competition issues and antitrust theories

Complaints against El Paso for violating Section 2 of the Sherman Act were included as a feature of the settlement agreement.³⁸ If an antitrust court had been asked to address liability, it might have done so on the basis of El Paso's refusal to make idle capacity available to competing

³⁷ Master Settlement Agreement at 15–16 ¶¶ 2.24–2.27 available at <http://ag.ca.gov/newsalerts/cms03/03-077.pdf> (filed with San Diego Superior Court on June 26, 2003).

³⁸ *Id.* at 15–16 ¶¶ 2.24–2.27.

suppliers. Arguably, the refusal violated El Paso’s customer contracts and its obligations to serve customer needs under federal and state regulatory authorizations. The underlying antitrust violation alleged, in that case, would have been a form of “refusal to deal” by the pipeline with competing natural gas suppliers for the purpose of raising the price of pipeline capacity to supra-competitive levels.

C. Market manipulation concerns in the merger context

The third case study involves Exelon Corporation and Public Service Enterprise Group (“PSEG”), the parents of regulated utilities in the Midwest and Northeastern United States, which entered into a merger agreement in 2004. Both corporations own electricity generating plants; Exelon’s plants are primarily located in the Mid-Atlantic and the Midwest, while PSEG operates mainly in New Jersey. Both the U.S. Department of Justice (“DOJ”) and FERC reviewed the merger for its effects on competition and both agencies approved the merger subject to significant divestitures.³⁹

1. Department of Justice review⁴⁰

The DOJ was concerned with the possibility that the merged entity would be able to reduce output and raise prices in two particular areas of the Mid-Atlantic – PJM East and PJM Central/East⁴¹ – where they are major producers of electricity. In making its determination, the DOJ analyzed the relevant product and geographic market, the likely competitive effects of the

³⁹ The final regulatory hurdle, authorization by the New Jersey Board of Public Utilities, proved fatal as neither party could agree on the terms of settlement with the Board.

⁴⁰ *United States v. Exelon Corp.*, Competitive Impact Statement, <http://www.justice.gov/atr/cases/f217700/217717.pdf> (Aug. 10, 2006) (hereinafter “Competitive Impact Statement”).

⁴¹ PJM Interconnection is a private non-profit organization which oversees the transmission grid. This grid is divided into regions. PJM East and PJM Central/East are considered constrained areas because often transmission restraints prevent the electricity generating units with the lowest offer from meeting demand.

transaction, and ease of market entry. According to the DOJ, the relevant product market was the market for wholesale electricity; that is, electricity generated for resale through a retailer. The DOJ determined that retail demand for electricity is insensitive to price increases at either the retail level or the wholesale level. The DOJ also determined the relevant geographic market was PJM East and PJM Central/East. PJM East consists of the heavily populated areas of northern New Jersey and Philadelphia and is defined by the Eastern Interface, which is a set of five major transmission lines. PJM Central/East includes central Pennsylvania and eastern Maryland and is defined by two major transmission lines, 5004 and 5005. The DOJ found that when these lines are constrained they are limited in their ability to purchase electricity produced outside of this region.

The DOJ found the merger would be anti-competitive because it would reduce price competition between the two generating companies and the merged entity would be able to reduce output and drive up price in the relevant geographic markets. The combined Exelon-PSEG would own a significant share of the total generating capacity in the already highly concentrated market. In PJM East, Exelon held 20% of the generating capacity and PSEG held 29%, so the combined company would have held 49%. In PJM Central/East, Exelon owned 19% of the generating capacity and PSEG owned 21%, so the combined company would have held 40%.

On June 22, 2006, DOJ filed a complaint to challenge the proposed merger and simultaneously entered into a consent agreement. The required remedies included divestiture of six identified generating plants in the PJM East and PJM Central/East areas. The effect of this divestiture would have been to reduce the combined company's market shares to 32% in PJM East and 29% in PJM Central/East. DOJ's goal via the divestitures was "to restore effective

competition by depriving Exelon of key assets that would have made it profitable for it to withhold output and raise prices in PJM East and PJM Central/East.”⁴² The objective of DOJ’s remedy was to ensure that the merged firm did not control generating assets with a combined operating profile and commercial value (i.e., heat rate) that would give it financial incentives to withhold output. The remedy was designed on the basis of economic models intended to capture post-merger market dynamics.

2. Federal Energy Regulatory Commission

Prior to the DOJ’s investigation, FERC approved the Exelon-PSEG merger subject to sizeable divestitures.⁴³ Although both the DOJ and FERC approved the merger subject to divestitures, the differences in the two outcomes from the two agencies illustrate certain analytical differences between antitrust enforcement and energy regulatory enforcement in the United States. The FERC analysis, which is described below, adopts a market definition derived from regulatory definitions of energy products and places a significantly greater emphasis on post-merger market structure – as compared to the DOJ’s focus on likely post-merger market behavior.

FERC identified three relevant product markets: non-firm energy, capacity, and ancillary services. Non-firm energy refers to energy supplied or available with limited or no assured commitment of availability.⁴⁴ Capacity refers to the amount of uncommitted capacity. Finally, ancillary services contribute to reliability and support the transmission of electricity from

⁴² See Competitive Impact Statement, *supra* note 40, at 14.

⁴³ *Order Authorizing Merger of Exelon Corp. and Public Serv. Enterprise Corp., Inc.*, Docket No. EC05-43-000, 112 FERC ¶ 61,011 (Docket No. EC5-043-000) (2005) (hereinafter “Exelon/PSEG Order”)

⁴⁴ Stated differently, non-firm energy is electricity that is not required to be delivered or to be taken under the terms of an electric purchase contract.

generation sites to the customer; ancillary services include spinning reserves and regulation services.

In the market for non-firm energy, FERC defined four geographic markets: expanded PJM, PJM pre-2004, PJM East, and Northern PSEG. Expanded PJM is all of the PJM service area including the areas of four other energy companies; PJM pre-2004 consists of original PJM members in the Mid-Atlantic Area Council (“MAAC”) plus one additional power company; PJM East is the portion of the PJM area that is east of the Eastern Interface; and finally, Northern PSEG is the part of PSEG territory in northeastern New Jersey.⁴⁵

To mitigate the anticompetitive effects of the merger, Exelon and PSEG agreed with FERC to divest 4,000 MW of intermediate and peaking generation facilities and to sell energy from 2,600 MW of nuclear capacity primarily in PJM East (“virtual capacity”).⁴⁶ Within these categories of facilities, the specific generating facilities to be divested could be determined by the merging parties. FERC agreed that this divestiture plan would eliminate the competitive harm from the merger, but required the parties to make compliance filings once the divestiture process was complete.

IV. CIVIL ANTITRUST CASES INVOLVING CLAIMS OF ENERGY MARKET MANIPULATION

There have been a number of recent antitrust cases brought by civil plaintiffs against energy companies. Although these cases often involve legitimate claims of market manipulation, federal courts have consistently dismissed these cases based on the filed rate doctrine. Federal courts have held that the filed rate doctrine prevents private parties from recovering antitrust

⁴⁵ See Exelon/PSEG Order, *supra* note 43, at ¶ 12.

⁴⁶ Press Release, FERC, Commission Approves Exelon-PSEG Merger Transaction (June 30, 2005), <http://www.ferc.gov/press-room/press-releases/2005/2005-2/06-30-05-exelon.asp> (last visited June 12, 2007).

damages based on allegedly unreasonable rates which have been filed with a regulatory agency.⁴⁷

For this reason, the merits of these market manipulation cases have never been addressed by a federal court.

V. CONCLUSION

Because the case studies presented in this paper all settled before courts had the chance to address the merits of potential claims under the antitrust laws, one can only speculate on how the conduct and practice described might have fared under judicial scrutiny. Each circumstance, nevertheless, highlights the challenging circumstances faced by regulators charged to foster and maintain competition in energy markets.

⁴⁷ See, e.g., *California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831 (9th Cir. 2004) (dismissing claims that energy producers fraudulently sold energy on the spot market, due to federal preemption and the filed rate doctrine); *Public Utility District No. 1 of Grays Harbor County Washington v. Idacorp., Inc.*, 379 F.3d 641 (9th Cir. 2004) (dismissing claims that electric power wholesalers manipulated the market rate of electric power, due in part to the filed rate doctrine); *Public Utility District No. 1 of Snohomish County v. Dynegy Power Marketing Inc.*, 384 F.3d 756 (9th Cir. 2004) (dismissing claims that electricity producers and wholesale traders violated antitrust laws by withholding electricity supply in order to manipulate the market, due to preemption and the filed rate doctrine); *Texas Commercial Energy v. TXU Energy, Inc.*, 2004 WL 1777597 (S.D. Tex. June 24, 2004), *affirmed*, 413 F.3d 503 (5th Cir. 2005) (dismissing antitrust claims against energy providers and wholesale traders, who allegedly withheld energy from the market despite excess capacity and manipulated the spot market, due to the filed rate doctrine).