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concentration but also evaluates whether market conditions are such that a seller, or group of sellers, would be likely to exercise market power. In addition to assessing market power, FERC may wish to take into account the potential costs, including distortions in investment incentives that may result from price regulation in deciding applications for market-based pricing authority.

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The FTC is an independent agency of the federal government responsible for maintaining competition and safeguarding the interests of consumers through enforcement of the antitrust and consumer protection laws and through competition policy research and advocacy. In the electric power industry, the FTC often analyzes regulatory or legislative proposals that may affect competition or the efficiency of resource allocation and reviews proposed mergers involving electric and gas utility companies. 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 to competition issues. As part of its competition advocacy program, the FTC has released two staff reports on electric power industry restructuring issues at the wholesale and retail levels.[7] In addition, the FTC and its staff have filed numerous competition advocacy

[7] *FTC Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform* (July 2000),

comments on electricity restructuring efforts with FERC and the states. The FTC staff also contributes to competition filings with international competition organizations.[8]

II. Description of Historical Contestable Load Analysis

The historical contestable load analysis proposal compares total wholesale load seeking competitive supply alternatives to the total competitive generation resources that are available to serve those loads during the test period. For the wholesale supplier seeking market-based rates, its available competitive generation consists of its total generation minus its load obligations (which consist primarily of obligations to serve native load).[9] According to the proposal, if available competitive generation resources are twice as large as the load seeking supply in the test period, and if the applicant can demonstrate that competitive generation resources are not "unduly concentrated," then supply. These considerations – all of which are relevant – include the amount of available generation in an area, the amount of demand in the area not covered by native load obligations, and the amount of transmission transfer capability available to bring in electric power from other areas.

delineation under the Merger Guidelines examines whether it would be profitable for a hypothetical monopolist in the proposed market to "impose at least a small but significant and nontransitory increase in price."[14] A chief reason why a price increase might not be profitable is that buyers could turn to suppliers outside of this proposed market who could undercut the price increase. In such a case, these close substitute products would be added to broaden the initial proposed market. One would continue to add the closest substitute products or services to the market until a hypothetical monopolist could profitably impose a small but significant nontransitory price increase.

Because the historical contestable load proposal does not include a price threshold in the assessment of available supply, it erroneously treats all suppliers as though they would be willing to operate their generators at capacity even if their variable costs for relevant outputs exceeded prevailing prices.[15] It also disregards the fact that product and

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[14] Merger Guidelines, § 1.0. Customers' responses to price changes are a key determinant of the profitability of restricting supply (raising prices above the competitive level). Also, differences in generation capacity portfolios give rise to different incentives to raise prices above competitive levels in

geographic markets vary by time of day – thus, each generating unit is not in each prescribed by the Merger Guidelines[18] takes into account contractual and legal restrictions. For example, the PJM RTO[19] restricts exports of power when reserve margins within PJM are low. If the PJM RTO declares a supply emergency within PJM, generators within PJM are obligated to curtail wholesale power sales to customers outside of PJM.[20] During peak demand periods in PJM, the proposal would assume that exports from PJM are available, when in fact they would not be.

Another example of relevant legal restrictions is state renewable fuel generation ("green power") requirements. Wholesale customers subject to state renewable resource generation requirements are legally obligated to procure a portion of their electricity supply from renewable generation sources. If this requirement is a binding constraint on

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[18] Electric demand and supply conditions at any one point in time are largely independent of those in other periods. Hence, "[i]n the current wholesale electricity market, short periods of time (*e.g.*, hour or one-half hour periods) often represent distinct product markets because electricity demand cannot easily be shifted from one time period to another and because electricity cannot easily be stored in large quantities." FTC, Analysis of Proposed Consent Order to Aid Public Comment, *PacifiCorp et al.*, FTC File No. 971 0091 (Feb. 18, 1998), *available at* http://www.ftc.gov/os/1998/02/9710091.ana.htm,

customers (that is, customers buy only as much green power as is required), then "green power" is likely to be a separate relevant product market.[21]

3. *Transmission Discrimination Affects Market Delineation*. The historical contestable load proposal ignores the potential for the transmission operator to prevent customers from switching away from the generation units it owns. It assumes that transmission discrimination is absent despite potential incentives to use transmission discrimination to reduce competition.[22]

Further, the transmission operator has incentives to select periods for historical contestable load analysis in which it did not discriminate and had no incentives to do so. There may be other periods, however, in which it did discriminate, and therefore was able to exercise market power. Consequently, the historical contestable load analysis could disregard important and common changes in market conditions. Interactions between generation market power and transmission market power that follow changes in supply[23]

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[21] For example, Maine has a requirement that 30 percent of each utility's supply come from renewable energy sources. Other states have adopted renewable requirements or are considering doing so. The FTC staff previously observed that Maine's renewable requirement could raise market power concerns regarding the subset of generators that qualify as renewable energy generators. Comment of the Staff of the Bureau of Economics before the Maine Department of the Attorney General and the Maine Public Utilities Commission regarding "The Interim Report on Market Power in Electricity" (May 29, 1998), *available at* http://www.ftc.gov/be/v980011.htm.

[22] FERC has described in detail how transmission discrimination disrupts the operation of wholesale electricity markets. *See Regional Transmission Organizations*, Order No. 2000 (Dec. 20, 1999), *available at* http://www.ferc.gov/industries/electric/indus-act/rto/iss-2000/order-2000/2000.pdf.

[23] Supply conditions are part of the analysis in the Merger Guidelines' assessment of (a) suppliers in the market and (b) entry conditions. Merger Guidelines §§ 1.3 and 3, respectively. The proposal does not address entry conditions. Additional demand conditions are taken into account in the analysis of potential adverse competitive effects in § 2 of the Merger Guidelines.

and demand conditions are potentially important and are not considered by the historic contestable load analysis.[24]

4. *Transmission Constraints Affect Market Delineation*. The proposal's treatment of transmission constraints is inconsistent with economically sound market delineation. The proposal identifies the relevant geographic market independent of the location of some of the suppliers to which customers likely would turn in the event of a price increase. By contrast, a properly delineated market contains all of the sources of supply to which customers likely would turn to in order to undermine an anticompetitive price increase imposed by one or more suppliers. Whether a customer is likely to turn to a particular alternative supplier depends on the risk that such supplier will not be able to deliver the product. This analysis is not – as the proposal suggests – a separate step to be completed after the geographic market has been delineated. Rather, it is an integral component of defining an appropriate geographic market.

IV. Conclusion

The historical contestable load proposal suffers from substantial defects. These defects involve conceptual and measurement techniques that are at odds with the sound economic framework for horizontal market power analysis set forth in the Merger Guidelines. Accordingly, the FTC recommends that FERC reject use of a contestable load in assessing generation market power.

[24] FERC Order No. 2004 consists of behavioral rules seeking to address concerns about strategic use of transmission discrimination by vertically integrated utilities to reduce wholesale competition facing affiliated generators. *See* Comment of the Federal Trade Commission before FERC in the Matter of Market-Based Rates for Public Utilities, *supra* note 2, § II.B; Comment of the Electric Power Supply Association before FERC in the Matter of Standards of Conduct for Transmission Providers, Docket No. RM01-10-000 (2002), *available at* http://www.epsa.org/forms/uploadFiles/afflconductcomments6-28.pdf.