

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

Long Term Transmission Rights in)
Markets Operated by Regional Transmission) **Docket No. AD05-7-000**
Organizations and Independent System)
Operators)

**Comment of the
Staff of the Federal Trade Commission¹**

I. Introduction and Summary

The Staff of the Federal Trade Commission (FTC) appreciates this opportunity to comment on the Federal Energy Regulatory Commission's (FERC's) initiatives to reduce entry impediments in wholesale electricity markets that may stem from long-term risk in obtaining transmission services.² Currently, wholesale electricity customers and their generation suppliers face substantial risk in the acquisition of long-term transmission access in markets operated by FERC-approved regional transmission organizations

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.⁶ In addition, the FTC and its staff have filed numerous competition advocacy comments on electricity restructuring efforts with FERC and the states. The FTC staff also contributes to competition filings with international competition organizations.⁷

II. The Ability to Reduce Long-Term Transmission Risk May Be Critical for Efficient Generation Entry in Areas with RTOs

A. Overview

The Notice is directed at long-term transmission rights in general, but many of the issues discussed in the FERC Staff Paper focus more narrowly on questions involving long-term FTRs.⁸ From a competition policy perspective, it is less important to focus on the specific policy instruments used to reduce long-term transmission risks. Rather, FERC may wish to focus more generally on the availability of some practicable manner to address this important element of long-term risk facing potential generation entrants,

⁶ *FTC Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform*

innovations that reduce costs to market.¹² However, efficient entry may be discouraged or delayed by high levels of risk (relative to expected returns) that cannot be managed through long-term supply contracts or other arrangements. Lack of efficient entry may harm consumers through higher prices, less customer choice, and inefficient production that wastes real resources. If FERC developed policies to mitigate long-term transmission risk, potential entrants would be able to address long-term transmission risk in the same way in which they address other major risks, such as volatile fuel prices.¹³

B. Other Risk Factors Facing Potential Generation Entrants

For a potential generation entrant, transmission price uncertainty is just one of several risks associated with entry. Generation investments are long-lived and many entry costs may not be readily recoverable if the entry fails due to higher-than-anticipated costs over the life of the generation assets. Unanticipated transmission price increases due to transmission congestion could be the cause of failed entry. A reduction in long-term risk through long-term contracts (or other means) allows the generator to reduce the likelihood that it will be forced into bankruptcy (with the attendant costs that it must bear) during the useful life of the generation assets. Risk reduction also increases the

¹² Entry is a key concept in industrial organization economics. The importance of entry conditions in the analysis of mergers is the focus of Section 3.0 of the *Horizontal Merger Guidelines*, *supra* note 11. FERC has indicated that development of competitive wholesale electric power markets is the principal goal of its regulatory reform efforts in the electric power sector.

¹³ Potential entrants face various sources of risk, many of which stem from volatile input prices that may cause fluctuations in profits. Transmission is an important input for generation entrants. Fluctuations in profits may lead to uncertainty about whether the entrant can cover its financial obligations in all periods of time over the life of the assets, in turn potentially leading to higher borrowing costs. The use of a supply contract with predetermined prices to reduce the risk of volatile prices in a spot market or in short-term bilateral trading is a form of hedging.

likelihood that the entrant will experience an orderly depreciation of its generation assets over their useful life. If longer-term risk cannot be addressed, a potential efficient entrant may be faced with an unacceptable level of risk.¹⁴ As a result, it may decide not to enter.¹⁵

A potential entrant may be more sensitive to transmission risk than an established independent generator because an entrant is likely to face different risk/return tradeoffs. Because a potential entrant has no fixed costs (but only variable costs) before it starts the entry process, it can readily turn to other investment opportunities without suffering any

¹⁴ Tolerance for risk may vary among potential entrants and will depend, in part, on the levels of risk associated with other investment opportunities available to the potential

losses.¹⁶

When risk is high and cannot be hedged, potential entrants generally need a higher expected profit level (to compensate for the increased risk they bear) before they will enter.¹⁹ As observed above, some potential entrants that would have entered, had long-term methods to reduce transmission risk been available, may not enter because they find the expected profit level insufficient to compensate them for the higher level of risk.²⁰ When efficient entry does not occur, existing market power may persist and efforts by incumbent firms to increase market power are more likely to succeed. If means to reduce long-term transmission risk were available, customers for wholesale electric power likely would face lower prices.²¹

In summary, when an investment – such as electric power generation – is long-lived and entails costs that are unrecoverable if the entrant later decides to exit the market, contracts for necessary inputs whose terms match the expected useful life of the

transmission risk. In the generation sector, long-term supply contracts are well-established means of reducing major sources of risk (*e.g.*, fuel prices). Long-term FTRs may reduce long-term transmission risk if the complexities and potential problems identified by FERC can be dealt with successfully.

III. Reducing Long-Term Transmission Risk Outside of RTOs May Be Even More Important for Efficient Entry Than Doing So Inside RTOs

A. Overview

The FTC recommends that FERC develop policies that would allow potential generation entrants and their customers to reduce long-term transmission risk in non-RTO areas (not merely in areas with an RTO). Long-term transmission risk is likely even greater for potential generation entrants (and existing independent generators) in areas of the nation without a functioning RTO. Incumbent or potential independent generators outside of RTOs face the risk of transmission price volatility and reliability problems stemming from both transmission di

B. Potential Generation Entrants Considering Locating Outside of RTOs Face an Additional Source of Transmission Risk

The previous section of this comment described the transmission congestion price risks faced by potential entrants supplying customers in areas with a fully operational RTO. Potential generation entrants in areas outside of a fully operational RTO face an additional source of transmission risk: transmission discrimination. Because the rates they can charge are regulated, a transmission-owning generator with market power at the transmission level is likely to have the incentive to exercise that market power by

In non-RTO areas, potential generation entrants as well as established independent generators may face non-price forms of transmission risk. In particular, transmission congestion difficulties outside of RTO areas are more likely to be addressed through curtailments of transmission service (in the form of transmission line loading relief orders) than through transmission pricing effects. The transmission operators outside of RTOs may have incentives and the ability to target the timing and location of curtailments toward independent suppliers. Similarly, transmission operators outside of RTOs may purposefully understate actual availability.²⁶ Under this form of transmission risk, available transmission access could be denied entirely to the entrant or the independent generator.

C. Potential Generation Entrants Considering Locating Inside RTOs Also Face Transmission Risk in Supplying Customers Outside of RTOs

To the extent that new generators are more efficient than existing generators because they utilize new technology, entrants can be expected to seek wholesale customers across broad geographic areas, especially absent transmission congestion and discrimination. Therefore, just because a generator is located within an RTO does not mean that the generator is immune to the risk of transmission discrimination and transmission congestion in non-RTO areas. Because wholesale transactions should – and

²⁶ FERC Docket No. RM05-17-000 is an initiative regarding this concern. Because reported congestion outside of RTOs may be influenced by available transfer capability (ATC) postings of transmission operators with incentives to understate ATC (in order to protect their generation assets from competition), FERC policies that encourage accurate ATC postings may also have a salutary effect on reported transmission congestion in these areas. National Electrical Reliability Council, *Long-Term AFC/ATC Task Force Final Report* (revised Apr. 14, 2005), available at ftp://www.nerc.com/pub/sys/all_updl/mc/ltatf/LTATF_Final_Report_Revised.pdf.

to some extent already do – span RTO and non-RTO areas, the transmission discrimination problems in non-RTO areas likely affect interstate supply from generators in non-RTO areas to wholesale customers in RTO areas as well as interstate supply from generators in RTO areas to customers in non-RTO areas. In recognition of the interaction between transmission risks in different areas, FERC may wish to address long-term transmission access rights in non-RTO areas as well.

IV. Policies to Reduce Long-Term Transmission Risk Should be Coordinated with Policies to Promote Efficient Transmission Investment

A. Overview

FERC may wish to coordinate its policies to reduce transmission risk with its policies to promote efficient transmission investment projects, including those whose primary benefits are in the form of enhanced reliability of the transmission system.²⁷ These two policy areas are closely related because transmission investment is often at least a partial substitute for long-term transmission rights from a transmission customer's perspective. A lack of efficient transmission investment can result in high, inefficient levels of transmission congestion that give rise to high levels of long-term transmission risk. If FERC considers the potential interaction between these two related policies, it may be able to enhance the competitiveness of wholesale electricity markets and increase both policies' likelihood of success.

B. Increased Transmission Investment Reduces Demand for FTRs

²⁷ *Comment of the Federal Trade Commission*, United States Department of Energy Matter of Designation of National Interest Electric Transmission Bottlenecks (Sept. 20, 2004), available at <http://www.ftc.gov/os/2004/09/040924nietbcomment.pdf>.

Because uncertainties about transmission congestion (and transmission discrimination in non-RTO areas) are the motivation for generators and other transmission customers to acquire FTRs or other instruments to reduce transmission risk,

V. Conclusion

The FTC encourages FERC to promote instruments that reduce long-term transmission risk in all areas of the nation in order to promote competitive wholesale electricity markets. FERC could make efficient generation entry more probable by coupling long-term FTRs (or a similar risk-reducing instrument) with policies to promote efficient transmission investment. Absent long-term FTRs (or similar means to reduce transmission risk) and efficient transmission investment, efficient potential generation entrants are likely to face high transmission pricing risk (relative to returns) that will be difficult to manage. Electricity customers may face higher prices if FERC does not promote efficient generation entry by pursuing a coordinated policy of reducing transmission risk and facilitating efficient transmission investment.

Respectfully Submitted,

Donald Clark
Secretary