





- x Pancaked rates impose added fees whenever a transmission service includes two or more transmission areas, but these increased fees do not necessarily correspond to the actual incremental costs of transmitting power across regions within an interconnect.<sup>(12)</sup>
- x Inconsistent ATC calculations create uncertainty about the feasibility of proposed wholesale market transactions. Such uncertainty discourages transmission agreements that may be efficient.<sup>(13)</sup>
- x Transmission line relief policies administratively determine which transmission trades are curtailed when transmission congestion occurs. If curtailments are biased in favor of incumbent users, for example, entrants face disproportionate risks that their transmission arrangements will be disrupted.<sup>(14)</sup> Bias in curtailment could dampen or eliminate the investment incentives of entrants that are more efficient than incumbent firms. This would harm customers b

The revised market monitoring proposals offer several specific behavioral and reporting requirements in addition to those contained in Order 2000. These additional requirements should make monitoring efforts more effective, subject to our concerns about measuring marginal costs as part of determining whether a supplier is withholding generation capacity.<sup>(25)</sup> FERC may wish to consider two additional market monitoring elements. First, FERC's efforts to develop an accurate and timely overview of the progress of the nation's electric power sector reforms, and remaining market power problems, are likely to be more successful if the MMUs use the same or very similar methods and data to evaluate and report on market conditions. Consequently, FERC may wish to include language in the Final Rule to encourage MMUs to coordinate their market analysis and reporting activities.<sup>(26)</sup> Second, if MMUs identify participant behavior that may violate the antitrust laws, it would be appropriate for them to refer such matters to the antitrust agencies.<sup>(27)</sup> FERC may wish to include a referral provision in its Final Rule.

#### **V. Promote Efficient, Customer-Oriented Transmission Service**

We continue to believe that efficient, customer-friendly operation of the transmission network is an important and appropriate goal for regulatory reforms. Accordingly, we reiterate our call for FERC to include operating efficiency in its set of minimum characteristics for RTOs and ISOs.<sup>(28)</sup> Without performance incentives and a mechanism to displace an RTO's or an ISO's board of directors, non-profit RTOs and ISOs run the risk that "independence will devolve into indifference to the quality of services, the pace of innovation, and changes in customer preferences."<sup>(29)</sup>

#### **VI. Conclusion**

FERC's present market design proposals entail greater deference to regional market design preferences. The potential benefits of variations in market design between regions within an interconnect should be weighed against the increased risk that such variations will impede efficient use of the present and future transmission network. FERC

2. The Energy Policy Act of 1992 was the first U.S. legislation directly related to wholesale market regulatory reforms in the electric power industry, but the Public Utility Regulatory Policy Act of 1978 provided the foundation for later reforms by demonstrating that independent generators could successfully be connected to the transmission network.

3. For a discussion of the benefits of competition in the electricity industry, see Paul L. Joskow, "Regulatory Reform in the U.S. Electric Power Sector," in *Deregulation of Network Industries, What's Next?* 113, 119-24 (Sam Peltzman et al. eds., 2000).

4. This comment is available at <<http://www.ftc.gov/be/v950008.htm>>.

5. See FTC Staff Comment, FERC Docket No. RM99-2-000 (Aug. 16, 1999) (FTC Staff RTO Comment); FTC Staff Comment, FERC Docket No. RM01-12-000 (July 22, 2002) (FTC Staff SMD Working Paio5/a2s4(on )13(of)2sg3(y)11( A 9Dw [(000)13e

result in dispatch of higher-cost generators within the load pocket and provide added ability and incentives for generators within the load pocket to exercise market power unilaterally or through coordinated interaction. The result of either is to raise prices in the load pocket above those in surrounding areas.

16. "We believe that many of the characteristics and functions for an RTO . . . suggest that the regional configuration of a proposed RTO should be large in scope. For example: Making accurate and reliable ATC determinations . . . resolving loop flow issues . . . managing transmission congestion . . . offering transmission service at non-pancaked rates . . . better allocate scarcity as regional transmission demand is assessed...promote simplicity and one-stop shopping . . . lower costs by reducing the number of OASIS sites . . . necessary transmission expansion would be more efficient when planned and coordinated over a larger region." RTO NOPR at 130-31.

17. Seams issues are a widespread concern that several regions of the continent are trying to address by coordinating market rules and approaches. See, e.g., "IMO of Ontario, ISO-NE and NYISO Complete Planning and Market Development Agreement" (news release dated July 17, 2002); "The Market Interface Committee of the Western Electricity Coordinating Council Organizational Guidelines" (approved by the Board of Trustees in December 2001); Christopher Eaton, "Infrastructure Issues in the Midwest: A 'Seams' Analysis," paper presented at the conference on Illinois Energy Policy for the 21<sup>st</sup> Century, Springfield, Ill. (May 23, 2002). For a general treatment of seams issues, see William W. Hogan, "Interregional Coordination of Electricity Markets," presented at the FERC Technical Conference on Interregional Coordination, Washington, D.C. (June 19, 2001).

18. This is one of the areas for improvement identified in the proposals for a combined day-ahead market in the Northeast. William W. Hogan, *supra* n. 17, at 10.

19. An extensive literature on both the theory of economic regulation and raising rivals' costs prompts our policy concern about the effects of disparities in market rules on entrants and firms that serve customers in more than one jurisdiction. The aspect of the theory of economic regulation most relevant here focuses on the incentives and ability of special interest groups to seek to bias regulations in their own favor. See George J. Stigler, "The Theory of Economic Regulation," 2 *Bell J. Econ.* 3 (1971); Sam Peltzman, "Toward a More General Theory of Regulation," 19 *J. L. & Econ.* 211 (1976). For a discussion of raising rivals' costs and its relationship to market definition, see Salop, Scheffman, and Schwartz, "A Bidding Analysis of Special Interest Regulation: Raising Rivals' Costs in a Rent Seeking Society," in B. Yandle and R. Rogowsky (eds.), *The Political Economy of Regulation: Private Interests in the Regulatory Process* (FTC 1984). The September 2001 FTC Staff Report (Ch. V) found a similar concern regarding variations among states in market rules for retail open access.

20. For a general treatment of the economics of electric power markets and the design of these markets, see Steven Stoft, *Power System Economics: Designing Markets for Electricity* at 95-106 (2002) (Chapter 1-9, "Designing and Testing Market Rules"). Use of simulation models for testing market design alternatives is discussed in William W. Hogan, *supra* n. 17, at 13-17. Examples of the extensive literature on market design in experimental markets include: Mark A. Olson, Stephen J. Rassenti, Vernon L. Smith, and Mary Rigdon, "Market Design and Motivated Human Trading Behavior in Electricity Markets," and Vernon Smith, Stephen Rassenti, and Bart Wilson, "California: Energy Crisis or Market Design Crisis?," papers presented at the University of New South Wales conference on Insights from Experimental Economics for the Design of Australian Electricity, Gas, and Environmental Markets (Mar. 2003). The Power Systems Engineering Research Center, in whose research program 11 universities participate, is conducting a wide array of experimental market research on electric power market design.

21. The FTC Staff RTO Comment and the FTC Staff SMD Comment both recognize that "economic theory and experience support using locational marginal pricing (LMP) as the basis of transmission congestion pricing."

22. Examples of the extensive literature on price-responsive demand include, for example, the September 2001 FTC Staff Report, Chapter III; Ahmad Faruqui and Stephen S. George, "Economic Analysis of Time-of-Use Pricing for Residential Customers," Charles River Associates (Dec. 21, 2001); Severin Borenstein, Michael Jaske, and Arthur Rosenfeld, "Dynamic Pricing, Advanced Metering and Demand Response in Electricity Markets," University of California Energy Institute Working Paper 105 (Oct. 2002).

23. This effort may be particularly important if national legislation is enacted to require each state to study and make decisions about real-time pricing and related policy options in the electric power industry.

24. "We encourage FERC and the states to emphasize direct approaches to creating structurally competitive markets, including policies that reduce concentration where it is a source of market power, ease entry impediments, and facilitate price-responsive demand." FTC Staff SMD Comment, Sec. II.D.

25. These caveats are discussed with respect to paragraphs 418 to 423 of the SMD NOPR in the appendix to the FTC Staff SMD Comment.

26. This issue was discussed with respect to paragraphs 406 to 412 of the SMD NOPR in the appendix to the FTC Staff SMD Comment.

27. Appendix A of the white paper proposes that MMUs be required to report to "the Commission [FERC], the regional state committee, and other appropriate state regulatory authorities." The reporting requirement could, for example, be modified by adding "and national and state antitrust authorities where competition issues arise that are under their jurisdiction."

28.