

Prepared Statement of the Federal Trade Commission

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Chairman**

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consumers will be substantially better off in terms of lower prices and increased choices.⁽⁸⁾ These potential savings and innovations will not appear automatically, however. Ensuring the benefits

usually established in response to some market failure, perceived or actual, that makes market forces inadequate to protect consumers and promote efficiency. Even if a consensus exists that the initial decision to regulate an industry was wrong, or technology obviates the need for regulation, the impact of the regulation on the industry structure, incentives, and expectations requires that the antitrust agencies be especially sensitive in applying antitrust rules while market forces regain primacy.

Applying the antitrust rules with special care does not, however, mean a "hands off" approach. The consumer and efficiency gains from deregulation may be jeopardized without vigorous antitrust enforcement during and after deregulation. The antitrust agencies must ensure that public regulation is replaced by private competition, not private collusion or dominant firm behavior. Here, the antitrust laws' flexibility is a major advantage. Antitrust jurisprudence unfolds on a case-by-case approach, constantly adapting to new learning and new experiences. Where, as here, the deregulated world will be so different from the experience of all industry participants, it is difficult to know in advance what oversight will work best. The difficulty of predicting how the industry will look in the future suggests that fixing government oversight policy in concrete at this stage could be counterproductive. In this type of uncertain environment, flexible antitrust enforcement may be particularly important.

The little first hand experience with deregulation in electric power that is available supports the application of the antitrust laws at each stage of regulatory withdrawal. In Britain, for example, deregulation was accompanied by the sale of the government's monopoly system. The government's conventional (non-nuclear) generating capacity was divided between only two entities, and the resulting duopoly has assertedly been able to raise market prices by withholding capacity.⁽¹⁰⁾ This experience counsels in favor of continuous antitrust scrutiny of a deregulated electric power industry.

III. Application of the Antitrust Laws to the Electric Power Industry

Congress designed the antitrust laws as general enforcement principles applicable to all industries. But the application is not mechanical. Thus, in applying these laws, the Commission is always cognizant that the competitive environment is different in each industry. The electric power industry exhibits its own unique characteristics, and antitrust analysis must take account of the industry as we find it.

A. Regulatory and Structural Background

Until recently, the electric power industry was dominated by vertically integrated monopolies. A retail customer bought electric power from a monopoly supplier that owned or controlled one or more generating plants, one set of transmission wires that moved the power from the generating plants to the local distribution grid, and one local distribution grid that moved the power to the customer.⁽¹¹⁾ The economies of scale in power generation were such that no single long term contract would be sufficient to justify entry, which entailed huge sunk costs and a long lead time. In addition, the complexity of the transmission and distribution system was thought to be such that reliability could not be guaranteed if the generating capacity was supplied by an independent source.⁽¹²⁾

This vertically integrated monopoly system was, and continues to be, regulated at both the state and federal levels. In the states, public utility commissions have substantial power over company operations, including the power to set retail prices and rates of return. At the federal level, FERC regulates the interstate transmission of electricity, including the setting of transmission prices. Under the Federal Power Act, FERC is also required to approve mergers of interstate utility companies, using a public interest standard.⁽¹³⁾ In addition, the antitrust agencies are empowered to enforce the Clayton Act's section 7 prohibition against anticompetitive mergers.⁽¹⁴⁾

In the 1970s and 1980s, a number of factors converged to change the perception of the industry.⁽¹⁵⁾ Congress passed the Public Utility Regulatory Policies Act of 1978 ("PURPA"),⁽¹⁶⁾ which authorized FERC to require utilities to purchase power from qualifying independent producers. Around the same time, new natural gas generation technology, assisted by a decrease in the price of natural gas relative to other fuels, began to make it economically feasible to generate electricity in much smaller plants. This so reduced the minimum efficient scale of power plants that generation of electricity could no longer be considered a natural monopoly. One unintended effect of PURPA was to provide information showing that independent generators would not disrupt the wholesale power grid. By 1994, approximately 8% of U. S. generating capacity was independently owned. In 1992, Congress passed the Energy Policy Act,⁽¹⁷⁾ which authorized FERC to order open access to the wholesale distribution system, which FERC did under Order 888⁽¹⁸⁾ on April 24, 1996.

It is apparent that these changes are only the beginning. A number of states have seized the initiative and moved to increase competition in their local distribution systems, either by requiring open access to the transmission and distribution monopolies within their reach or by establishing independent system operators ("ISOs") to determine access and pricing.⁽¹⁹⁾ Congressional interest also has been sparked. Several options are available for federal legislation. One is to allow the state experiments to continue without federal interference. Some, believing that interstate commerce will be affected by sharpened market forces and that there is the potential for one or more states to impede the introduction of competition, believe

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that the benefits of new competition occurring in power generation reach the consumer. A key to effective competition is to provide open access

market comprises the locations of all of the alternative suppliers to which customers would likely turn if prices rose in the relevant product market.

In many industries, the more distinctive and important inquiry concerns the relevant product market, where the consumers' substitutes are determined. In the electric power industry, both product and geographic markets may prove difficult to define with absolute precision. Product markets will need to be defined, taking into account time, reliability, and interruptibility. The more difficult issue in this industry may be defining the relevant geographic market. As open access to the transmission and distribution grids becomes the norm, consumers will be able to turn to ever more distant sources of electricity. The geographic market may be national, or perhaps even international if Canadian and Mexican generators become tied into the U. S. grids. But establishing the relevant markets may be more complicated because the elements of defining the product market also change the scope of the geographic market. Electricity cannot be stored in any measurable quantities; it must be generated as it is consumed. Also, demand varies substantially not only seasonally but by time of day. Thus, the substitute sellers of electricity to any given consumer may be a number of firms offering subtly different products. Some consumers may want guaranteed reliability, while others may opt for interruptible power at lower prices. Some consumers may choose to defer power consumption to off-peak hours in return for lower prices. Each of these consumer decisions affects the definition of the relevant product market and may affect the number of potential suppliers in that market.

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how to promote the environmental features of their product without misleading consumers. In addition, the requirement of section 5 of the Federal Trade Commission Act that marketing claims be truthful and substantiated will apply to claims made in the marketing of electricity.

It may be very difficult to evaluate the types of environmental claims that are likely to be made in promotional materials for electricity. These claims might include such features as the fuel mix of a power seller (e.g., coal, nuclear, renewable resources) and the emissions associated with the generation (e.g., carbon dioxide, nitrous oxides, sulfur dioxide). When even technical experts do not agree on what is more important to the environment, it will be difficult to convey this information to consumers so that they can make a meaningful choice. Thus, effective consumer education and enforcement of the law against unfair or deceptive acts or practices will be important.

IV. Conclusion

Deregulation in a number of industries has proven to be beneficial to consumers and the competitive process. The deregulated industries exhibit lower prices, increased quality and quantity of goods and services, and heightened innovation. The electric power industry is on the verge of substantial deregulation. While it is unclear whether that process will be driven by the states or by the federal government, the outcome in either case should be that market forces will have an effect on firms long accustomed to the slower pace of regulated life.

The potential for consumer savings and increased choice is enormous, but it is certainly not guaranteed. Vigilant antitrust enforcement is an essential component of a market economy, especially in the formative years after the regulatory grasp is loosened. In particular, strong merger enforcement is necessary to ensure that the inevitable restructuring does not result in the accumulation and abuse of private market power. The Commission stands ready to provide this enforcement to protect the consumer gains that should follow the introduction of market forces to the electric power industry.

1. This written statement represents the views of the Federal Trade Commission. My oral presentation and response to questions are my own, and do not necessarily represent the views of the Commission or any other Commissioner.

2. See Comment of the Staff of the Bureau of Economics, Federal Trade Commission, "Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities," Dkt. No. RM96-6-000 (Aug. 7, 1995) ("BE/FERC I").

3. See Comment of the Staff of the Bureau of Economics, Federal Trade Commission, "Inquiry Concerning Commission's Merger Policy Under the Federal Power Act," Dkt. Nos. RM95-8-000 and RM94-7-001 (May 7, 1996) ("BE/FERC II").

4. See Comment of the Staff of the Bureau of Economics of the Federal Trade Commission to the South Carolina Legislative Audit Council on The Statutes and Regulations Covering the South Carolina Public Service Commission (Feb. 28, 1994); Letter to The Honorable Kim Malcolm, Administrative Law Judge, Public Utilities Commission of the State of California, from Ronald S. Bond, Acting Director of the Bureau of Economics, Federal Trade Commission, enclosing South Carolina Comment (June 8, 1994).

5. 15 U.S.C. 41-58.

6. 15 U.S.C. 12-27.

7. 15 U.S.C. 18.

8. See R. Crandall and J. Ellig, *Economic Deregulation and Customer Choice: Lessons for the Electric Industry*, Center for Market Processes at 2-3 (1996) (within 10 years of substantial deregulation, prices in the natural gas, long distance telecommunications, airlines, trucking, and railroad industries decreased between 25 and 50 percent while quality of service improved).

9. In the electric power and telephone industries, for instance, regulatory agencies require providers to offer basic, low-

