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FERC Approves Termination of Market Power Mitigation Measures.

Market power mitigation measures adopted in 2005 to address horizontal market power concerns arising from the merger of Louisville Gas and Electric Company and Kentucky Utilities and the subsequent withdrawal of LG&E/KU from the Midcontinent Independent System Operator, Inc. have recently been terminated by the Federal Energy Regulatory Commission, over the objection of Commissioner Cheryl LaFleur. *Louisville Gas and Electric Company and Kentucky Utilities Company*, 166 FERC ¶ 61,206 (2019).

Need for Market Power Mitigation

LG&E and KU are electric public utilities in Kentucky which proposed to merge in 1998. One of the issues FERC considers when it reviews utility mergers under Section 203 of the Federal Power Act is the effect of the merger on competition. In order to allay horizontal market power concerns raised by their proposed merger, LG&E/KU committed to join the Midcontinent Independent System Operator, Inc. (MISO), which was then being organized as an independent regional transmission organization.

Members of MISO may obtain transmission service throughout the multi-state MISO footprint for a single, non-pancaked transmission charge. Therefore, LG&E/KU's participation in MISO enabled load-serving entities connected to its transmission system to obtain electricity from sources outside of the LG&E/KU footprint without paying multiple transmission charges. In its order approving the merger, the FERC found that the availability of transmission service to customers connected to the LG&E/KU system from anywhere within the MISO footprint at a single, non-pancaked rate helped to mitigate any horizontal market power concerns. An increase in potential electricity suppliers within the LG&E/KU destination market meant more competitive rates for consumers.

Adoption of De-pancaked Mitigation Measures

In 2005, after the merger had closed, LG&E/KU sought FERC authorization to withdraw from MISO, and proposed instead to offer transmission service over their combined transmission systems through a stand-alone Open Access Transmission Tariff (OATT). In order to provide transmission customers the benefits of non-pancaked transmission rates comparable to those enjoyed while LG&E/KU belonged to MISO, it also adopted a De-pancaking Mitigation mechanism involving transmission rates for new service into and through its system from MISO.

Under that mechanism, certain load-serving municipal electric utilities within the LG&E/KU footprint that purchase power from generation sources in MISO receive a credit for transmission service under the LG&E/KU OATT equal to charges for transmission and ancillary services they paid under the MISO Tariff. In addition, LG&E/KU waived transmission and ancillary service charges under the LG&E/KU OATT for power delivered by such customers from generation sources connected to the LG&E/KU system into MISO. As a result, load-serving utilities within the LG&E/KU footprint have continued to obtain transmission service through the KG&E/KU and the MISO systems for a single, non-pancaked transmission charge.

Termination of De-pancaked Mitigation Mechanism

In August 2018, LG&E/KU filed an application with the FERC to terminate the De-pancaking Mitigation provisions. In considering this request, the FERC rejected arguments that any market power mitigation measures either (a) must remain in effect in perpetuity, or (b) have a finite term. Instead, the FERC explained that the De-Pancaking Mitigation measures could be terminated "if LG&E/KU has demonstrated that loads located in the LG&E/KU market will continue to have access to a sufficient number of competitive suppliers after the mitigation is removed."

In support of its request, LG&E/KU argued that market conditions in the Midwest have changed substantially since the adoption of the De-pancaking Mitigation mechanism. LG&E/KU submitted an analysis showing that the wholesale requirements customers within its boundaries have many more sources of power available today than in 1998; that many of those customers had successfully solicited power supply arrangements from suppliers other than LG&E/KU; and that a delivered-price test revealed more than 100 entities with capacity that could be delivered into the LG&E/KU footprint at competitive rates. After reviewing the record, the FERC found that:

…the Merger continues to be consistent with the public interest without the De-pancaking Mitigation because the record shows that loads located in the LG&E/KU market will continue to have access to a sufficient number of competitive suppliers after the mitigation is removed.

Transition Period

At the time of the FERC's acceptance of the De-pancaking Mitigation, all wholesale requirements customers connected to the LG&E/KU system had long-term contracts to purchase the electricity needed to meet their bulk power supply requirements from LG&E/KU. Some of those customers have now terminated the purchase of power from LG&E/KU and are purchasing power from third-party suppliers, while other customers are in the process of doing so.

Nevertheless, the FERC was concerned that these customers may have made arrangements to procure power from generation sources located outside of the LG&E/KU footprint in reliance on the De-pancaking Mitigation measures. Therefore, as a condition of their termination, the FERC required that the De-pancaking Mitigation measures remain in effect for all wholesale requirements customers dependent upon the MISO transmission system during a transition period equal to the initial term of each power purchase agreement entered into by each such customer.

Commission La Fleur's Dissent

Although the FERC granted the request to terminate the De-pancaking Mitigation provisions after a transition period, Commissioner LaFleur was concerned that the delivered price test provided by LG&E/KU showed that customers would have limited access to alternative generation suppliers during periods of the year when the market is highly or moderately concentrated. She also believes that because the solicitations relied on by LG&E/KU were conducted while the De-pancaking Mitigation mechanism was in place, they were insufficient evidence of adequate competitive options that might be available without mitigation. She therefore would have preferred that the FERC set the matter for an evidentiary hearing in order to confirm that the wholesale requirements customers connected to the LG&E/KU system would have adequate access to competitive third party generation suppliers after the mitigation was terminated. With due regard for rate pancaking, she concluded by saying that:

…while people frequently talk about how the sausage gets made, this case shows how the pancakes get made. While a single pancake may be fine, I do not believe that LG&E/KU should be able to force feed a short stack of pancakes to [the wholesale requirements customers]. Without better ingredients than are presented in this record, the conclusion that these customers have adequate menu alternatives is half-baked at best. While I expect the majority would rather than I hop to their decision, I am not waffling, and respectfully dissent.

Conclusions

The order reflects the FERC's pragmatic attitude in determining whether horizontal market power mitigation measures are needed to protect against potential adverse effects of utility mergers on competition. Although termination of the De-pancaking Mitigation mechanism might affect the ability of some potential suppliers to serve loads within the LG&E/KU market economically, the FERC was satisfied that loads located in the LG&E/KU market would continue to have access to a sufficient number of competitive suppliers after the mitigation is removed. Although Commissioner LaFleur would have preferred that there be additional evidence to support the FERC's conclusion, the transition arrangements provide a reasonable opportunity for affected wholesale customers of LG&E/KU to test the FERC's conclusions while seeking new supplies of electricity to take effect when their existing power purchase agreements with LG&E/KU expire.

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