**Before the**
**United States of America**
**Federal Energy Regulatory Commission**

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| **Wholesale Competition in Regions )** | **Docket No. RM07-19-000** |
| **With Organized Electric Markets )** | **Docket No. AD07-7-000** |

**Comment of the**
**Federal Trade Commission**

September 13, 2007

## I. Summary

The Federal Trade Commission ("FTC") appreciates the opportunity to comment on proposals of the Federal Energy Regulatory Commission ("FERC") to enhance consumer welfare and increase economic efficiency in electric power markets by strengthening competition in regions with Regional Transmission Organizations ("RTOs") or Independent System Operators ("ISOs").[1] The proposals are contained in an Advance Notice of Public Rulemaking ("ANOPR")[2] that sets forth the most recent in a series of regulatory reform proposals issued by FERC over the last dozen years.[3]

[1] RTOs and ISOs are the result of a form of "structural unbundling" pursuant to which the control of the transmission system in a region has been transferred to an independent transmission operator in order to eliminate a transmission owner's ability to discriminate against independent electric generating firms. FERC has approved RTOs and ISOs in California, New England, New York, the Mid-Atlantic states, the Midwest, and portions of the South Central states north and east of Texas. (Most of the grid in Texas also operates like an RTO, although Texas utility regulators – rather than FERC – have jurisdiction over most of the grid in Texas at the wholesale level, in addition to regulating retail activities.)

[2] The ANOPR was published in the Federal Register on July 2, 2007 (72 Fed. Reg. 36275).

[3] Some of the proposals have been specified in energy legislation, while others have been at FERC's initiative. The major laws affecting FERC regulatory reform proposals include the Energy Policy Acts of 1992 and of 2005.

These proposals cover a number of subjects: the responsiveness of demand to changes in wholesale electric power prices; the difficulties of arranging long-term power supply contracts; concerns about the objectivity with which market monitors carry out their duties; and alleged deficiencies in grid operators' responsiveness to customers in organized power markets.

A major long-term objective of these proposals is to replace reliance on traditional, cost-based rate regulation with reliance on vigorous competition to determine prices in wholesale electric power markets. We encourage this development. Technological improvements have made smaller electricity generators more cost-efficient, and these smaller generators thus have become competitive sources of power supply. Moreover, computerization has made electricity transmission more efficient. Electricity can also be traded more easily in energy markets. These factors have combined to increase competition in electricity generation overall. Many economists now believe that electric power generation is not a natural monopoly, *i.e.*, it is not a market in which a larger competitor will always have a competitive advantage due to economies of scale.[4]

One of the greatest impediments to electric power market reform to date has been retail price regulations that reduce or eliminate the incentive of retail customers to curtail consumption when wholesale prices increase. States typically set a single retail price for each class of electricity customer of a given utility. This price reflects historic costs averaged over an extended period and does not vary with the wholesale price in real time. Because the retail price does not increase when the wholesale price increases in real time,

[4] Sally Hunt, *Making Competition Work in Electricity*, Ch. 3 (2002).

an increase in the wholesale price does not lead to a reduction in the quantity of electricity demanded. The quantity demanded at wholesale is equal to the quantity demanded at retail and is not influenced by the wholesale price in real time.[5] The resulting artificially low elasticity of wholesale demand with respect to wholesale prices makes electricity markets susceptible to attempts by electric power generators to raise prices above the competitive level, to the detriment of consumers.

"Demand response" (or "DR") refers to a reduction in consumption of electricity in response to an increase in price. FERC's ANOPR focuses on the problem of limited DR and on other competitive concerns. Such concerns include rules or policies that can impede consumers' access to preferred suppliers of electricity or can block entry by independent electricity generators. Either type of impediment can make it profitable for incumbent generators to maintain prices above the competitive level. FERC points to:

- Regulatory policies that add to the transaction costs associated with long-term power supply contracts between customers and the generators that otherwise would be the lowest-priced suppliers.

- Organizational design features of some RTOs and ISOs – such as their management's direct control of the market monitor – that can increase the perceived risk of exclusionary conduct because they undermine the independence of market monitors.

- Deficiencies in the quality of service provided by RTOs and ISOs that frustrate customers' ability to minimize their costs of searching for and accessing preferred suppliers (as reported by some large industrial customers in states that allow retail customers to pick their own suppliers).

[5] Consumption by retail customers (plus transmission and distribution losses) must be closely and promptly matched by generation at the wholesale level in electricity systems. Failure to do so results in brownouts or blackouts. If a generator reduces output, the shortfall cannot be filled by expecting customers to reduce consumption or by drawing down inventories (which are impractical on a large scale in the electric power industry). Instead, the shortfall must be made up by buying power from more expensive suppliers, which will cause the wholesale market-clearing price to rise above the competitive level (although this wholesale price increase will not affect the prices that most retail customers pay until state regulators implement retail price increases through "rate cases").

Although we commend FERC for its proposals to remove regulatory obstacles to vigorous competition and efficient resource allocation in electricity markets and for the specific changes proposed in the ANOPR, we also encourage FERC to improve the proposals as discussed below. We are concerned that the proposals do not fully recognize the crucial role of timely, accurate price signals and of incentives to minimize costs and improve the quality of service in electric power markets. We believe that a focus on the removal of regulatory obstacles to efficient real-time price signals and on the creation of performance incentives for market participants can lead to improvements in the proposals and in subsequent market performance.

## II. Interest of the Federal Trade Commission

The FTC is an independent agency of the federal government responsible for maintaining competition and safeguarding the interests of consumers through enforcement of the antitrust and consumer protection laws and through competition policy research and advocacy. In the electric power industry, the FTC often analyzes regulatory or legislative proposals that may affect competition or the efficiency of resource allocation, and reviews proposed mergers that involve electric and gas utility companies. In the course of this work, as well as in antitrust and consumer protection research, investigation, and litigation, the FTC applies established legal and economic principles and recent developments in economic theory and empirical analysis to competition issues.

The energy sector, including electric power, has been an important focus of the FTC's antitrust enforcement and competition advocacy.[6] The FTC's competition

[6] *See, e.g.*, Deborah Platt Majoras, Chairman, Federal Trade Commission, Opening Remarks at the FTC Conference on "Energy Markets in the 21st Century: Competition Policy in Perspective" (Apr. 10, 2007),

advocacy program has produced two staff reports on electric power industry restructuring issues at the wholesale and retail levels,[7] and FTC staff also contributed to the work of the Electric Energy Market Competition Task Force, which issued a *Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy*.[8] The Commission also has held public conferences on energy topics.[9] The FTC and its staff have filed numerous competition advocacy comments with FERC and the states concerning electricity restructuring initiatives.[10] The FTC staff also participates in preparing United States Government filings before international competition organizations regarding energy policy matters.[11]

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*available at* http://www.ftc.gov/speeches/majoras/070410energyconferenceremarks.pdf. FTC merger cases involving electric power markets have included *DTE Energy/MCN Energy* (2001) (consent order ), *available at* http://www.ftc.gov/os/2001/05/dtemcndo.pdf; and *PacifiCorp/Peabody Holding* (1998) (consent agreement), *available at* http://www.ftc.gov/os/1998/02/9710091.agr.htm. (The FTC subsequently withdrew the *PacifiCorp* settlement when the seller accepted an alternative acquisition offer that did not pose a threat to competition.)

[7] FTC Staff Report, *Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform: Focus on Retail Competition* (Sept. 2001), *available at* http://www.ftc.gov/reports/elec/electricityreport.pdf; FTC Staff Report, *Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform* (July 2000), *available at* http://www.ftc.gov/be/v000009.htm (compiling previous comments that the FTC staff provided to various state and federal agencies).

[8] That report is available at http://www.ferc.gov/legal/maj-ord-reg/fed-sta/ene-pol-act/epact-final-rpt.pdf.

[9] The most recent FTC conference on energy issues was *Energy Markets in the 21st Century: Competition Policy in Perspective*, held on April 10-12, 2007 (conference materials *available at* http://www.ftc.gov/bcp/workshops/energymarkets/index.shtml). *See also* the FTC's public workshop on *Market Power and Consumer Protection Policies Issues Involved with Encouraging Competition in the U.S. Electric Industry,* held on September 13-14, 1999 (workshop materials *available at* http://www.ftc.gov/bcp/elecworks/index.shtm); and the Department of Justice and FTC Electricity Workshop, held on April 23, 1996.

[10] FTC competition advocacy filings after mid-1994 are available in reverse chronological order at http://www.ftc.gov/opp/advocacy_date.shtm. FTC competition advocacy efforts regarding the electric power sector began in 1994 with a Comment of the Staff of the FTC Bureau of Economics to the South Carolina Legislative Audit Council on the Statutes and Regulations Covering the South Carolina Public Service Commission (Feb. 28, 1994).

[11] The FTC and the Department of Justice participate as United States delegates in a number of international organizations, such as the Organization for Economic Cooperation and Development. As part of this process, the FTC staff contributes to the United States' "country reports" on competition topics.

## III. FERC Proposals on Demand Response and Pricing During Power Shortages

FERC's ANOPR proposes several steps intended to increase DR – *i.e.*, to increase the degree to which consumers reduce consumption when wholesale prices increase[12] – with an emphasis on periods in which reliability is at risk. Both of the FTC staff reports on electricity restructuring cited in note 7, *supra* – as well as the recent report to Congress by the Electric Energy Market Competition Task Force, *supra* note 8 – emphasized the potential market power and other problems that can result from regulations that impede DR. FERC's proposals to increase DR include a mechanism to pay for DR at the wholesale level when DR performs the same functions as increased generation. Like other approaches, however, DR proposals should be evaluated in terms of their costs and benefits. DR is not an end in itself; rather, it is one potential avenue toward enhancing the welfare of consumers. Consumers can be harmed rather than

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*See, e.g.*, United States Department of Justice and Federal Trade Commission, "Note by the US Department of Justice and US Federal Trade Commission," OECD Roundtable on Energy Security and Competition Policy (Feb. 21-22, 2007), *available at* http://www.ftc.gov/os/2007/02/WD200725OilGasUnited%20States.pdf. When requested by the Department of State, the FTC staff also contributes to comments by the United States on proposed regulatory reforms in other nations.

[12] State regulators, utilities, and researchers have gathered evidence about DR programs that is encouraging with regard to both the potential quantity of DR and the likely effects of DR on wholesale prices. Some DR approaches, however, entail significant costs that must be compared to DR's benefits in any evaluation of the net effects of DR proposals. For example, real-time prices encourage consumers to reduce consumption during peak demand periods and to invest in ways to increase DR, but real-time prices require advanced meters that can be expensive. "Experiences in New York, Georgia, California, and other states and pricing experiments have demonstrated that customers do take actions to adjust their consumption, and are responsive to price (*i.e.*, they have a nonzero price elasticity of demand). Georgia Power Company's successful real-time pricing tariff option has demonstrated that industrial customers who receive real-time prices based on an hour-ahead market are relatively price-responsive (price elasticities ranging from approximately -0.2 at moderate price levels, to -0.28 at prices of $1/kWh or more) given the short-time period in which to act. Among day-ahead real-time pricing customers, price elasticities range from approximately -0.04 when prices are at moderate levels to -0.13 when customers are exposed to higher prices. A critical peak-pricing experiment in California in 2004 determined that small residential and commercial customers are price responsive and will produce significant reductions. Participants reduced load 13 percent on average, and as much as 27 percent, when price signals were coupled with automated controls such as controllable thermostats." FERC Staff Report, *Assessment of Demand Response and Advanced Metering* 13-14 (Aug. 2006), *available at* http://www.ferc.gov/legal/staff-reports/demand-response.pdf (footnotes omitted).

helped by a decision, for example, to provide excessive compensation for DR, or if DR policies are implemented without regard to their costs.

### A. Demand Response Proposals

FERC's ANOPR (72 Fed. Reg. at 36281-82) identifies and explains three benefits of increased DR: reduced wholesale prices (accompanied by diminished wholesale price volatility), which are "valued especially during peak [demand] periods;" a flatter "load profile" (*i.e.*, one with fewer and less pronounced demand spikes) that allows lower system costs by increasing the proportion of load supplied by lower-cost base-load generators;[13] and increased demand elasticity that makes it more difficult for a generator to raise prices profitably above the competitive level.

The specific proposals in the ANOPR include the following.

- Require RTOs and ISOs (1) to allow demand resources to bid to supply certain ancillary services in their markets (unless prohibited by state law) and (2) to modify tariffs to let demand resources provide spinning and supplemental reserves without being required to sell into the energy market.

- Modify RTO and ISO tariffs to eliminate certain charges for purchasing less energy in real time than in the day-ahead market during a system emergency.

- Amend market rules to permit an entity that aggregates the demand responses of individual retail consumers to bid the aggregate demand reduction directly into an RTO or ISO energy market (unless prohibited by state law).[14]

- Modify market power mitigation rules so that pricing during a system emergency can elicit more DR.

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[13] This makes it possible to supply electricity reliably with less generation and transmission capacity.

[14] Some observers are concerned that DR in the form of bidding into wholesale markets is not well suited to low-volume (*e.g.*, residential) customers, because bidding into a wholesale market can be a complex undertaking involving high information and transaction costs for participants. The provision in the ANOPR regarding participation by aggregators in wholesale markets is an effort to respond to this concern.

Although all of these proposals are likely to enhance DR,[15] they have two shortcomings. First, they do not directly address the fundamental problem inhibiting DR: retail customers usually do not receive efficient and timely price signals because most retail prices do not track changes in wholesale prices. As discussed above, traditional regulated retail rates underprice or subsidize consumption in peak demand periods and overprice consumption in off-peak periods. As long as traditional retail price regulation persists in subsidizing consumers for buying electric power in periods of high demand,[16] the electric power system will not be efficient and is likely to be less reliable than it could be.[17] Further, improving the efficiency and timeliness of direct price signals to retail customers may be more effective than bidding into wholesale ancillary service markets in drawing the attention of customers to DR incentives, as well as easier for customers to understand, less costly to implement, and less subject to administrative errors. We recommend that FERC urge state utility regulators to cease impeding retail DR. Greater retail DR will increase DR at the wholesale level.

Second, the ANOPR does not directly recognize that increased DR can protect customers from generator market power, and thus can reduce pressures for price regulation, including price caps. Relaxation or removal of wholesale market price caps

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[15] Allowing customers to bid into wholesale (or wholesale ancillary service) markets and to get paid for consuming (or promising to consume) less power, as FERC proposes, can serve as a means to bypass states' traditional retail pricing regimes. It may be the best available approach to expanding DR if states are unwilling to reform traditional retail pricing.

[16] In fact, one could argue that the large cross-subsidies inherent in traditional retail price regulation result in prices that do not satisfy the statutory requirement that they be "just and reasonable." Such subsidized prices accentuate wholesale price volatility, undermine reliability, and increase the average costs of the electric power system.

[17] *See, e.g.*, Hethie Parmesano, "Rate Design Is the No. 1 Energy Efficiency Tool," 20:6 Electricity J. 18 (July 2007); Sheldon Switzer and Jeffrey Trout, "The 'Optimal' Structure of the Deregulated Electric Utility Industry," 20:6 Electricity J. 8 (July 2007).

also would give investors more efficient price signals and thus would improve investment decisions.[18]

FERC also may wish to take account of three additional aspects of DR that have ramifications for competition, as it considers the benefits and costs of policies to increase DR. First, efficient incentives for DR (through the provision of more efficient prices when customers offer DR) can cause customers to take advantage of the technological advances in small generators by investing in onsite generation. An increase in self-supply not only lowers existing prices by reducing the demand for power from the grid – as FERC recognizes – but also increases the sensitivity of demand to changes in price, which makes attempts to impose anticompetitive price increases less profitable and, thus, less likely. And, in fact, customers with onsite generation capacity (for example, industrial customers that have their own generators because electric reliability is essential in their manufacturing processes) have been found to have higher elasticity of demand because they can continue to consume electric power without purchasing any from the grid if prices for power from the grid exceed the competitive level.[19]

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[18] FERC has approved "capacity markets" in some RTOs and ISOs in an effort to compensate for a shortfall in investment incentives that stems from wholesale price caps. (In capacity markets, the RTO or ISO makes payments to owners of generators in the region, based on a generator's capacity and its record of being a reliable supplier during peak demand periods. Capacity market payments augment the revenues that generators receive when they sell electric power to wholesale or retail customers.) More timely and accurate price signals for retail customers should alleviate the perceived need to augment investment incentives and thus would have positive effects on the efficiency and organization of wholesale markets. Other RTOs and ISOs are considering this approach but also are considering an "energy-markets-only" approach to resource adequacy. The latter RTOs and ISOs generally recognize that higher wholesale price caps – or the outright elimination of these caps – will be necessary under an energy-markets-only approach to resource adequacy. Similar issues arise in ancillary service markets. *See, e.g.*, Yann Rebours, Daniel Kirschen, and Marc Trotignon, "Fundamental Issues in Markets for Ancillary Services," 20:6 Electricity J. 26 (July 2007).

[19] "[C]ustomers . . . with onsite generators had, on average, arc elasticities about 40% higher than customers that did not." Charles Goldman, Nicole Hopper, Ranjit Bharvirkar, Bernie Neenan, and Peter Cappers, "Estimating Demand Response Market Potential among Large Commercial and Industrial Customers: A Scoping Study," Lawrence Berkeley National Laboratory Report LBNL 61498, at xiii (Jan. 2007), *available at* http://eetd.lbl.gov/ea/EMS/reports/61498.pdf.

Second, the removal of regulatory barriers to retail customers' ability to bid to reduce their own consumption and thereby effectively enter wholesale "ancillary service" markets – *i.e.*, markets for services such as reactive power, voltage control, loss compensation, system protection, and other services necessary to support transmission while maintaining reliable operations – could make it more difficult for traditional suppliers to exercise market power in ancillary service markets. If coordinated interaction is a concern in such markets, allowing entry by customers offering DR will increase the number and diversity of actual or potential market participants. (See Section 2.1 of the Horizontal Merger Guidelines promulgated by the U.S. Department of Justice and the Federal Trade Commission (issued Apr. 2, 1992; Section 4 revised Apr. 8, 1997), which describes the effects of easier entry and supplier diversity on the likelihood and effectiveness of coordinated interaction among sellers.) Ancillary service markets appear to be more susceptible than wholesale electric energy spot markets to an exercise of market power.[20]

Third, efficient financial rewards for DR not only can lead to immediate reductions in consumption, but also can encourage retail customers to invest in ways to increase their future DR. This means that the price elasticity of demand will increase over time, making it progressively more difficult for suppliers to profit from raising prices above the competitive level. Empirical evaluations of price elasticity often find that the long-term price elasticity of demand exceeds the short-term price elasticity of

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[20] Concerns that ancillary service markets are prone to unilateral market power or coordinated interaction have been expressed by market monitors – most notably, by Frank A. Wolak, Robert Nordhaus, and Carl Shapiro, "The Competitiveness of the California Energy and Ancillary Services Markets" (Mar. 9, 2000), *available at* http://www.caiso.com/docs/09003a6080/04/30/09003a60800430ed.pdf. *See also* Rebours *et al.*, "Fundamental Issues in Markets for Ancillary Services," *supra* note 18, at 32-33.

demand.[21] FERC's consideration of the benefits of initiating supplementary compensation for DR that would be efficient in the absence of efficient retail pricing should take into account the benefits of speeding DR's growth.

### B. Proposals on Customization of DR Bids, Double Payment for DR, and Caps on DR Prices

Three other aspects of FERC's discussion of DR warrant comment from a competition policy perspective because they are likely to affect efforts to increase DR (and thus affect suppliers' efforts to exercise of market power). First, FERC observes that RTOs and ISOs routinely allow electricity generators to specify minimum prices and minimum durations in their wholesale spot market bids.[22] 72 Fed. Reg. at 36283. FERC suggests permitting prospective DR providers to include provisions for minimum duration and price. The customization options described by FERC may not be as broad as necessary to facilitate efficient DR. Retail customers are more likely to participate in DR programs if they can customize their DR bids to reflect the opportunity costs they face to change energy consumption patterns. FERC may wish to allow a range of customization for DR bids that corresponds to the range of opportunity costs faced by potential DR providers. The range of types of opportunity costs faced by potential DR providers may differ from those of generators. For example, a grocery retailer offering DR may be able to reduce refrigeration cooling as long as food cases remain within a safe temperature range, but could face substantial losses from spoilage if the temperature in

[21] For a discussion of the importance of efficient price signals for the development of onsite (distributed) generation, *see, e.g.*, Parmesano, "Rate Design Is the No. 1 Energy Efficiency Tool," *supra* note 17.

[22] RTOs and ISOs do this because some generators face fixed costs whenever they change the level of output. By bidding a minimum time period at a minimum price, these generators can be assured of covering their marginal costs of being dispatched by the RTO or ISO. Without this assurance, some of these generators are unlikely to bid even during peak demand periods.

food cases were to rise above a safe level. This type of customer might be willing to bid DR only if a maximum, rather than a minimum, duration can be specified because there could be high opportunity costs for exceeding that duration.

Second, FERC asks for comments on the view expressed by the Edison Electric Institute ("EEI") that an inappropriate subsidy (a "double payment") occurs whenever a retail customer is paid for wholesale demand reductions that also result in savings on the customer's retail bill. 72 Fed. Reg. at 36286. In most electric power markets, EEI's conclusion is incorrect with regard to most customers because retail prices do not accurately reflect wholesale prices in a timely manner.[23] The basic problem is that the reduction in a customer's retail bill, due to lower use of electricity during peak demand periods, understates the economic value of the reduction when traditional retail pricing is in place. In order to give efficient incentives for conservation during peak demand periods, the savings on the customer's power bill must be supplemented so that the combination – savings on the bill plus the supplementary compensation – results in an efficient price to the retail customer. Contrary to EEI's view, such a system would not constitute an improper subsidy, and it likely would enhance DR and undermine any efforts by suppliers to exercise market power. Acceptance of EEI's position would prevent or reverse FERC's DR regulatory reforms at the wholesale level.[24]

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[23] EEI's conclusion is most likely to be correct if real-time retail prices are in effect and there are no production or consumption externalities or other market failures. This is often not the case.

Additional compensation for DR can also be warranted if the customer is contractually obligated to reduce consumption when requested by the system operator. This gives the operator greater certainty than other forms of DR of being able to meet its system reliability responsibilities. Similarly, additional compensation for DR can be warranted if there are positive externalities associated with DR that are not captured by the consumer's own reduced retail power bill.

[24] EEI nonetheless is correct that it is possible to overcompensate DR participants, and FERC may wish to guard against this possibility.

Third, FERC is concerned that application of the existing wholesale price caps to payments for DR has the unintended effect of inefficiently reducing DR at the period when it is most needed to sustain system reliability. FERC identifies four methods to address this concern (72 Fed. Reg. at 36286-87):

1. Lift the wholesale price caps across the board in order to increase DR and thus maintain required reserve levels.

2. Lift the price cap for DR but not for generation. The rationale for an asymmetric price cap is that there is little ability or incentive for anyone to exercise market power by withholding DR, whereas withholding generation can be an attractive means to exercise of market power (because generation firms can gain profits on inframarginal generators by withholding marginal generators).

3. Use an administratively determined demand curve as the basis for an increase in the energy and/or reserve prices across the board if reserves fall below required levels. The demand curve is designed to approximate the demand if real-time retail pricing were in effect. The New York ISO uses this approach.

4. Set the market-clearing price at the price paid to participants in the RTO's or ISO's emergency DR program.

The costs and benefits to customers of these alternative approaches should be compared under three scenarios that describe potential conditions that could prevail in electric power markets, and the probability of each should be assessed. In the first scenario, high wholesale prices result from a genuine scarcity of resources.[25] In the second scenario, suppliers reduce their generation output or curtail transmission in an effort to exercise market power, so that high prices result from the exercise of market power. The third scenario includes a combination of resource scarcity and market power due to withholding of generation or curtailment of transmission service.

[25] If the price cap is currently performing ideally, the cap prevents the exercise of market power, but there is no scarcity. In other words, supply would be adequate but for suppliers' restrictions of output. In this situation, removal of the price cap would pit the effects of incremental efforts to exercise market power against the effects of incremental DR. The net result for customers could be positive or negative depending on which effect predominates. If the ideal price cap is already in place, leaving it in place for generators but lifting it for DR may be superior to raising the cap across the board.

## IV. FERC Proposals on Long-term Power Supply Contracts

FERC has a long-standing concern, based on complaints of some groups of wholesale power customers, that information problems and regulatory arrangements discourage efficient long-term supply contracts. Incumbent generators are more likely to succeed in exercising market power if there are regulatory impediments to efficient long-term supply contracts.[26] In response to customers' perceptions about potential RTO and ISO services,[27] FERC proposes several new steps that would reduce obstacles to long-term power supply contracts:

- Require RTOs and ISOs to post information that would facilitate long-term power supply contracts.

- Require or encourage efforts by RTOs and ISOs to develop standardized forward products.

- Dedicate a portion of the ISO's or RTO's website for market participants to post long-term buy/sell offers.

If their benefits are likely to exceed their costs and they are implemented efficiently, all of these proposals could increase wholesale electric power competition because they remove obstacles to the entry of large generation projects that are expected to be in service for several decades. Further, long-term forward contracts can be an

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[26] Chapter 3 and Appendix E of the *Report to Congress on Competition in Wholesale and Retail Markets for Electric Energy*, *supra* note 8, discuss issues regarding long-term supply contracts. FERC's most recent effort to remove regulatory obstacles to long-term supply contracts was FERC Order No. 681, *Final Rule on Long-term Firm Transmission Rights in Organized Electricity Markets* (issued July 20, 2006). Order No. 681 implements Section 1233(b) of the Energy Policy Act of 2005, which directed FERC to facilitate the planning and expansion of transmission facilities to meet the reasonable needs of load-serving entities and enable them to secure long-term transmission rights to meet such needs. One of Congress's primary concerns was that the lack of long-term financial transmission rights in RTOs and ISOs prevented developers of long-lived generation projects from hedging the risk of future transmission congestion in marketing a project's output. Increasing the risk of a generation project can raise the cost of the project and make it uneconomical.

[27] The current lack of such services from some RTOs and ISOs is one element of the concern expressed by some transmission customers that RTOs and ISOs are not responsive to their interests. We discuss incentives for RTOs and ISOs to be responsive to customers in Part VI of this comment.

important way to limit the incentives of incumbent generators to exercise market power in wholesale electricity markets.[28] Some large wholesale and retail customers contend that long-term supply contracts are difficult to arrange because market design problems add costs and uncertainty to the contract process. Removal of any such obstacles that wholesale customers (such as municipal power distribution systems and cooperatives) face to backward integration (via investment in generation) can also help alleviate concerns about supplier market power. This is true because the ability to integrate backward gives such customers a viable alternative if incumbent suppliers set prices above the competitive level.

## V. FERC Proposals on Market Monitoring and Information Sharing

FERC has established that the independence of market monitors is a necessary characteristic of RTOs and ISO. FERC proposes the following additional requirements to bolster this independence:

- Assure that the management of an RTO or an ISO does not control the "market monitor" – the entity that is responsible for monitoring the markets within the RTO or ISO.

- Require that the market monitor (1) inform FERC and other stakeholders of any market design flaws and (2) report to FERC any tariff violations it believes the RTO or ISO (or other market participants) may have committed.

- Hold regular conference calls among the market monitors, interested state regulatory commissions, and FERC staff.

- Following an appropriate lag period, release the offer and bid data developed by RTOs and ISOs (after masking the market participants' identities).

[28] Frank Wolak, "Lessons from the California Electricity Crisis," University of California Energy Institute, Center for the Study of Energy Markets, Paper 110 (2003), *available at* http://repositories.cdlib.org/cgi/viewcontent.cgi?article=1010&context=ucei/csem.

- Subject to certain limitations, permit state regulatory commissions within an RTO or ISO, upon request, to receive information from the RTO's or ISO's market monitor.

- Develop a *pro forma* market monitoring provision for each RTO's or ISO's tariff that mirrors the market monitoring provision set forth in the ANOPR.

These proposals may enhance competition because they reassure potential independent suppliers and customers that the market monitor is objective and that market monitors at the RTO/ISO and at the state level have access to more relevant information, subject to antitrust concerns about inadvertently fostering coordinated interaction among suppliers.[29]

As described in previous FTC comments,[30] the credibility of market monitors depends on their independence, but there is a concern that market monitors managed within RTO/ISO operations may not be sufficiently independent. Because FERC relies on market monitors to help develop its policy and enforcement decisions related to market power, there should be a clear delineation of the market monitor's responsibilities to report to FERC on both market design flaws and potential violations of market rules.

If FERC continues to mandate the market monitoring function, but is concerned about the independence and objectivity of RTO and ISO market monitors, then FERC

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[29] Comments of the U.S. Department of Justice before FERC, *Transparency Provisions of the Energy Policy Act of 2005*, Docket No. AD06-11-000 (filed Jan. 25, 2007), *available at* http://www.usdoj.gov/atr/public/comments/223049.htm. *See also* Comment of the Staff of the Bureau of Economics and of Policy Planning of the Federal Trade Commission before the United States Department of Energy, Energy Information Administration, *Agency Information Collection Activities: Proposed Revision and Extension of EIA Form 767 and Other Electric Power Surveys* (filed May 14, 2001), *available at* http://www.ftc.gov/be/v010007.shtm.

[30] Comment of the Staff of the Bureau of Economics, Federal Trade Commission, *Regional Transmission Organizations*, Section III.F, FERC Docket No. RM99-2-000 (filed Aug. 16, 1999), *available at* http://www.ftc.gov/be/v990011.pdf.

may wish to consider the costs and benefits of alternative arrangements to ensure independence.

## VI. FERC Proposal on Customer Responsiveness of RTOs and ISOs

FERC has heard the views of wholesale and retail transmission customers that RTOs and ISOs are insufficiently responsive to customer concerns about the quality and variety of transmission services.[31] In order to improve the customer responsiveness of RTOs and ISOs, FERC proposes to provide RTO and ISO customers with direct access to RTO and ISO boards of directors.

Although there is nothing objectionable about more communication between customers and RTO/ISO boards of directors, the underlying problem is likely to be the lack of incentives for non-profit RTOs and ISOs to minimize costs and provide high-quality service.[32] A lack of attentive, high-quality customer service from RTOs and ISOs can reduce DR in states with retail competition, if eligible customers find it more difficult to gain access to independent generators that offer more efficient and timely retail price signals.

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[31] *See, e.g.*, John A. Anderson, President and CEO, Electricity Consumers Resource Council, "What Do Energy Managers Need and How Do They Get the Necessary Results?" (presentation to the Energy Solutions Network Conference in Long Beach, California, Aug. 14-17, 2005), *available at* http://www1.eere.energy.gov/femp/energy_expo/2005/pdfs/lsp_s3a.pdf.

[32] An alternative way to organize RTOs and ISOs – in the form of a "club" of customers (*i.e.*, of local distribution utilities) – was found to be ineffective in the United Kingdom, which transferred the ownership of the grid to an independent, for-profit firm (National Grid). Similarly, the previous composition of the California ISO's board of directors – board positions allocated to specified stakeholder groups – appears to have contributed to gridlock on the board during the California energy crisis of 2000-01. FERC ordered a reorganization of the board of the California ISO so that it would consist of independent directors. FERC Order Directing Remedies for California Wholesale Electric Markets, FERC Docket Nos. EL00-95-000 *et al.*, at 5-6 (issued Dec. 15, 2000), *available at* http://www.caiso.com/docs/2000/12/15/2000121516224116 81.pdf.

As described in previous FTC staff comments,[33] FERC should consider a requirement that efficiency and customer responsiveness be minimum attributes of RTOs and ISOs. For-profit Transcos are likely to perform better than nonprofit entities in this regard because they have strong profit incentives to satisfy customers and minimize costs. In the United Kingdom, for example, the choice of an independent, for-profit entity to operate the electric transmission grid – with financial incentives to reduce grid congestion and achieve other efficiencies – has been associated with remarkable decreases in transmission congestion and other improvements in transmission customer service.[34]

## VII. Conclusion

FERC has proposed a variety of steps to improve DR and address other concerns about competition in wholesale electricity markets. Increased DR can benefit electric power customers by making it more difficult for generators to exercise market power. We commend FERC for these proposals, and also encourage FERC to do the following:

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[33] "FERC may wish to establish an additional minimum characteristic concerning efficient operations of RTOs. With any new independent institution, there is a risk that independence will devolve into indifference to the quality of service, the pace of innovation, and changes in customer preferences. RTOs are unlikely to be an exception. To avoid traveling down such a path, FERC may wish to identify minimum efficiency incentives that will characterize RTOs.

"For example, an RTO is more likely to operate efficiently and be responsive to customer preferences if the RTO (or its employees) gain by reducing costs and increasing the volume of wholesale transmission. Similarly, efficiency may be enhanced by providing a mechanism for displacing management and the board of directors if either or both fail to operate and manage the RTO efficiently or fail to respond to customer preferences. A Transco completely separated from generation might serve as the benchmark for FERC's consideration of an efficient operations minimum characteristic. From a policy perspective, the efficient operations functions may present the greatest challenge to an RTO organized as an ISO. ISOs are non-profit entities and, therefore, lack profit incentives to perform efficiently and responsively unless methods to provide such incentives are specifically incorporated into the ISO structure." Comment of the Staff of the Bureau of Economics, Federal Trade Commission, *Regional Transmission Organizations*, FERC Docket No. RM99-2-000, at 27-28 (filed Aug. 16, 1999), *available at* http://www.ftc.gov/be/v990011.pdf (footnote omitted).

[34] For a discussion of the process and results, *see* Paul L. Joskow, "Patterns of Transmission Investment," at 25-31 (Mar. 15, 2005), *available at* http://www.ksg.harvard.edu/hepg/Papers/Joskow_Patterns_of_Transmission_Investment.pdf.

- FERC should acknowledge more of the competitive benefits of DR so as to enrich its assessment of the benefits and costs of DR policies.

- FERC should work with states to encourage direct implementation of efficient retail prices if such a course of action is likely to yield net benefits compared to a regime of supplementary wholesale DR payments. A system by which RTOs and ISOs pay DR suppliers (*i.e.*, retail electric power customers) at the same rates that they pay generators for equivalent services can compensate to some degree for the lack of timely and accurate price signals that many consumers face at the retail level.

- As DR grows, FERC may wish to rely increasingly on DR rather than wholesale price caps to prevent generators from exercising market power.

- If RTO and ISO market monitors are found to lack independence and objectivity when they operate within an RTO or an ISO, FERC may wish to consider alternative means to ensure independence in market monitoring.

- FERC may wish to address the underlying issue of lack of incentives for RTOs and ISOs to achieve efficiencies and be responsive to transmission customers.