

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

RTO/ISO Performance Metrics)

Docket No. AD10-5-000

REPLY COMMENT OF THE FEDERAL TRADE COMMISSION

March 19, 2010

I. Introduction

The Federal Trade Commission (FTC) appreciates this opportunity to comment on the Federal Energy Regulatory Commission's (FERC's) Notice Requesting Comments on RTO/ISO Performance Metrics (Notice).¹ FERC lists several potential performance measures that it developed in consultation with regional transmission organization (RTO) and independent system operator (ISO) employees in response to a Government Accountability Office report recommending the development and use of standardized measures of the performance of RTOs and ISOs.²

Developing and tracking the performance of RTOs is a laudable objective. We note, however, that the potential performance measures that FERC has proposed do not measure all "minimum characteristics and functions" of RTOs that FERC articulated in the founding orders for those organizations. For example, none of the proposed performance metrics assesses whether an RTO is constructively engaged in resolving issues that require regional coordination. Further, the Notice and accompanying list do not recognize the adverse consequences that could occur unintentionally if RTOs were evaluated by quantitative performance metrics that do not include all relevant aspects of their performance.

We recommend that FERC select performance metrics that will evaluate accurately the degree to which RTOs display the required characteristics and perform their required functions. We further urge FERC to address explicitly the risk of potential distortions in RTO performance that may result from flawed or incomplete performance metrics. Next, we recommend that FERC consider adding to the minimum characteristics and functions of RTOs a requirement to operate efficiently, including being responsive to grid users and the retail customers they serve. Finally, we respond to the approach that the "Consumer Commenters" group has taken in its initial comment.

II. Interest of the FTC

The FTC is an independent agency of the United States Government responsible for maintaining competition and safeguarding the interests of consumers, both through enforcement of the antitrust and consumer protection laws and through competition policy research and advocacy. The FTC often analyzes regulatory or legislative proposals that may affect competition or allocative efficiency in the electric power industry. The FTC also reviews proposed mergers that involve electric and natural gas utility companies, as well as other parts of the energy industry. In the course of this work, as well as in antitrust and consumer protection research, investigation, and litigation, the FTC applies established legal and economic principles and recent developments in economic theory and empirical analysis.

The energy sector, including electric power, has been an important focus of the FTC's antitrust enforcement and competition advocacy.³ The FTC's competition advocacy program has produced two staff reports on electric power industry restructuring issues at the wholesale and retail levels.⁴

The FTC and its staff have filed numerous competition advocacy comments with FERC and participated in FERC technical conferences on market power issues. For example, in March 2007, the Deputy Director for Antitrust in the FTC's Bureau of Economics served as a panelist for a technical conference on FERC's merger and acquisition review standards under Federal Power Act (FPA) Section 203 (Docket No. AD07-2-000). Similarly, the FTC submitted comments in December 2009 in FERC's proceedings on possible elements of a National Action Plan on Demand Response (Docket No. AD09-10-000)⁸ and on transmission planning processes (Docket No. AD09-8-000).⁹ The FTC also has commented on FERC's initiatives to promote wholesale electricity competition and on various state issues associated with restructuring the electric power industry.¹⁰

III. The Risk of Unintended Consequences from Incomplete Performance Metrics

Performance metrics are an important part of any incentive system developed to address principal-agent problems. Principal-agent problems typically arise whenever one individual – the principal – contracts with another – the agent – to perform tasks that the former otherwise would have had to perform personally. The basic cause of the principal-agent problem is that it is impossible or costly to observe the effort made by an agent.¹¹ In order to reduce principal-agent problems, principals typically develop both monitoring systems to keep track of agents'

⁷ Conference materials <http://www.ftc.gov/bcp/workshops/carbonoffsets/index.shtml>. Other programs have included the FTC's public workshop on

, held on September 13-14, 1999 (workshop materials <http://www.ftc.gov/bcp/elecworks/index.shtml>); and the Department of Justice and FTC workshop on , held on April 23, 1996.

⁸ This comment is available at <http://www.ftc.gov/os/2009/12/V100002ferc.pdf>.

⁹ This comment is available at <http://www.ftc.gov/os/2009/12/V100001ferc.pdf>.

¹⁰ , , Federal Trade Commission, Comment before the Federal Energy Regulatory Commission on Wholesale Competition in Regions with Organized Electric Markets (Apr. 17, 2008), <http://www.ftc.gov/be/v070014b.pdf>. A listing of FTC and FTC staff competition advocacy comments to federal and state regulatory agencies (in reverse chronological order) is available at http://www.ftc.gov/opp/advocacy_date.shtml.

¹¹ DENNIS CARLTON AND JEFFREY PERLOFF, MODERN INDUSTRIAL ORGANIZATION 414-15 (4th ed. 2005).

work efforts and incentive systems based on performance metrics.¹² Performance metrics attempt to align the interests of agents with those of principals.

FERC articulated objectives for RTOs in the orders establishing those organizations.¹³ FERC Order No. 2000 established “minimum characteristics and functions” that an RTO must satisfy in the following areas:

Minimum Characteristics:

1. Independence
2. Scope and Regional Configuration
3. Operational Authority
4. Short-term Reliability

Minimum Functions:

1. Tariff Administration and Design
2. Congestion Management
3. Parallel Path Flow
4. Ancillary Services
5. Open Access Same-Time Information System, Total Transmission Capability, and Available Transmission Capability
6. Market Monitoring
7. Planning and Expansion
8. Interregional Coordination

¹² An early framework for the economic analysis of these issues was developed by Oliver Williamson in *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975) and *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* (1985).

¹³ “Independent System Operators grew out of Orders Nos. 888/889 where the Commission suggested the concept of an Independent System Operator as one way for existing tight power pools to satisfy the requirement of providing non-discriminatory access to transmission. Subsequently, in Order No. 2000, the Commission encouraged the voluntary formation of Regional Transmission Organizations to administer the transmission grid on a regional basis throughout North America (including Canada). Order No. 2000 delineated twelve characteristics and functions that an entity must satisfy in order to become a Regional Transmission Organization.” FERC’s description of the origin of ISOs and RTOs is available at <http://www.ferc.gov/industries/electric/indus-act/rto.asp>. The final version of Order No. 2000 (after rehearing) is available at <http://www.ferc.gov/legal/maj-ord-reg/land-docs/2000A.pdf>.

In order to avoid (at a minimum) the worst problems that can arise from using incomplete performance metrics, there should be metrics concerning these minimum characteristics and functions, with the relevance of each metric demonstrated.

Each RTO has an independent board of directors responsible for ensuring that the RTO has the characteristics and functions prescribed in Order No. 2000 and related orders. A stakeholder process within each RTO connects grid users to the board of directors.¹⁴ There are debates about how much weight RTOs should accord to the views of customer and other stakeholder organizations. Some observers argue that RTO performance metrics would benefit from a greater consideration of feedback from market participants (including grid users) alongside the quantitative performance criteria. With the exception of transmission owners who can transfer control of their facilities from one RTO to another, RTO customers have no choice regarding their assigned RTO. Accordingly, some assessment of how well RTOs respond to customer needs seems necessary.¹⁵

If FERC decides to use quantitative performance metrics to evaluate RTOs, it should ensure that the selected performance metrics effectively gauge all of the important characteristics and functions of RTOs. FERC should consider the relative importance that it attaches to different metrics if an aggregate quantitative performance assessment is to be made. FERC also should bear in mind the costs and time involved in collecting performance information.

The process of linking metrics to objectives may be challenging. Academic articles regarding optimal incentive contracts (and on principal-agent issues generally) identify many examples of flawed or insufficient performance metrics that led to detrimental, unintended consequences for organizations, their suppliers, and their customers.¹⁶ In some situations, insufficient metrics can lead an organization to focus only on certain of its responsibilities, but to neglect others that are measured poorly or not at all.¹⁷ In other situations, the flaws can lead to

¹⁴ Issues considered in the development of the stakeholder process include what groups have a voice in decision making, the weight given to the views of different groups, and the level of agreement required to reach a decision.

¹⁵ The FTC disfavors “customer satisfaction” surveys because consumers in most markets learn from their mistakes and are able to purchase their preferred products in the long run. By contrast, such surveys may be appropriate in the RTO context, where customers generally choose their RTO.

¹⁶ , , Jonathan Levin, “Relational Incentive Contracts,” 93 835 (2003), and citations therein (<http://www.stanford.edu/~jdlevin/Papers/RIC.pdf>).

¹⁷ George Baker, “Distortions and Risk in Optimal Incentive Contracts,” 37 727 (2002).

characterize RTOs.”²² The adoption of an RTO minimum characteristic that encompasses operational efficiency would form a basis for appropriate performance metrics. Although some of the metrics proposed in the Notice – such as organizational effectiveness – seem to be related to the efficiency characteristic that we propose,

approach combined with plant-specific price controls²⁵ – reflects an energy policy decision. The results of that policy decision are not under the control of RTOs. Thus, using “generator costs compared to revenues” as a performance metric for RTOs would hold those organizations