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A BRIEF ANALYSIS OF POLICY AND LITIGATION

Market Definition in the Arch/Peabody Coal Joint Venture

Stephanie M. Mirrow

EI Vice President Stephanie M. Mirrow has worked on numerous matters involving market definition, including joint ventures and mergers and acquisitions.

The Federal Trade Commission ("FTC") recently filed an administrative complaint, and has sought a preliminary injunction, to block the proposed joint venture between Arch Coal, Inc. ("Arch") and Peabody Energy Corporation ("Peabody"). Arch and Peabody are seeking to combine their coal mining operations in the Southern Powder River Basin ("SPRB") of northeastern Wyoming. The FTC alleges that Arch and Peabody are the two largest coal-mining companies in the United States, and that the proposed joint venture would eliminate competition for thermal coal in the SPRB.

Market definition will be a fundamental point of contention between the FTC and the joint venture parties. Specifically, this case raises issues of how traditional inputs (thermal coal) compete with new products and technology -- such as natural gas made available through hydraulic fracturing ("fracking") and renewable energy sources, including wind and solar.

The joint venture parties, Arch and Peabody, argue that natural gas from fracking and renewable power from solar and wind generation are displacing the use of thermal coal and that thermal coal production in the SPRB has declined by over 50 percent since 2008. They claim that the FTC, by considering and defining a relevant market that includes only the sale of SPRB coal, is ignoring the competitive dynamics of energy markets in the United States.

However, the FTC does consider the decline in demand for SPRB coal in its Complaint. The FTC states: "While the total demand for SPRB coal in the economy has been falling over time, industry regulators such as EIA, and SPRB coal producers (including Peabody and Arch), expect that SPRB coal plants will continue to purchase and burn many millions of tons of SPRB coal for many years to come." The FTC further argues that utilities that own plants that rely on SPRB coal, but also can generate electricity using power from plants that can use alternative fuel sources, would not reduce their purchases of SPRB coal by enough to defeat a small, but significant increase in the price of SPRB coal.

The Courts have recognized the dynamic effect that the emergence of new technologies can have on industry competition (e.g., distributors of only on-demand content such as Hulu and Netflix in the *AT&T/Time Warner* litigation). This Complaint suggests that the antitrust agencies will continue to investigate and pursue mergers and joint ventures between firms in traditional industries that are losing customers or cutting production due to new products and technologies.

Also In This Issue

FERC Remakes PJM Capacity Market

John R. Morris

On December 19, 2019, the Federal Energy Regulatory Commission ("FERC") issued the much-awaited order on the operations of the PJM Interconnection LLC ("PJM") capacity auctions. FERC's order will require PJM to extend its Minimum Offer Pricing Rule ("MOPR") to all generation, both new and existing. Whereas the prior MOPR mainly addressed offers from new gas-fired generation with state support, FERC will now require the MOPR to cover all non-utility existing thermal generation (such as nuclear, coal, gas, and oil) with state support as well as all new generation with state support—including new renewable generation and new utility generation.

PJM is the world's largest centrally-dispatched electric power market, covering parts of thirteen states plus the District of Columbia. Most of PJM's revenue comes from wholesale sales of electric energy, which retailers resell to homes and businesses. PJM also requires retailers to pay for the generation capacity that is necessary to serve the demand reliably. Capacity prices are determined in annual capacity auctions in which PJM sets a demand curve and generation owners submit offers to supply capacity.

"Thus, the only certainty going forward is that the capacity auction process in PJM will be changing."

Historically, there was a single capacity auction for the entire PJM market. Because PJM had excess generation capacity, capacity prices were low. In 2007, the capacity auctions were revamped, using the Reliability Price Model, to allow for locational prices. The Reliability Price Model allowed higher prices where capacity was needed for reliability reasons. Following its implementation, capacity prices rose significantly—particularly in the eastern part of PJM. In response, New Jersey and Maryland authorized programs to subsidize the financing of new generation facilities in order to drive down capacity prices in their regions. Each state required these new subsidized facilities to clear the capacity auctions, and their electric retail customers would cover any losses the new plants would incur. Because the subsidies were less than the decline in capacity payments, the programs benefited retail customers at the expense of generation companies not participating in these state-subsidized programs.

Several of these independent power producers filed lawsuits challenging the New Jersey and Maryland programs. In *Hughes v. Talen Energy Mktg., LLC*, the Supreme Court ruled the state programs unconstitutional, because they required the recipients of the subsidies to clear the PJM capacity auctions and drive down the auction prices. Specifically, the Court ruled that state programs that required price effects in federally-controlled auctions are impermissible.

Principal John R. Morris leads the energy practice at EI. He is an expert on price formation in energy markets, including the price effects of proposals to reform generation capacity markets.

Other states undertook different approaches to address capacity issues. Both New York and Illinois adopted Zero Emission Credit programs that subsidized nuclear power plants to keep them viable. Part of the rationale for these programs was that the states had an interest in maintaining enough capacity without emissions to meet federal and state carbon-reduction goals for electric generation. The Second and Seventh Circuit Courts found the new programs permissible, because they did not require the subsidized generation to clear long-term capacity auctions. The Supreme Court upheld these rulings in April 2019. In July 2019, Ohio adopted a similar subsidy program to maintain both nuclear and coal-fired generation in Ohio.

Although the courts differentiated between the programs offered by New Jersey and Maryland and those offered by New York and Illinois on legal grounds, all of the programs have the same economic effect. By keeping generation capacity in the market that would otherwise exit, the programs depress prices in capacity and energy auctions.

FERC's new PJM order will counteract the state subsidies' price-decreasing effect on capacity. The new MOPR establishes different offer floors on generation units supplying capacity, based on whether a unit is new or existing and the generation technology of existing capacity. The floor for new units is 90 percent of the Net Cost of New Entry, which is a measure of annualized greenfield unit installation costs less the expected net revenues from energy and ancillary service sales. The floor for existing units is set at the Net Avoidable Cost Rate (Net ACR), which is a measure of the annual losses that a unit would incur if its net revenues came only from energy and ancillary service sales. FERC's new order requires PJM to calculate the Net ACR by technology

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Data Use As An Antitrust Concern?

Robert D. Stoner

Antitrust enforcers at the Department of Justice ("DOJ") and Federal Trade Commission ("FTC") have signaled increasing concern that the collection and commercial use of data by large digital firms may raise novel antitrust questions. In a November 2019 speech at Harvard University, Assistant Attorney General Makan Delrahim discussed some of these potential antitrust concerns. Delrahim's speech also highlighted the debate among antitrust scholars on how to analyze data markets and the balanced approach antitrust enforcers should pursue.

In an antitrust analysis with traditional goods, high share in and of itself is not indicative of market power. Similarly, the mere possession of a large quantity of data is not necessarily anticompetitive. There are potential benefits to consumers from data collection and aggregation (e.g. knowledge of one's current location, restaurant ratings/reviews, personal exercise data). Simply, as Delrahim noted in his speech, data have economic value. Like traditional goods, the economic value of a particular type of data depends on numerous market-specific facts, including how difficult it is for firms to collect such data, the number of firms able to collect such data, the degree to which the data are refined and organized so that they are useful, and potential substitutes for the data. Thus, how data are collected and used may warrant antitrust scrutiny if the result of such data collection is reduced entry, reduced consumer choice, or reduced competition for the acquisition of data itself (which can result in reduced consumer bargaining power). At the same time, antitrust enforcers also must consider the potential disincentives to innovation and product improvements from undue intervention.

The debate among antitrust scholars revolves around whether data should be analyzed differently than traditional goods and services. Data perhaps can best be viewed as an input into a "two-sided" production process where firms with digital platforms offer subsidized or free services (e.g., online travel services) to consumers who give those firms implicit or explicit permission to collect and analyze their personal information. The firms then use the consumer information to improve the consumer product, as well as to monetize the resulting data (e.g., through ad placement) on the other side of their business.

EI Principal Robert D. Stoner has worked on a number of matters, both at the FTC and in his consulting practice, concerning the application of antitrust to novel issues.

Scholars who argue for special treatment of data in an antitrust context state, fundamentally, that allowing firms with digital platforms to control large amounts of data can create entry barriers and allow the exercise of market power. Some of these scholars argue that data collection can create a 'feedback loop' -- in which data that permit product improvements also allow incumbent platforms to leverage data usage to make entry more difficult, in turn allowing incumbent firms to gain market power over data collection. In this conceptualization, a new platform entrant that does not have access to the same volume and type of data may not be able to compete successfully (or enter at all), and the incumbent firms will have reduced incentives to innovate and expand aggressively.

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Further, these scholars argue that traditional antitrust tools are inadequate, because data collection typically does not have a nominal price, and thus cannot be readily analyzed using price-based economic tests for the existence or extension of market power. For example, in digital industries where "prices" of the digital platform itself are not readily observed or are zero, market power may be better measured by share of control over data rather than traditional market power measures (such as the ability to raise price by some small but significant amount). This viewpoint recognizes that data have economic value to digital firms, even if they are producing a "zero-price" product. For example, if data are a necessary input into the platform production process, the acquisition of data by firms is best seen as part of an implicit or explicit bargain with consumers who provide that data. In order to get the data they need, firms offer privacy protection and potentially other items that make the bargain more palatable to consumers. Thus, if there is inadequate competition in the platform market caused by the accumulation of data, firms might degrade privacy protection or refuse to sweeten the bargain.

FTC Commissioner Rohit Chopra recently discussed this

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class. The Net ACR likely will be set at a level above the auction price caps, so that nuclear and coal-fired generation will be unable to clear capacity auctions.

All generation units will be subject to these price floors unless a unit meets one of five exemptions. The exemptions indicate that existing rate-base and existing renewable generation will not be subject to the floor, nor will demand response, energy efficiency, or storage devices. Also, as currently, generation not receiving state support (competitive generation) will not be subject to the floor.

The likely effect of the new FERC PJM order will be higher capacity prices in the PJM, because some generation units will have higher offers than they would otherwise. Thus, states may seek ways to reduce the burden of the order. States may respond through litigation. States also may consider requiring retailers to utilize the Fixed Resource Requirement (FRR) alternative to the capacity auctions. Under the FRR alternative, energy retailers obtain capacity resources outside of the auction and thus do not pay the auction prices for capacity. Additionally, subsidized units become valid resources without a price floor, and the demand served by them reduces the demand in the auction. This depresses auction prices just as if the subsidized resources had cleared the auction. States requiring the FRR alternative also could operate their own auctions to match supply and demand (and also realize other goals such as renewable energy, carbon reduction, and employment).

Although the new MOPR addresses state programs that depressed prices in capacity auctions and negatively impacted non-subsidized generation, the new MOPR also creates uncertainty. States may challenge the new rule or require their electric retailers to forego the PJM auction process and obtain capacity directly. Thus, the only certainty going forward is that the capacity auction process in PJM will be changing.

Data Use As An Antitrust Concern?

issue at a conference. He indicated that digital platforms can potentially force "take it or leave it" propositions on potential platform users, where they must agree to the terms offered in order to use the site. While users may not be explicitly paying anything to use a service like Google or Facebook, they are implicitly paying for access with their data. As such, Chopra stated that the antitrust authorities need to inquire whether platforms with market power can influence the bargaining process between platforms and users to their advantage -- for example, by offering less security for data.

Scholars on the other side of this debate argue that possession of significant data is not likely to preclude competitive platform entry, that there is no empirical support for the proposition that lack of data has impeded entry, that data are becoming easier to collect and use as new technologies are developed, and that new platform entrants can employ new technologies to store and analyze data. These experts argue that data are ever-present and are difficult to use in a rivalrous manner, because data can be amassed simultaneously by numerous firms. Data also can become "stale," so potential entrants have the opportunity to gather new data. These scholars argue that antitrust should consider the procompetitive aspects of widespread consumer data availability that spur innovation and product improvements. Further, these scholars argue that even if data are a necessary expense for an entrant, it is not a true economic entry barrier, since entrants and incumbents alike face this cost. These scholars further argue that traditional antitrust tools are sufficient for analyzing any potential antitrust problems due to data collection.

In sum, while both DOJ and FTC have expressed potential antitrust concerns pertaining to data collection, aggregation, and use, there is still significant debate in the scholarly research on whether data acquisition markets should be analyzed differently than traditional goods or services.

EI News and Notes

Robert Arons Joins EI

Senior Economist Robert A. Arons recently joined EI's Washington DC office. Prior to joining EI, Dr. Arons was a staff economist with the Department of Justice's Antitrust Division ("DOJ"). While at DOJ, Dr. Arons provided econometric and theoretical analysis in support of market definition and competitive effects in a wide range of industries, including cable and satellite television, broadcast television, health insurance, hospital conduct, agriculture, paper storage, cloud-based platforms, and software as a service. Dr. Arons earned his Ph.D. from the University of Rochester.

Paper on Changing Entry Conditions in the Electric Power Industry

Principal John R. Morris, Senior Economist Jéssica Dutra, and Energy Analyst Tristan Snow Cobbs' paper "Should Market Power Still Be a Concern in the U.S. Electric Power Industry" is being published in the May 2020 issue of *The Electricity Journal.* The paper examines entry into new generation supply in the United States. The authors find that entry into new generation is typically small scale and accomplished by companies with below average market shares, and this construction of new generation meets the likely, sufficiency, and timeliness standards in the *Horizontal Merger Guidelines*.

EI Economists Participate in Panel Discussion at the Department of Labor

Senior Vice President Michael DuMond and Principal Robert B. Speakman participated in a panel discussion at the United States Department of Labor with representatives of the National Industry Liaison Group and the Office of Federal Contract Compliance Programs (OFCCP). Drs. DuMond and Speakman suggested several improvements to the OFCCP's methodological approach to analyzing potential compensation disparities, as outlined in Directive 2018-05.

EI Economists Submit Comments on Draft Vertical Guidelines

EI Principals Lona Fowdur and John R. Morris submitted comments on the Draft Vertical Merger Guidelines. Dr. Fowdur and Dr. Morris recommend that more clarity on transactions that are unlikely to be anticompetitive and those that are likely to be anticompetitive would benefit both the business and legal communities. They also propose eight specific recommendations, including better delineated market share thresholds, use of market power pressure indices, and the reinstatement of regulatory evasion as a potential theory of harm.

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