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Assessing Competition in Electricity Markets: Perspectives from the Federal Trade Commission*

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**These comments reflect the views of the author and do not necessarily reflect the views of the Commission and any individual Commissioner.*

Market Power In Electricity Markets

- Introduction to the FTC
- Evaluation of Market Power Under the Federal Antitrust Statutes
- Assessment of State Retail Competition Programs

Introduction to the FTC

- Competition agency
  - The FTC shares with the Department of Justice the ability to prohibit corporate acquisitions that may tend substantially to lessen competition in violation of the Clayton Act.
  - The FTC enforces Section 5 of the FTC Act that prohibits unfair methods of competition in or affecting commerce.
    - Unfair methods of competition generally include any conduct that would violate Sections 1 and 2 of the Sherman Act. (the Department of Justice also enforces the Sherman Act).
- Consumer protection agency
  - The FTC enforces Section 5 of the FTC Act that also prohibits unfair prevent unfair or deceptive acts or practices in or affecting commerce.
- Business trends

Introduction to the FTC: Activities in the Electricity Restructuring Arena?

- Participated in proceedings in over a dozen states and at FERC involved with restructuring the electricity industry.
  - How to apply traditional competition and consumer protection principles to restructuring efforts.
  - Examples, measuring market power, environmental information disclosures.
- FTC Workshop (September 1999)
- July 2000 Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform
- September 2001 Staff Report: Focus on Retail Competition

Introduction to the FTC: Electricity Competition and Consumer Protection Principles

- Competition Principles
  - Eliminate Substantial and Durable Horizontal Market Power in Electricity Generation Markets.
  - Remove Incentives for Vertically Integrated Firms to Engage in Undue Discrimination and Cross-Subsidization.
- Consumer Protection Principles
  - Foster Accurate, Non-Deceptive Information Disclosure to Customers About Price and Service Offerings.
  - Promote Uniform Disclosure of the Price and Other Relevant Attributes of Offers to Customers.

Evaluation of Market Power Under the Federal Antitrust Statutes

- What is Market Power?
  - The ability of a firm, alone or in concert with other firms, profitably to maintain the prices of a product above competitive levels for an extended period of time.
  - The seller is a price-maker, not a price-taker.
- Examples of Market Power in Electricity Markets
  - Withholding of generation
  - Managing the transmission grid to disadvantage rivals

Evaluation of Market Power Under the Federal Antitrust Statutes

- Sherman Antitrust Act
  - Section 1 prohibits any unreasonable contract, combination or conspiracy which restrains trade or commerce and affects interstate or foreign commerce. Examples: Agreements to fix prices or divide markets.

  - Section 2 prohibits monopolization, attempts to monopolize, and conspiracies to monopolize. This requires two elements: the possession of monopoly power in the relevant market and the willful acquisition or maintenance of that power as distinguished from the growth or development as a consequence of superior product, business acumen or historical accident. ("Big and Bad").

Evaluation of Market Power Under the Federal Antitrust Statutes

- Clayton Act
  - Section 7 of the Clayton Act prohibits mergers and acquisitions in which the effect of such merger of acquisition may be substantially to lessen competition, or to tend to create a monopoly.
- Department of Justice/FTC Merger Guidelines

Evaluation of Market Power Under the Federal Antitrust Statutes

- Identify relevant product and geographic markets.
  - 5% test for both markets.
- Measure levels of concentration in each market and determine if competitive concerns are raised.
  - HHI’s and computer simulation models.
- Evaluate entry conditions and determine whether that entry would counteract or deter any of the competitive concerns
  - Is entry timely and sufficient?
- Conclude whether prices are likely to exceed competitive levels.

Evaluation of Market Power Under the Federal Antitrust Statutes

- Common Misperceptions
  - Market power problems can be dealt with adequately by enforcement of the antitrust laws.
  - Illegal behavior is not easily detected.
  - Antitrust cannot change existing market structures.
- Common Assumption
  - All businesses want to become unregulated monopolists.

Evaluation of Market Power Under the Federal Antitrust Statutes

- What can be done if market power is found?
  - Structural remedies (eliminate incentives to exercise market power, but may sacrifice economies of scope and scale)
    - Divestiture, long-term contracts
    - Expand transmission capacity and new generation
  - Behavioral Remedies (continue incentives to exercise market power, hard to detect, costly to comply)
    - Open access rules, RTO market monitoring
  - Increase Customer Responsiveness

Assessment of State Retail Competition Plans: FTC September 2001 Staff Report

- Congress requested that the Commission produce a report on:
  - Features of state retail plans that have benefited consumers and those that have not; and
  - Whether states have sufficient authority to implement successful retail competition programs.
- Staff researched and examined the features of 12 restructuring plans in states that have introduced, or are about to introduce, retail competition.

Overall Thoughts on the State of Retail Competition

- Competition is likely to result in lower prices, higher quality, and greater innovation than occurs under a regulatory regime.
- The states are in a *transition* period. No state has completed the transition period.
- Most policy choices that confront states during this transition period involve *tradeoffs*, with each option presenting potential costs and benefits.
- Given the transition, many of the expected benefits of competition have not yet emerged.

Report Themes

- Competitive Wholesale Markets Are Important to Achieving Effective Competition in Retail Markets.
- Policies Are Needed in Retail and Wholesale Markets That Will Increase Demand-Side Responsiveness.
- State Policies Should Be Designed to Minimize Entry Barriers Into Retail Markets.
- Consumer Protection Policies Affect Both Consumers and the Likelihood of New Entry.

Importance of Competitive Wholesale Markets

- Independent and nondiscriminatory open access to the transmission grid is essential.
  - Current ISOs have assisted the development of retail competition.
  - Accurate congestion pricing is mandatory.
- Pricing transmission services the same, regardless of the use, assists competition.
  - No preference should be afforded any particular transmission use.

Importance of Competitive Wholesale Markets (cont'd)

- Regional transmission siting is necessary.
- States have sufficient authority over generation siting and most have eliminated any "need" requirement.
- Interconnection standards for new generation should be streamlined and made uniform.
- Eliminate technical, regulatory, and business practices that impede interconnection of distributed resources.

Increase Demand-Side Responsiveness

- Retail electricity markets generally do not allow consumers to protect themselves.
  - Variable pricing for retail customers, based on real-time prices, or time-of-day prices, are needed so that customers can respond to the rapid and substantial changes in wholesale prices of obtaining electricity.
  - Retail suppliers should be able to offer competitive metering and billing services.
- Increased price sensitivity will help constrain existing or potential market power in generation.

Entry is at the Heart of the Transition to Competition

- State Dilemma: Some means must be chosen to facilitate the long-run, efficient entry of entities to compete with the incumbent in both generation and retail marketing.
  - States have generally relied on new entry by electricity marketers or utilities expanding beyond their franchise territory, rather than breaking up existing generation assets
  - Exceptions (*e.g.*, CA, ME, MA, NY).
- Initial Policy Decision: Customers must still have access to this essential service.

Standard Offer Service Pricing Is the Most Significant Factor Affecting Entry

- Standard offer service (SOS) is offered to those customers that have not chosen a new supplier or whose supplier has exited the market.
- SOS is usually offered by the incumbent and has been structured to resemble pre-restructuring rate design used by the utility (*i.e.*, average pricing by customer class).
- The SOS price is the price that new suppliers compete against to attract customers.

Standard Offer Service

- Determinants of SOS Pricing
  - Whether changes in fuel and other wholesale market price increases are passed through to SOS prices.
  - Length of stranded cost recovery period.
  - Initial rate reductions, some of which are not based on cost reductions.
- SOS providers should have flexibility to acquire electricity in the best way to serve their customers.
- States should use pilot programs to test alternatives to SOS programs.

Effect of Consumer Protection Policies: Too Soon To Tell

- Retail electricity supplier requirements
  - Licensing
  - Customer switching procedures
- Consumer information
  - Uniform disclosure
- Distribution utility behavior
  - Protect against improper cost-shifting
  - Exercise discrimination in the provision to retail suppliers of inputs over which the utility has a monopoly.

Conclusion

- Better understanding of who the FTC is and what we do.
- Understand how the antitrust authorities evaluate market power.
- Appreciate the complexities of retail restructuring plans and the need to get market structure right at the beginning.