

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on the Motion of the Commission)
In Regard to Reforming the Energy Vision: DPS Staff) Case 14-M-0101
Straw Proposal on Track One Issues)

REPLY COMMENT OF THE STAFF OF THE FEDERAL TRADE COMMISSION¹

October 23, 2014

I. Introduction

The Federal Trade Commission (FTC) staff appreciates this opportunity to submit a comment in reply to certain comments filed last month in this proceeding before the State of New York Public Service Commission (NY PSC). The NY PSC has requested input concerning the NY PSC staff's Straw Proposal on Track One Issues in the Reforming the Energy Vision (REV) project.²

We commend the NY PSC and its staff for their efforts to rethink the role of the electricity distribution system in the face a number of key developments. Those developments include (1) important technical advances in distributed energy resources (DERs); (2) increasing concerns about the environmental impacts of fossil-fueled generation; and (3) growing evidence that conventional power supplies may lack the resilience to satisfy electricity customers' differing preferences for increased reliability. Our comment draws on the FTC's experience both in enforcing competition laws and in advising state and federal regulatory agencies about the competitive effects of an array of regulatory programs focused on the electric power system.

Most fundamentally, the NY PSC staff's Straw Proposal contemplates a transformation of the function of the electric distribution system. This transformation would involve the adoption of a Distributed System Platform (DSP) framework for the distribution stage of the electric industry. This step, which is akin to creating a separate system operator at the distribution level of the industry, would be a departure from the historic design and operation of the electricity distribution stage.

¹ This comment expresses the view of the FTC's Office of the General Counsel, Office of Policy Planning, and Bureau of Economics. The comment does not necessarily represent the views of the FTC or of any individual Commissioner. The Commission, however, has voted to authorize the filing of this comment.

² State of New York, Department of Public Service, "Developing the REV Market in New York: DPS Staff Straw Proposal on Track One Issues" (Aug. 22, 2014) ("Straw Proposal"), available at <http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId=%7BCA26764A-09C8-46BF-9CF6-F5215F63EF62%7D>.

the advantages of such a selection process that would entail an objective and transparent evaluation of the costs and benefits associated with different potential DSP operators. Section IV addresses the issue of potential distribution service discrimination against independent DER owners by DSP operators that also own DERs. The potential for such discrimination is the genesis of our recommendation in Section III that the NY PSC institute a competitive selection process to choose DSP operators – a process that would weigh the associated costs and benefits of different applicants for the DSP operator role.

In addition, to a considerable extent, the Straw Proposal would allow each incumbent distribution utility to invest in DERs in its own distribution territory. The Straw Proposal would thus fail to take full advantage of the lessons learned about vertical market power and associated transmission discrimination (in the form of lower quality or more costly transmission service) during the restructuring of wholesale electricity markets.⁶ The initial comments of NRG Energy and the National Energy Marketers Association (NEM), among others, also expressed a concern about the Straw Proposal’s treatment of vertical market power issues.⁷ As the Federal Energy Regulatory Commission (FERC) concluded in Order No. 2000, it has been difficult to detect, document, and prevent violations of behavioral rules against discrimination in transmission services, and thus behavioral rules have been insufficient to prevent transmission monopolists from using transmission discrimination to raise the costs and risks of rival centralized

⁶ See Section IV of this comment.

⁷ NRG Energy, an independent power producer, asserted: “[A]llowing utilities to own and operate DERs in competition with competitive entities will result in anti-competitive pricing, barriers to entry, and bias, and will drive away competitive investment in DERs.” Initial Comments of NRG Energy, Inc. to the DPS Staff Review Proposal on Track One Issues, at 2 (Sept. 22, 2014), *available at*

<http://documents.dps.ny.gov/public/Common/ViewDoc.aspx?DocRefId={403F3AE0-09F4-4184-9BB8-755D442CA8F3}>. Similarly, NEM contended: “[A]fter nearly two decades of

experience with competitive retail markets, it is abundantly clear that the anti-competitive

generators.⁸ With regard to the distribution system, we similarly doubt that behavioral rules – intended to curb distribution service discrimination that could reduce the competition faced by utility-owned DERs – will be sufficient by themselves to remedy these concerns over distribution service discrimination. Discrimination in electric system operations at any stage of moving power from generators (or other DERs) can be very subtle, and even the appearance of discrimination in the provision of such services can discourage investment in beneficial DERs in New York by raising the perceived risks and costs facing such investments. To address this concern, we recommend that the NY PSC and its staff revise the Straw Proposal to include: (1) an open competitive process to select each DSP operator with selection criteria that include preventing distribution service discrimination and alleviating perceptions of such discrimination; and (2) one or more independent DSP market monitors (also selected through a competitive process) to augment the enforcement and market monitoring efforts of the NY PSC and its staff.

We also encourage the NY PSC staff to consider two related topics for inclusion in the Straw Proposal, as mentioned in Section V of this comment.

II. Interest and Experience of the FTC

The FTC is an independent agency of the United States Government responsible for maintaining competition and safeguarding the interests of consumers. The FTC does so through law enforcement, policy research, and advocacy. For example, in the field of consumer protection, the FTC enforces Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive acts or practices. In its competition mission, the FTC enforces antitrust laws regarding mergers and unfair methods of competition that harm consumers. In addition, the FTC often analyzes regulatory or legislative proposals that may affect competition, allocative efficiency, or consumer protection. It also engages in considerable consumer education through its Division of Consumer and Business Education.⁹ In the course of all of this work, the FTC applies established legal and economic principles as well as recent, innovative developments in economic theory and empirical analysis.

The energy sector, including electric power, has been an important focus of the FTC’s merger review and other antitrust enforcement, competition advocacy, and consumer protection efforts.¹⁰ The FTC and its staff have filed numerous comments advocating competition and

⁸ See the italicized material in the body of Section IV of this comment (presented in a less abridged form in the Appendix).

⁹ For an overview of the FTC’s education efforts, see the FTC staff’s comment to the Consumer Financial Protection Bureau concerning “Request for Information on Effective Financial Education,” Docket No. CFPB-2012-0030 (Nov. 2, 2012), available at <http://www.ftc.gov/os/2012/11/1211cfpb.pdf>.

¹⁰ See, e.g., Opening Remarks of the FTC Chairman at the FTC Conference on *Energy Markets in the 21st Century: Competition Policy in Perspective* (Apr. 10, 2007), accessible at <http://www.ftc.gov/news-events/events-calendar/2007/04/energy-markets-21st-century-competition-policy-perspective>. FTC merger cases involving electric power markets have included *DTE Energy/MCN Energy* (2001) (consent order), accessible at

consumer protection principles with state utility commissions, state legislatures, the Department of Energy (DOE), and FERC.¹¹ In particular, we have filed a number of advocacy comments concerning restructuring of wholesale electricity markets, DR, dynamic pricing, and the interactions of these developments with retail competition.¹² The FTC's competition advocacy

<http://www.ftc.gov/enforcement/cases-and-proceedings/cases/2001/05/dte-energy-company-and-mcn-energy-group-inc>; and

program also has issued two staff reports on electric power industry restructuring issues at the wholesale and retail levels.¹³ In addition, the FTC staff (along with staff from FERC, the Department of Justice, the Department of Agriculture, and DOE) contributed to the work of the Electric Energy Market Competition Task Force, which issued a *Report to Congress* in the spring of 2007.¹⁴

III. Straw Proposal § III.A: “Identity of the DSP Provider”

The Straw Proposal’s blanket administrative determination that each incumbent distribution utility should serve as its own DSP operator does not offer potential rival DSP operators any opportunity to show how they can benefit customers and surpass the distribution utilities in avoiding the potential distribution service discrimination threats outlined in the Straw

[rules/131114delawareretailelectric.pdf](http://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comment-rules/131114delawareretailelectric.pdf); Comment Before the Public Utility Commission of Texas in the Rulemaking Regarding Demand Response in the Electric Reliability Council of Texas (ERCOT) Market, Project No. 41061 (Mar. 11, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comment-

Proposal. Nor does it motivate the distribution utilities seeking to serve as their own DSP operators to think creatively about ways to minimize the actual or perceived risk of distribution service discrimination. If the REV process lacks a focus on open competition in the selection of DSP operators, it may fall short of its potential to benefit New York electricity customers, who generally will be worse off than under a

Conclusion on Competitive Designation of DSP Operators

When a decision is as important to the success of the REV process as the selection of DSP operators, we encourage the NY PSC and its staff to rely on an open competitive selection process rather than on an administrative determination. Specifically, we encourage revisions in the Straw Proposal to incorporate a competitive procurement process to determine the DSP operator in each distribution territory, leaving open the possibility that applications for the DSP designations might show that consolidation of two or more DSP territories under a single DSP operator would provide net benefits for customers.

IV. Straw Proposal § VI: “Mitigating Market Power”

Concerned about the prospect of distribution utilities’ vertical and horizontal market power, New York was one of the jurisdictions that encouraged distribution utilities to divest most generation facilities. Now, based on several factors described in Section III.A of the Straw Proposal, there could be a rebundling of distribution and generation by allowing distribution utilities to invest extensively in DERs. At the same time, the Straw Proposal also acknowledges

and its staff to highlight issues involving possible distribution service discrimination by taking account of those issues in the competitive procurement criteria for selecting each DSP operator. We base our recommendation on the lessons learned about transmission service discrimination in the process of restructuring the wholesale electricity market, as explained below. At a minimum, a DSP operator applicant should bear the burden to demonstrate that it will not engage in distribution service discrimination against other DER investors. A DSP operator application should be downgraded or rejected if it does not effectively address concerns over distribution service discrimination. A sufficient case would include ways in which the applicant proposes (1) to eliminate its own incentives to discriminate in providing distribution services and (2) to facilitate the detection, documentation, and prevention of distribution service discrimination.

Although DERs and related advances in technology are major developments in the electric power industry, it remains uncertain how to confer the benefits of these advances on customers. DERs are a major development, but they are not the first such development in the electric power industry. In the late 1970s, initial efforts to remove barriers to less fossil-fuel-dependent types of generation led to regulatory changes (*e.g.*, the Public Utility Regulatory Policies Act of 1978) as well as to the recognition that the transmission system could be adjusted to accommodate independent power producers of many types.¹⁹

The period preceding FERC's promulgation of Order No. 2000 saw policy developments involving experimentation with various ways to unbundle the transmission system from other utility operations, in order to address concerns over discrimination in transmission service while preserving economies of vertical integration, scale, and scope. A key impetus for putting grid operations in the hands of ISOs and RTOs was the realization that simple behavioral rules against transmission service discrimination would not prevent such discrimination (or the perception of such discrimination) and could not deliver to customers all of the available advantages of wholesale competition. At the same time, the decision to create ISOs and RTOs – rather than to require utilities to divest transmission facilities outright – rested in part on an understanding that ISOs' and RTOs' operation of the transmission grid would not entail as many lost economies of vertical integration or increased transaction costs as might stem from a change in transmission ownership patterns or a disruption in the existing arrangements used to build or maintain transmission lines or connect generators to transmission facilities.²⁰

With respect to FERC Order No. 888, the FTC and its staff repeatedly raised this concern about relying exclusively on behavioral rules to prevent transmission service discrimination.

¹⁹ Electric Energy Market Competition Task Force, *Report to Congress*, *supra* note 14, at 19-23.

²⁰ Some utilities eventually decided that it would be worth more to concentrate their business at the distribution level than to preserve economies of vertical integration between transmission and distribution. Thus, although they were never required to do so, these utilities sold their transmission assets to newly formed transmission-only utilities ("Transcos"). The largest Transco, ITC, owns parts of the transmission grid operated by the Midcontinent (formerly Midwest) Independent System Operator.

Moreover, as we observed above regarding the scope of DSP operations, we recommend further consideration of whether consolidation of DSP areas for market monitoring would be a better way to deliver benefits to electricity customers.²⁴

V. Additional Considerations

We encourage the PSC staff to address the following questions as additions to the Straw Proposal, particularly if distribution utilities serve as DSP operators and invest in DERs within their respective distribution territories:

x If

APPENDIX

Excerpt from FERC Order No. 2000
Regarding Transmission Discrimination²⁵

Continuing Opportunities for Undue Discrimination

The NOPR explained that the Commission considers allegations of discrimination, even if not reduced to formal findings, to be a serious concern for two reasons. First, this can be indicative of additional, unreported, discriminatory actions, because there are significant disincentives to filing and pursuing formal complaints that would result in definitive findings.²⁷ The NOPR expressed a concern that actual problems with functional unbundling may be more pervasive than formally adjudicated complaints would suggest. Second, the NOPR explained that allegations of discrimination are serious because, if nothing else, they represent a perception by market participants that the market is not working fairly. If market participants perceive that other participants have an unfair advantage through their ownership or control of transmission facilities, it can inhibit their willingness to participate in the market, thus thwarting the development of robust competition. The NOPR added that such mistrust can also harm reliability.

The NOPR explained the potential for undue discrimination increases in a competitive environment unless the market can be made structurally efficient and transparent with respect to information, and equitable in its treatment of competing participants. Also, a system that attempts to control behavior that is motivated by economic self-interest through the use of standards of conduct will require constant and extensive policing and requires the Commission to regulate detailed aspects of internal company policy and communication. The NOPR added that functional unbundling does not necessarily promote light-handed regulation and undoubtedly imposes a cost on those entities that have to comply with the standards of conduct and abide by rules that limit the flexibility of their internal management activities. The NOPR stated that the perception that many entities that operate the transmission system cannot be trusted is not a good foundation on which to build a competitive power market, and it created needless uncertainty and risk for new investments in generation.

²⁷ Here, footnote 70 of Order No. 2000 reads: “As noted in the NOPR, transmission customers are reluctant to make even informal complaints because they fear retribution by their transmission supplier; the complaint process is costly and time-consuming; the Commission's remedies for violations do not impose sufficient financial consequences on the transmission provider to act as a significant deterrent; and, in the fast-paced business of power marketing, there may be no adequate remedy for the lost short-term sales opportunities in after-the-fact enforcement.” (Citation omitted.)