UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

**Before the**
**United States of America**
**Federal Energy Regulatory Commission**

# Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorization; Order Establishing Refund Effective Date and Proposing to Revise Market-Based Rate Authorization

**Docket No. EL01-118-000**

## Comment of the Staff of the Bureau of Economics and the Office of the General Counsel of the Federal Trade Commission(2)

**January 7, 2002**

## I. Introduction and Summary

The staff of the Bureau of Economics and the Office of the General Counsel of the Federal Trade Commission (FTC) appreciates this opportunity to present its views concerning the Federal Energy Regulatory Commission's (FERC) proposal to revise market-based rate tariffs and authorizations. Under the proposal, authorization to charge marketpreferences. Moreover, behavioral remedies, such as reverting to regulated rates, may distort investment decisions and create other inefficiencies.

Nonetheless, if behavioral rules are used to attempt to remedy exercises of market power, we agree that FERC should clarify the conditions under which a supplier exercises its marketprices may distort the investment decisions of both suppliers and customers. Clarifying standards for granting market-based rates and the exercise of that authority is likely to improve market performance by reducing regulatory risk, thus providing increased certainty about investment incentives for suppliers and customers. To the extent that FERC continues to apply behavioral rules against the exercise of market power, we encourage FERC's efforts to clarify and increase the accuracy of the behavioral criteria it uses in granting market-based rate authority

In general, FERC has identified appropriate and reasonable definitions of the exercise of market power in the electric power context. The implementation of these definitions, however, raise potential issues that may be difficult to overcome from an antitrust enforcement perspective and an economic efficiency perspective. We discuss the antitrust issues first, followed by the economic efficiency issues, with the expectation that there may well be others.(9)

Another ambiguity in applying the proposed rules involves determining whether the price offered by a supplier is above the market price (assuming the offered price is also above the firm's full incremental costs). After the fact, such a determination is likely to be straightforward (if a mechanism for determining the market clearing price in each period exists), but a comparison between the offered price and the actual market clearing price may not distinguish between bids that constitute intentional withholding and bids that result in unintentional withholding. In a market context in which many small suppliers are all paid the market clearing price (which implies that differences in bids that exceed incremental costs, but are accepted, do not affect the revenues received by a generator), there is little incentive for suppliers to bid above incremental costs.(17) Markets that nominally provide a single price to all dispatched suppliers, however, may not function this way due to other market rules.(18) Where markets have a pay-as-bid aspect, suppliers have strong incentives to bid at a level just below the anticipated market clearing price. But the market clearing price is unknown ex ante -- therefore it is likely that some suppliers will unintentionally overestimate the market clearing price and bid accordingly.

Unless FERC can assure itself that there are no aspects of the market that function on a pay-as-bid basis, it may not be possible to separate intentional from unintentional withholding on the basis of a bid by a low-cost supplier that is

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Endnotes:

1. See endnote 2.

2. This comment represents the views of the staff of the Bureau of Economics of the Federal Trade Commission and the staff of the General Counsel's Office of Policy Studies. They are not necessarily the views of the Federal Trade Commission or any individual Commissioner. The Commission has, however, voted to authorize the staff to submit these comments. Inquiries regarding this comment should be directed to John C. Hilke, Economist and Electricity Project Coordinator in the Bureau of Economics (801-524-4440 or jhilke@ftc.gov) or Michael Wroblewski, Assistant General Counsel for Policy Studies (202-326-2155 or mwroblewski@ftc.gov).

3. FTC Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform (Jul. 2000) http://www.ftc.gov/be/v000009.htm [FTC July 2000 Staff Report]. This report compiles previous comments that FTC Staff had provided to various state and federal agencies. For example, FTC Staff has commented to FERC on electric power regulation in Docket No. RM99-2-000 (regional transmission organizations) (Aug. 16, 1999); Docket EL99-57-000 (Entergy transco proposal) (May 27, 1999); Docket RM98-4-000 (Sept. 11, 1998) (merger filing guidelines); Docket No. PL98-5-000 (May 1, 1998) (ISO Policy); Docket Nos. ER97-237-000 and ER97-1079-000 (New England ISO) (Feb. 6, 1998); Docket No. RM96-6-000 (merger policy) (May 7, 1996); Docket Nos. RM95-8-000 and RM94-7-001 (open access) (Aug. 7, 1995). The FTC staff comments are available at: http://www.ftc.gov/be/advofile.htm.

4. FTC Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform, Focus on Retail Competition (Sep. 2001) http://www.ftc.gov/reports/index.htm [FTC September 2001 Staff Report].

5. The discussion occurs within the context of FERC's authority to regulate rates and its decision to seek some of the benefits of competition in wholesale electric power markets by granting authority to charge market based-rates within

17. See Alfred E. Kahn, Peter C. Cramton, Robert H. Porter, Richard D. Tabors, "Blue Ribbon Panel Report: Pricing in the California Power Exchange Electricity Market: Should California Switch from Uniform Pricing to Pay-as-Bid Pricing?" (Jan. 23, 2001).

18. See, e.g., Scott Harvey, William W. Hogan, "Issues in the Analysis of Market Power in California," working paper of Oct. 27, 2000 http://www.whogan.com (describing the implications of the ISO's "rational buyer" approach to securing ancillary service and the means of selecting generators to provide real-time intra-zonal congestion management). See also Market Surveillance Committee of the California Independent System Operator, Frank A. Wolak, Chairman, "Report on Redesign of California Real-Time Energy and Ancillary Services Markets (Oct. 18, 1999).

19. In providing estimates of the social costs of market power, some analysts include wealth transfers (as well as the dead weight loss), in part because firms have incentives to spend up to that value to defend the exercise of market power. (For discussion, see, e.g., F.M. Scherer and David Ross, Industrial Market Structure and Economic r18 ers) 13(ex)24(er)4(c)-3(i)-1aving market power,a1(ude)(dead w)19(ei)-1(g(t)2( )]TJ ET 1 scn 70.509 33..6 470.88 12.36 re f* BT 0