



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

**BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION
DEPARTMENT OF ENERGY
WASHINGTON, D.C.**

In The Matter of New England Power Pool

Docket Nos. ER97-237-000 and ER97-1079-000

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

February 6, 1998

I. Introduction and Summary

The staff of the Bureau of Economics of the Federal Trade Commission ("FTC")(2) appreciates this opportunity to respond to the Federal Energy Regulatory Commission's ("FERC's") Notice of Filing concerning market power monitoring and mitigation by the New England Power Pool ("NEPOOL") independent system operator, ISO New England, Inc.(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 natural gas and electric power industries. Staff has submitted numerous comments concerning these issues at both the federal and state levels.(4) Moreover, the FTC regularly reviews proposed mergers involving electric and gas utility companies.

To further the advance of competition, FERC has adopted rules that call for utilities to offer open, non-discriminatory access to wholesale transmission services.(5) Our Open Access Comment in that proceeding expressed concerns that (1) behavioral constraints do not remove incentives to discriminate in transmission decisions and (2) violations may prove difficult to detect.(6) We recommended consideration of operational unbundling, which would separate operation of, and access to, the transmission grid from economic interests in generation, as an alternative to behavioral rules against discriminatory access. Subsequently, FERC has approved two independent system operators ("ISOs"), which incorporate an operational unbundling approach similar to what we had advocated.

Within the context of considering an additional ISO, ISO New England, Inc., and the request for market-based rates filed by NEPOOL, FERC now entertains NEPOOL's proposal to deal with potential horizontal market power stemming from generator dominance. NEPOOL proposes a system employing behavioral monitoring by ISO New England and relying exclusively on behavioral remedies, rather than a restructuring of generation assets, if a market power problem is detected at the generation level.(7)

We believe that the potential difficulties in detecting market power and in preventing its exercise through behavioral rules identified in our previous comment also apply here. Consequently, as FERC considers this and similar proposals for forming ISOs or restructuring power pools into ISOs, it may wish to consider carefully the use of structural remedies instead of or in addition to behavioral solutions.

We take no position as to whether market power is present in the generation market or markets at issue in this proceeding. However, if FERC finds generator dominance in an initial market power assessment in this proceeding, or if ISO New England detects generator market power through its monitoring of operations, FERC may wish to consider structural remedies in order to increase the likelihood of effective competition in New England. Further, to the extent that structural remedies are not initially adopted, FERC may wish to establish a date for a subsequent evaluation of whether there is a need for structural remedies.⁽⁸⁾

II. Restructuring May Complement Behavioral Monitoring and Mitigation in Ameliorating Horizontal Market Power in Generation

In our Open Access Comment we discussed two basic difficulties with taking a solely behavioral approach to market power in the electric industry. One of the concerns was the difficulty of detecting the exercise of market power. Specifically, we observed that monitoring and mitigation through behavioral regulations could require virtually transaction-by-transaction oversight and likely would be particularly difficult when transactions are highly time sensitive, as they are in electric power.⁽⁹⁾

We believe that much the same problem is likely to exist in detecting the exercise of horizontal generation market power. Because of the need to balance supply and demand continuously in the electric industry, hour-by-hour or even half-hour by half-hour product markets are relevant, and geographic markets fluctuate with transmission congestion conditions on this same basis. Within this context, subtle bidding and generation availability decisions can have marked effects in raising prices and reducing output, and it could be very difficult to determine and document that these actions are anticompetitive. In addition, there is the risk that competitive behavior will be misidentified as

9. Open Access Comment at 8.

10. Restructuring itself may entail costs, but an assessment of the relative costs and benefits of restructuring is necessary before deciding which remedies, if any, afford the greatest net benefits.

11. Absent separation of the operation of transmission services from the ownership of generating plants, we explained, mandating equal access to the transmission grid required transmission operators to ignore their own economic interests and left incentives in place to find ways to evade regulatory constraints. Open Access Comment at 7-13.

12. The United Kingdom restructured its electrical system in March 1990. See Richard J. Green and David M. Newberry, "Competition in the British Electricity Spot Market," 100 J. Pol. Econ. 929 (1992), for a discussion of the extensive data and detailed statistical analyses used to establish the nature and extent of market power in the United Kingdom's system. In July 1993, the United Kingdom's Director General of Electricity Supply indicated that the extent of competition was not sufficient to restrain the exercise of market power by the two dominant generators. See Statement of the Director General of Electricity Supply, "Proposed Acquisition by Eastern Group PLC of 4,000MW of Plant from National Power PLC" at 2 (May 9, 1996).

13. Divestitures were completed in June 1996 to remedy the Director General's concerns. See Press Release of the Director General of Electricity Supply (June 25, 1996); Statement of the Director General of Electricity Supply, "Proposed Acquisition by Eastern Group PLC of 4,000MW of Plant from National Power PLC" (May 9, 1996).