consumer protection laws and through competition advocacy. In the electric power industry, the FTC often analyzes regulatory or legislative proposals that may affect competition or the efficiency of resource allocation in addition to its review of proposed mergers involving electric and gas utility companies. In the course of this work, as well as in antitrust research, investigation, and litigation, the Commission applies established principles and recent developments in economic theory and empirical analysis to competition issues. As part of its competition advocacy mission, the FTC has issued two Staff Reports (July 2000 and September 2001) on electric power industry restructuring issues at the wholesale and retail levels. The July 2000 FTC Staff Report established a policy framework for increased competition in wholesale and retail electric power markets.[3] The September 2001 FTC Staff Report reviewed those features of state retail competition plans that have provided benefits to consumers and those that have not. It also provided recommendations as to whether states had sufficient authority to implement successful retail competition programs.[4]

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[3] FTC Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform (July 2000), *available at* <http://www.ftc.gov/be/v000009.htm>. This report compiles previous comments that FTC Staff had provided to various state and federal agencies.

[4] FTC Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform, Focus on Retail Competition (Sept. 2001), *available at* <http://www.ftc.gov/reports/elec/electricityreport.pdf>.

[5] FTC Staff Comment on Docket No. RM01-10-000 (Dec. 20, 2001), *available at* <http://www.ftc.gov/be/v020001.htm>.

[6] FTC Staff Comment on Docket No. RM02-1-000 (Dec. 21, 2001), *available at* <http://www.ftc.gov/be/v020002.htm>.

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responsive demand programs. If direct approaches are too costly, slow, or otherwise unavailable, then less direct means to curtail market power, including bid caps and must run obligations such as those proposed in the NOPR, may warrant consideration on an interim basis. In general, the indirect approaches are less efficient and may undermine

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[11] FTC Staff Comment Docket No. RM01-12-000 (Nov. 15, 2002), § II.B, *available at* <http://www.ftc.gov/be/v020022.htm>.

[12] FTC Staff Comment Docket No. RM01-12-000 (July 23, 2002) at 4-6, *available at* <http://www.ftc.gov/be/v020018.pdf>.

[13] U.S. Dept. of Justice and Federal Trade Comm., Horizontal Merger Guidelines (Apr. 2, 1992, as revised Apr. 8, 1997) (Horizontal Merger Guidelines).

[14] *See* Stephen J. Rassenti, Vernon L. Smith, and Bart J. Wilson, "Demand-Side Bidding Will Control Market Power and Decrease the Level and Volatility of Prices," University of Arizona, Economic Science Laboratory (Feb. 2001). Other examples of the extensive

manipulate or attempt to manipulate market prices, market conditions, or market rules for electric energy, or result in market prices for electric energy and/or electric energy products which do not reflect the legitimate forces of supply and demand." FERC provides a non-exclusive list of five practices that the general rule specifically prohibits.[16]

We have separated our discussion of Market Behavior Rule #2 into three parts. First, we offer two observations about the proposed rule and identify potential conflicts between antitrust law and the rule. To avoid these potential conflicts, FERC may wish to revise the rule so that conduct that violates the antitrust laws also is prohibited by rule. Second, for conduct that does not violate the antitrust laws but nonetheless leads to unjust and unreasonable rates, we offer suggestions to describe more precisely the actions to be prohibited, based on conduct FERC identified in the Western Markets Report using competition policy and consumer protection insights. Third, we discuss disgorgement remedies for violations of Market Behavior Rule #2.

A. Two General Observations About Market Behavior Rule #2

First, we note that FERC proposes Market Behavior Rule #2 within the context of Section 206 of the Federal Power Act (FPA), which requires FERC to assure that wholesale electric power prices are "just and reasonable."[17] FERC has determined to rely "upon

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[16] These five practices are: (A) Pre-arranged offsetting trades of the same product among the same parties ("wash trades"); (B) transactions predicated on submitting false information to transmission providers (such as submitting inaccurate load or generation data; scheduling non-firm service as firm; or falsely designating resources that are unavailable); (C) transactions in which an entity first creates transmission congestion and then "relieves" it; (D) collusion with another party for the purpose of creating market prices at levels differing from those set by market forces; and (E) bidding the output of or misrepresenting the operational capabilities of generation facilities. 68 Fed. Reg. 40924, 40927 (July 9, 2003).

[17] 16 U.S.C. § 824e (2000).

behavior.[21] Over time, the courts and the FTC have refined the jurisprudence surrounding each type of conduct based on insights gained from adjudicative experience and from developments in economic and legal learning.[22]

Second, the general rule and the specific examples listed in Market Behavior Rule #2 use antitrust-type terms that may conflict with how those terms are employed in antitrust enforcement and, therefore, may create confusion and regulatory uncertainty for market participants. Such uncertainty may cause firms to stop making efficient investments or entering into procompetitive agreements that would be permissible under antitrust law.

For instance, the fourth example under the general rule prohibits "collusion with another party for the purpose of creating market prices at levels differing from those set by market forces." Several elements of this example may be at odds with the criteria for enforcement of prohibitions against unreasonable restraints of trade under the antitrust laws.[23] The language in the example does not explicitly focus on agreements between *competitors*, whereas antitrust enforcement does so. One interpretation of the proposed rule might be that a transaction

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[21] *See* III Areeda & Hovenkamp, Antitrust Law ¶ 630a, at 44-45 (2003).

[22] *In the Matter of Polygram Holding, Inc., Decca Music Group Limited, UMG Recordings, Inc., and Universal Music & Video Distribution Corp.*, Docket No. 9298, Federal Trade Commission Opinion and Final Order at 13 (July 24, 2003), *available at* <http://www.ftc.gov/os/2003/07/polygramopinion.pdf> ("*Three Tenors*").

[23] We have the same concerns about proposed Rule #6, which states that a "Seller shall not violate or collude with another party in actions that violate Seller's code of conduct or Order No. 889 standards of conduct." FERC appears to illustrate the collusion element in the proposed rule with the example (paragraph 35) of "a power marketer [that] used a third party to circumvent the Commission's prohibition on affiliate sales." Here the cited conduct might be more accurately characterized as an evasion of FERC's behavioral regulations (regarding conduct of affiliates) facilitated through arrangements with a third party, rather than as collusion between competitors.

[29] *See* Competitor Collaboration Guidelines, *supra* note 20, § 3.31 at 16, n. 35 ("Anticompetitive intent alone does not establish an antitrust violation, and procompetitive intent does not preclude a violation. . . . But extrinsic evidence of intent may aid in evaluating market power, the likelihood of anticompetitive harm, and claimed procompetitive justifications where an agreement's effects are otherw.,Ae7mbiguous.").

Section 5 of the Federal Trade Commission Act, by adopting and adhering to a schedule limiting hours of operation for the sale or lease of motor vehicles in the Detroit area. The alleged agreement limited weekday evening hours to Mondays and Thursdays and eliminated Saturday hours altogether, except for occasional special sales. The Commission's Final Order, among other provisions, prohibited the dealers from conspiring in any way to fix hours of operation. *Detroit Auto Dealers Ass'n, Inc.*, 111 F.T.C. 417 (1989), *aff'd in part and rev'd in part*, 955 F.2d 457 (6th Cir.), *cert. denied,* 506 U.S. 973 (1992). Charges against the respondents were resolved in a series of settlements.

[33] *See* Oliver Williamson, "Wage Rates as a Barrier to Entry: The Pennington Case in Perspective," 82 Q. J. Econ. 85 (1968). Williamson describes the economic incentives involved in *United Mine Workers v. Pennington,* 381 U.S. 657 (1965). In that case, operators of large coal mines were found to have agreed with each other and with the United Mine Workers to exclude operators of small coal mines from the market. The key conditions for the operation and profitability of this agreement were that uniform wage rates would prevail across all mines, that small coal mining operations were more labor-intensive than large coal mining operations, and that prices could be raised profitably if small coal mines left the market. Because of these three conditions, operators of large coal mines would collectively find it advantageous to offer higher wages than they would individually offer because an increase in wages, when applied across all mines, would disproportionately increase the costs of their smaller rivals and either

[36] *See Three Tenors*, *supra* note 22, at 33-35.

[37] The FTC's Deception Statement is attached to *Cliffdale Associates, Inc.*, 103 F.T.C. 110 (1984).

[38] The antitrust laws prohibit, among other things, unreasonable restraints of trade

Antitrust teaches that if the conduct is not likely to result in anticompetitive *effects*, prohibition of the conduct may lead to less efficient market operation. By analogy, prohibition of conduct that does not lead to unjust and unreasonable rates may lead to less efficient market operation.[39]

C. Disgorgement for Violations of Market Behavior Rule #2

FERC proposes to order a seller to disgorge unjust profits gained through conduct prohibited by Market Behavior Rule #2. The FTC recently released a Policy Statement on Monetary Equitable Remedies in Competition Cases that discusses when disgorgement and other equitable remedies are appropriate for antitrust violations.[40] FERC may wish to evaluate whether the three principles outlined in the FTC's Policy Statement apply to FERC's enforcement under the FPA.

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[39] Care should be taken to adjust the definition of just and reasonable rates to account for changes in the quality or other characteristics of service. For example, collaboration that results in a higher quality of service may benefit consumers but may also have a higher price. This price might be higher than the previous price in nominal terms but lower on a quality-adjusted basis.

[40] Federal Trade Commission, Policy Statement on Monetary Equitable Remedies in Competition Cases (July 2003), *available at* <http://www.ftc.gov/os/2003/07/disgorgementfrn.htm>.

remedies are likely to fail to accomplish the purposes of the antitrust laws or when disgorgement may provide important additional benefits. FERC may wish to evaluate whether these criteria are met if it decides to order disgorgement based on violation of Market Behavior Rule #2.

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[41] We generally encourage use of a cost/benefit framework in evaluating alternative regulatory approaches. It is difficult for a proposal to be justified within this framework if the compliance costs have the potential to be quite large.

[42] Often the incentives to undertake investment projects, invent new processes, or introduce new products depend upon the profits that a supplier can accumulate before other market participants emulate the first mover. Early disclosure of a firm's plans in any of these categories is likely to diminish incentives to carry out these projects. As a result, some projects may no longer be sufficiently attractive to undertake. Another potential concern is that rapid disclosure of price and quantity information to these public entities by all market participants will result in rapid public disclosure of the price and quantity involved in a high proportion of all individual transactions. Such rapid, inclusive disclosures in a market may facilitate monitoring

Market Behavior Rule #4 requires that sellers that elect to report data used to compile price indices "shall provide complete, accurate and factual information to any such publisher."[43] Although accurate price indices can be essential to efficient operation of commodity markets, imposing a highly exacting standard for reporting may actually lead to less accurate (rather than more accurate) indices. If the standard imposes high reporting costs, some firms may decide not to submit any data to the index publishers.[44] If enough transactions are not included in a price index, its accuracy with respect to price may suffer along with its accuracy with respect to volume.[45]

In some instances, a strict standard may force one or more firms to withdraw from reporting. For example, in some markets, fully accurate transactions prices are not known at the time of the sale because the transaction price includes cumulative discounts that remain unknown until the end of the year or another date in the future.[46] Absent a strict requirement for

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of a collusive agreement and make collusion more likely in that market.

[43] We assume that complete, accurate, and factual reporting to private publishers does not necessitate disclosure of individual transaction prices and volume or, alternatively, that such information will be held in confidence by the publisher if it is disclosed by individual suppliers. We encourage FERC to avoid any requirement that would tend to result in rapid disclosure of individual transaction data that could facilitate monitoring compliance with a collusive agreement among suppliers.

[44] Each firm in the market is likely to make its own cost/benefit assessment of contributing data. If the costs of doing so rise sufficiently, one or more data contributors are likely to cease participating.

[45] Unlike a situation in which a small, random portion of transactions data may be used with statistical confidence to report on the characteristics of all transactions, here the sample would not be random, and estimates for the whole population of transactions might well be biased.

[46] Whether or not such discounts already exist in electricity supply contracts, they may be advantageous to customers and may become more common in electricity supply

reporting complete and accurate price data, a supplier could contribute to the accuracy of price indices by reporting its price and volume for known transactions, its expected volume discounts, and the volume covered by such discounts. FERC may wish to provide some leeway for reporting best estimates of prices.

V. Conclusion

FERC proposes new behavioral rules to curtail anticompetitive behavior identified in its investigation of wholesale electricity prices in western markets during 2000 and 2001. Despite its present focus on additional behavioral rules, we encourage FERC to emphasize efforts to create structurally competitive markets. We believe that structurally competitive markets offer a more certain and effective remedy for existing market power than additional behavioral rules. Efforts by FERC and the states to expand geographic markets by implementing efficient RTOs, to remove entry impediments, and to increase the price responsiveness of demand are all important elements in creating structurally competitive markets.

We are concerned about FERC's use of the terms "collusion" and "legitimate business purpose" in proposed Market Behavior Rule #2. We encourage FERC to confirm that a seller's violation of the antitrust laws also violates Market Behavior Rule #2. FERC also may wish to specify that deceptive conduct can lead to unjust and unreasonable rates that violate the FPA, even if it does not run afoul of the antitrust laws. Moreover, FERC may wish to incorporate the concepts of materiality and confidentiality into proposed Market Behavior Rules # 3 and 4. Such clarifications are warranted because excessively detailed rules that conflict with established

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contracts in the future.

norms for competitive behavior, as defined by the antitrust laws, may distort investment, output, and pricing decisions and result in serious harm to consumers.

August 28, 2003