



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

Comment of the Staff of the Bureau of Economics
of the Federal Trade Commission(1)

Before the
FEDERAL ENERGY REGULATORY COMMISSION

In the Matter of
Entergy Services, Inc.

Docket No. EL99- 57 - 000

May 27, 1999

I.
Introduction and Summary

Comments can then be presented to all interested

stakeholders and local regulatory authorities.(3)

The FTC is an independent administrative agency responsible for maintaining competition and safeguarding the interests of consumers. The staff of the FTC often analyzes regulatory or legislative proposals that may affect competition or the efficiency of the economy. In the course of this work, as well as in antitrust research, investigation, and litigation, the staff applies established principles and recent developments in economic theory and empirical analysis to competition issues.

The staff of the FTC has a longstanding interest in regulation and competition in energy markets, including proposals to reform regulation of the electric power and natural gas industries.(4) Most of the FTC's reviews concern mergers

involving electric and gas utility companies.

Entergy seeks to establish a for-profit, independent transmission company affiliate (Transco) that would manage and operate the transmission lines(5) currently owned by Entergy and other transmission owners that elect to join the proposed Transco. Entergy would accomplish this by functionally unbundling(6) its generation assets from its transmission assets and placing the transmission assets in a separate affiliate, which would continue to be owned by Entergy. Transmission fees charged by the Transco would be subject to rate caps administered by FERC. Entergy describes various institutional arrangements and regulatory constraints to promote the independence of its proposed Transco affiliate, including appointment of a board to oversee the transmission assets transferred by Entergy to the proposed Transco. Entergy also describes broadly the efficiencies of vertical integration between the management and operation of the transmission grid and indicates that these efficiencies would be lost under an ISO that only manages the grid.(7)

This comment raises several issues about competition and efficiency that FERC may wish to address in its review of Entergy's Transco proposal.⁽⁸⁾ The FTC staff believes that competition and efficiency issues identified here are of general applicability and would apply not only to Entergy's Transco proposal but also to similarly-situated proposals that FERC may be called upon to review.

Entergy's proposal may pose potential vertical and horizontal threats to competition. It also may present potential efficiency benefits, but these likely could be obtained by an ISO that would both manage and operate the transmission grid. As an alternative to Entergy's Transco proposal, FERC may wish to consider an ISO structure that would both manage and operate the transmission grid, to avoid the potential vertical and horizontal threats to competition posed by the proposed Transco while capturing the vertical integration advantages identified anecdotally by Entergy. FERC also may wish to consider informally supplementing its ISO principles with the four warning signs of competition problems that the staff has identified in prior comments to various states about ISO arrangements.

II.

Entergy Continues to Have Incentives to Vertically Discriminate Against, and Raise Costs of, its Competitors in Electricity Sales (Including Generation)

Entergy proposes a wide variety of rules to establish the independence of the proposed Transco, including an independent board of trustees arrangement. The proposed governance arrangements may be inadequate for the same reasons underlying the reservations that we expressed about FERC's open access rules in our Open Access Comment.⁽⁹⁾ Behavioral rules leave in place the basic incentives (created by ownership of generation assets) to discriminate in transmission.⁽¹⁰⁾ In particular, the Transco's rules will allow the Transco to discriminate against its competitors in electricity sales (including generation) by setting rates for transmission service that are based on the Transco's own costs, rather than on the costs of its competitors. This will allow the Transco to discriminate against its competitors in electricity sales (including generation) by setting rates for transmission service that are based on the Transco's own costs, rather than on the costs of its competitors. This will allow the Transco to discriminate against its competitors in electricity sales (including generation) by setting rates for transmission service that are based on the Transco's own costs, rather than on the costs of its competitors.

ISO Warning Sign Number Two: There is no plan for generation restructuring even when there is a potential generation market dominance problem. As a general proposition, a market power monitoring office within the ISO may not be a good substitute for up-front divestiture of generation capacity if market power is present. Several states, including California, have confronted the generation market dominance issue directly and required divestitures of key generation capacity in conjunction with forming an ISO.⁽²³⁾ Divestiture that simply replaces one dominant generating firm with another is unlikely to address market power problems in generation. Divestiture to multiple buyers is likely to be necessary. In evaluating divestiture proposals, it is important to address potential biases in the divestiture process as well as partial cross-ownerships of generating plants that may thwart competition. Antitrust may not be an effective policy tool for addressing existing market power created under past regulation. Hence, state public utility commissions and FERC may be in the best position to address this aspect of restructuring as part of the ISO formation process.⁽²⁴⁾

ISO Warning Sign Number Three: The "I" part of the ISO is missing or weak. Independence is a keystone of successfully launching competition through an ISO. For competition to develop, current and prospective industry participants need to have trust in the objectivity of the ISO. If, for example, incumbent vertically integrated utilities can veto expansions of the transmission grid, or limit who may use the grid, the ISO's independence is likely to be at risk.⁽²⁵⁾ In this regard, FERC's recent order questioning the

10. Vertical discrimination and raising rivals' costs are potential competitive concerns in the electric industry because the transmission system is likely to remain a monopoly, with regulatory protections against entry as well as other entry impediments. A vertically integrated monopolist in such circumstances may have incentives to favor its own generation assets and discriminate against competitors by offering inferior or higher-priced access to the transmission grid or by seeking other methods to raise costs of rival electricity suppliers. Absent such downstream market power, the competitive concerns about vertical integration are likely to be less severe.

11. The anticompetitive behavior described here may occur regardless of whether the proposed Transco has for-profit or non-profit status.

12. If the antitrust authorities were reviewing a merger in which the acquiring entity was only in the business of generation and distribution of electric power and the acquired entity was a transmission provider in the same geographic market, an important antitrust concern would be the potential harm to consumers and competition of vertical discrimination in access to transmission services. The antitrust authorities would question the effectiveness of

20. *Id.* at 25.

21. In the context of the hypothetical merger discussed *supra*, note 12, the efficiencies attributed to the Transco are unlikely to be cognizable efficiencies as defined in the DOJ/FTC Horizontal Merger Guidelines because they could be achieved with an alternative, less anticompetitive arrangement (e.g., an ISO that also operates the grid).

22. Another disadvantage may be that it does not provide enough diversity in generation (with respect to number and type of generators) to optimize system reliability.

23. The National Association of Regulatory Utility Commissioners (NARUC) adopted a resolution at its 1998 Annual Summer Meeting in which NARUC advocates that states have a continuum of options for the mitigation of market power and that states be authorized to require divestiture of generation assets where appropriate and necessary. NARUC, Resolution Relating to Market Power in a Restructured Electric Power Industry (July 29, 1998).

24. The Administration's recent proposals respond to this concern by recommending that Congress give FERC (in consultation with the FTC and DOJ) authority to require divestiture of generation assets by generating firms that have market power in the context of wholesale competition or (in conjunction with the states) retail competition. "Comprehensive Electricity Competition Plan" (Apr. 15, 1999) <<http://home.doe.gov/policy/ceca.htm>>.

25. See James Barker Jr., Bernard Tenenbaum, and Fiona Wolf, *supra* note 19 (a report on international comparisons of ISO governance systems written in part by FERC staff); Alex Henley, Contrasts in Restructuring Wholesale Electric Markets: England/Wales, California, and the PJM, 11 *Elect. J.* 24 (Aug./Sept. 1998).

26. See FERC, Order Denying in Part and Granting in Part Rehearing and Clarification, Rejecting Proposed Settlement and Authorizing Transfer of Jurisdiction Transmission Facilities, Docket Nos. ER97-1523-000 and 001, OA 97-470-000 and 002, and EC 99-31-000, 87 FERC Stats. & Regs. 61,135 (Apr. 30, 1999).

27. "Transmission congestion" refers to conditions in which transmission lines are being used to full capacity and additional transmission efforts between a generator and load reduce the efficiency of other transmissions on the grid. Transmission congestion is most likely during peak demand (load) periods.

28. A variety of transmission congestion pricing systems have been approved by FERC for use by ISOs, and FERC may wish to compare the effects of the different systems as more experience is gained. California, for example, opted for a "zonal transmission pricing" approach. The PJM ISO has chosen to address transmission congestion problems with much more narrowly defined pricing zones. PJM's approach is termed "locational marginal pricing" or "nodal pricing." Locational marginal pricing is a transmission pricing system that attempts to take full account of transmission loop flows. Loop flows are a complication of the physics of electricity (electricity follows the path of least resistance) that results in transmission congestion arising in places and at times that are counter to the intuitive, traditional view of transmission congestion.