Before the
United States of America
Federal Energy Regulatory Commission

Investigation of Terms and Conditions	)	**Docket Nos. EL01-118-000**
Of Public Utility Market-Based Rate	)	**and EL-01-118-001**
Authorizations	)	

Comment of the Federal Trade Commission

August 28, 2003

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I. Introduction and Summary

The Federal Trade Commission (FTC or Commission) appreciates this opportunity to present its views concerning the Federal Energy Regulatory Commission's (FERC) proposed revisions to market-based rate tariffs and authorizations.[1] FERC proposes six behavioral rules to safeguard against "unjust and unreasonable rates" when an electricity generator or marketer is granted authority by FERC to charge market-based rates in wholesale electricity markets.[2]

We recognize that the misconduct of some suppliers in the western energy markets in 2000 and 2001 may motivate FERC to impose additional behavioral rules on these and other electric power marketers. Nonetheless, we urge FERC not to lose sight of the goal of developing structurally competitive markets. Long experience has taught antitrust enforcers that competitive

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[1] The present proposals follow public comments on earlier proposals to "condition all new and existing market-based rate tariffs and authorizations to include provisions prohibiting the seller from engaging in anticompetitive behavior or the exercise of market power" and also stem from the investigation of pricing behavior during 2000 and 2001 in energy markets in the western states (Docket No. PA02-2-000). This investigation culminated in the FERC staff's "Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices" (March 2003) (Western Markets Report). *See also* FTC Staff Comment, Docket No. EL01-118-000 (Jan. 7, 2002), *available at* <http://www.ftc.gov/be/v020005.htm>.

[2] In a parallel proceeding (FERC Docket No. RM03-10-000), FERC proposes to modify similarly the natural gas blanket certificates under subpart G of Part 284 of FERC's regulations. We believe that the same types of concerns about structurally competitive markets and consistent use of terms in regulatory and antitrust contexts arise in that matter.

markets that exhibit ease of entry are more likely than behavioral rules imposed on market participants to protect consumers and result in efficient pricing, output, and investment.

The relationship between federal antitrust law and FERC's authority to prevent unjust and unreasonable rates prompts a number of the suggestions in this comment. Some seller conduct could violate both the antitrust laws and FERC's proposed rules. Other conduct could violate FERC's proposed rules but not the antitrust laws. The comment suggests that FERC may wish to revise Market Behavior Rule #2, which prohibits market manipulation by sellers of wholesale electric power, so that conduct that violates the antitrust laws also is prohibited under this rule. FERC also may wish to use competition policy and consumer protection principles to identify accurately conduct that does not violate the antitrust laws but nonetheless leads to unjust and unreasonable rates. The comment suggests ways in which FERC can apply these principles to identify such conduct. In addition, Market Behavior Rules #3 and #4, which require accurate communications with and reporting to FERC, market monitors, and others, may not achieve the goals FERC has articulated or may have the unintended consequence of curtailing efficient transactions. We suggest that FERC consider building the concepts of materiality and confidentiality into these rules.

We make these suggestions because, as written, the cited rules may chill procompetitive behavior. Detailed rules that conflict with established norms for competitive behavior, as defined by the antitrust laws, may distort investment, output, and pricing decisions and result in serious adverse consequences for consumers.

The FTC is an independent administrative agency responsible for maintaining competition and safeguarding the interests of consumers through enforcement of the antitrust and

consumer protection laws and through competition advocacy. In the electric power industry, the FTC often analyzes regulatory or legislative proposals that may affect competition or the efficiency of resource allocation in addition to its review of proposed mergers involving electric and gas utility companies. In the course of this work, as well as in antitrust research, investigation, and litigation, the Commission applies established principles and recent developments in economic theory and empirical analysis to competition issues. As part of its competition advocacy mission, the FTC has issued two Staff Reports (July 2000 and September 2001) on electric power industry restructuring issues at the wholesale and retail levels. The July 2000 FTC Staff Report established a policy framework for increased competition in wholesale and retail electric power markets.[3] The September 2001 FTC Staff Report reviewed those features of state retail competition plans that have provided benefits to consumers and those that have not. It also provided recommendations as to whether states had sufficient authority to implement successful retail competition programs.[4] Since the September 2001 FTC Staff Report, FTC staff has filed eight comments with FERC regarding standards of conduct for

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[3] FTC Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform (July 2000), *available at* <http://www.ftc.gov/be/v000009.htm>. This report compiles previous comments that FTC Staff had provided to various state and federal agencies.

[4] 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>.

transmission providers,[5] interconnection standards,[6] market-based rates,[7] costs and benefits of Regional Transmission Organizations (RTOs),[8] and various aspects of standard market design.[9]

II. The Advantages of Creating Structurally Competitive Markets as a Remedy for Existing Market Power

Traditional antitrust analysis recognizes that the benefits of competition are most likely to accrue to consumers when markets operate unburdened by substantial and durable market power. The Commission has recognized that economically practicable policies that lessen existing market power in electric power markets by broadening product markets, expanding geographic markets, and lowering entry barriers are likely to enhance consumer welfare.[10] In the FTC staff comment on Standard Electricity Market Design, the staff stated:

> The goal of structurally competitive electric power markets may be pursued directly through policies that reduce concentration, ease entry impediments, and facilitate price-

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[5] FTC Staff Comment on Docket No. RM01-10-000 (Dec. 20, 2001), *available at* <http://www.ftc.gov/be/v020001.htm>.

[6] FTC Staff Comment on Docket No. RM02-1-000 (Dec. 21, 2001), *available at* <http://www.ftc.gov/be/v020002.htm>.

[7] FTC Staff Comment on Docket No. EL01-118-000 (Jan. 5, 2002), *available at* <http://www.ftc.gov/be/v020005.htm>.

[8] FTC Staff Comment on Docket No. RM01-12-000 et al. (Apr. 23, 2002) *available at* <http://www.ftc.gov/be/v020014.pdf>.

[9] FTC Staff Comments on Docket No. RM01-12-000 (Apr. 3, 2002; July 23, 2002; Nov. 15, 2002; and June 27, 2003), *available at* <http://www.ftc.gov/be/advofile.htm>.

[10] Letter of the Federal Trade Commission to House Commerce Committee Chairman Thomas Bliley, Analysis of H.R. 2944 (Jan. 14, 2000), available at <http://www.ftc.gov/be/v000002.htm>.

> responsive demand programs. If direct approaches are too costly, slow, or otherwise unavailable, then less direct means to curtail market power, including bid caps and must run obligations such as those proposed in the NOPR, may warrant consideration on an interim basis. In general, the indirect approaches are less efficient and may undermine investment incentives, thereby delaying structurally competitive markets. Consequently, we encourage FERC and the states to emphasize direct approaches to achieving structurally competitive electricity markets.[11]

We continue to believe that structurally competitive markets are generally the best remedy for anticompetitive behavior and existing market power in wholesale electricity markets. We continue to encourage FERC to give high priority to achieving structurally competitive markets while it pursues interim measures, if any, to address findings from its investigations of market conduct.

In addition, accurate and realistic assessments of seller market power prior to FERC's awarding or renewing a seller's market-based rate authority are likely to diminish the need for the behavioral rules proposed in this proceeding. To achieve more accurate and realistic assessments of seller market power, FERC may wish to reexamine its methodology for awarding market-based rates. The FTC staff has commented previously that FERC may wish to harmonize its various tests to identify whether a seller has market power.[12] In particular, the FTC staff recommended that FERC base its market power analysis on the techniques and approaches outlined and discussed in the Department of Justice and Federal Trade Commission Horizontal Merger Guidelines.[13] The techniques in the Horizontal Merger Guidelines could

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[11] FTC Staff Comment Docket No. RM01-12-000 (Nov. 15, 2002), § II.B, *available at* <http://www.ftc.gov/be/v020022.htm>.

[12] FTC Staff Comment Docket No. RM01-12-000 (July 23, 2002) at 4-6, *available at* <http://www.ftc.gov/be/v020018.pdf>.

[13] U.S. Dept. of Justice and Federal Trade Comm., Horizontal Merger Guidelines (Apr. 2, 1992, as revised Apr. 8, 1997) (Horizontal Merger Guidelines).

provide a more informed and realistic analysis of existing or potential market power problems.

Moreover, price responsive demand is an aspect of electric power market restructuring that is likely to be highly effective in making it unprofitable for sellers to raise prices above the competitive level.[14] Programs such as the NYISO's Emergency Demand Response Program that allow retail customers to bid load reductions as capacity reserves (*i.e.*, offer to reduce demand when the price of capacity reserves is high) may be a particularly appealing policy option, because they can both increase the responsiveness of demand to price changes (thereby making efforts to raise prices above competitive levels less profitable to suppliers) and reduce market concentration in ancillary services markets for reserves (by turning retail electric power customers into potential suppliers in these markets).[15]

III. Reform the Market Manipulation Rule in Light of Antitrust Usage and Experience

FERC has proposed six new behavioral rules to prevent sellers with market-based rate authority from charging unjust and unreasonable rates. Market Behavior Rule # 2: Market Manipulation prohibits "actions or transactions without a legitimate business purpose which

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[14] *See* Stephen J. Rassenti, Vernon L. Smith, and Bart J. Wilson, "Demand-Side Bidding Will Control Market Power and Decrease the Level and Volatility of Prices," University of Arizona, Economic Science Laboratory (Feb. 2001). Other examples of the extensive literature on price-responsive demand include: Steven Braithwait and Michael O'Sheasy, "RTP Customer Demand Response," in A. Faruqui and B.K. Eakin (eds.) Electricity Pricing in Transition, Kluwer Academic Publishers (2002); Severin Borenstein, Michael Jaske, and Arthur Rosenfeld, "Dynamic Pricing, Advanced Metering and Demand Response in Electricity Markets," University of California Energy Institute, Working Paper 105 (Oct. 2002).

[15] *See* the invitation for retail business customer participation in the NYISO's Emergency Demand Response Program in the "Ask PSC" section of New York State's website, *available at* <http://www.askpsc.com/bizprograms/?view=commercial&subview=efficiency>.

manipulate or attempt to manipulate market prices, market conditions, or market rules for electric energy, or result in market prices for electric energy and/or electric energy products which do not reflect the legitimate forces of supply and demand." FERC provides a non-exclusive list of five practices that the general rule specifically prohibits.[16]

We have separated our discussion of Market Behavior Rule #2 into three parts. First, we offer two observations about the proposed rule and identify potential conflicts between antitrust law and the rule. To avoid these potential conflicts, FERC may wish to revise the rule so that conduct that violates the antitrust laws also is prohibited by rule. Second, for conduct that does not violate the antitrust laws but nonetheless leads to unjust and unreasonable rates, we offer suggestions to describe more precisely the actions to be prohibited, based on conduct FERC identified in the Western Markets Report using competition policy and consumer protection insights. Third, we discuss disgorgement remedies for violations of Market Behavior Rule #2.

A. Two General Observations About Market Behavior Rule #2

First, we note that FERC proposes Market Behavior Rule #2 within the context of Section 206 of the Federal Power Act (FPA), which requires FERC to assure that wholesale electric power prices are "just and reasonable."[17] FERC has determined to rely "upon

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[16] These five practices are: (A) Pre-arranged offsetting trades of the same product among the same parties ("wash trades"); (B) transactions predicated on submitting false information to transmission providers (such as submitting inaccurate load or generation data; scheduling non-firm service as firm; or falsely designating resources that are unavailable); (C) transactions in which an entity first creates transmission congestion and then "relieves" it; (D) collusion with another party for the purpose of creating market prices at levels differing from those set by market forces; and (E) bidding the output of or misrepresenting the operational capabilities of generation facilities. 68 Fed. Reg. 40924, 40927 (July 9, 2003).

[17] 16 U.S.C. § 824e (2000).

competitive markets to establish just and reasonable rates" and has deemed it necessary that conditions be added to public utility sellers' tariffs "to ensure that market-based rates remain within the zone of reasonableness required by the Federal Power Act."[18]

Unlike the FPA, the antitrust laws are not a price-control statute or a public-utility or common-carrier rate-regulation statute.[19] Rather, the antitrust laws help maintain effective competition by prohibiting conduct that unreasonably restrains trade. For example, agreements among competitors that unreasonably restrain trade violate the antitrust laws. Antitrust law also makes it unlawful to maintain or attempt to create a monopoly through conduct that unreasonably excludes firms from the market or significantly impairs their ability to compete. It is not unlawful under the antitrust laws, however, for a seller with market power to charge a profit-maximizing price.

The determination of which agreements among competitors are anticompetitive, however, is not always straightforward. In particular, since the late 1970s, antitrust enforcers have become more aware that agreements among competitors may create efficiencies as well as carry the potential for competitive harm. This insight counsels care in assessing the competitive implications of particular agreements.[20] In addition, antitrust has been leery of prohibiting single-firm conduct that may simply represent vigorous competition, rather than anticompetitive

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[18] 68 Fed. Reg. at 40927.

[19] *Blue Cross Blue Shield United v. Marshfield Clinic*, 65 F.3d 1406, 1413 (7th Cir. 1995), *cert. denied*, 516 U.S. 1184 (1996).

[20] For example, in the *BMI* case, the Supreme Court found that the blanket copyright licenses challenged were not per se illegal, even though they literally involved price fixing. *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc*., 441 U.S. 1 (1979). *See generally* U.S. Dept. of Justice and Federal Trade Comm., Antitrust Guidelines for Collaborations Among Competitors (Apr. 7, 2000) ("Competitor Collaboration Guidelines").

behavior.[21] Over time, the courts and the FTC have refined the jurisprudence surrounding each type of conduct based on insights gained from adjudicative experience and from developments in economic and legal learning.[22]

Second, the general rule and the specific examples listed in Market Behavior Rule #2 use antitrust-type terms that may conflict with how those terms are employed in antitrust enforcement and, therefore, may create confusion and regulatory uncertainty for market participants. Such uncertainty may cause firms to stop making efficient investments or entering into procompetitive agreements that would be permissible under antitrust law.

For instance, the fourth example under the general rule prohibits "collusion with another party for the purpose of creating market prices at levels differing from those set by market forces." Several elements of this example may be at odds with the criteria for enforcement of prohibitions against unreasonable restraints of trade under the antitrust laws.[23] The language in the example does not explicitly focus on agreements between *competitors*, whereas antitrust enforcement does so. One interpretation of the proposed rule might be that a transaction

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[21] *See* III Areeda & Hovenkamp, Antitrust Law ¶ 630a, at 44-45 (2003).

[22] *In the Matter of Polygram Holding, Inc., Decca Music Group Limited, UMG Recordings, Inc., and Universal Music & Video Distribution Corp.*, Docket No. 9298, Federal Trade Commission Opinion and Final Order at 13 (July 24, 2003), *available at* <http://www.ftc.gov/os/2003/07/polygramopinion.pdf> ("*Three Tenors*").

[23] We have the same concerns about proposed Rule #6, which states that a "Seller shall not violate or collude with another party in actions that violate Seller's code of conduct or Order No. 889 standards of conduct." FERC appears to illustrate the collusion element in the proposed rule with the example (paragraph 35) of "a power marketer [that] used a third party to circumvent the Commission's prohibition on affiliate sales." Here the cited conduct might be more accurately characterized as an evasion of FERC's behavioral regulations (regarding conduct of affiliates) facilitated through arrangements with a third party, rather than as collusion between competitors.

between a customer and a supplier that increases the market clearing price would be a prohibited action. Although such bilateral agreements are within the purview of the antitrust laws, they are not usually considered to restrain trade unreasonably.

The term "collusion" may be used in various ways in the antitrust context. Antitrust law prohibits explicit agreements – *i.e.*, collusion – between competitors that unreasonably restrain trade.[24] Antitrust law does not condemn tacit collusion that may be inferred from interdependent or parallel conduct.[25] Tacit collusion is equally consistent with competitive and anticompetitive conduct.[26] Oligopolies are characterized by interdependent behavior among firms because each seller is large enough to affect the market by its price and output decisions; as a result, in raising or lowering prices or output, each firm has profit incentives to take into account its competitors' likely responses to its actions.[27] Unilateral pricing decisions by oligopolists do not constitute an unlawful agreement, even if each firm bases its own decision on a belief that its competitors will act similarly.[28] FERC's use of the term "collusion" does not specify the types of agreements to which it refers and thus may create uncertainty for industry participants (and their counsel) and

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[24] Explicit agreements may be shown through direct evidence or through circumstantial evidence sufficient to permit an inference of an agreement. Antitrust also condemns vertical agreements they have anticompetitive effects.

[25] The presence of "plus" factors, however, can lend to an inference of an actual (not tacit) agreement. *See* VI Areeda & Hovenkamp, Antitrust Law ¶ 1416, at 101-04 (2003).

[26] *Blomkest Fertilizer, Inc. v. Potash Corp. of Saskatchewan, Inc.*, 203 F.3d 1028, 1043 (8th Cir. 2000).

[27] *See* Herbert Hovenkamp, Federal Antitrust Policy: The Law of Competition and Its Practice 37 (1999).

[28] *Clamp-All Corp. v. Cast Iron Soil Pipe Institute*, 851 F.2d 478 (1st Cir. 1988) (Breyer, J.).

could conflict with existing enforcement of the antitrust laws.

The example also appears to establish an intent requirement for any finding of an anticompetitive agreement. The modern antitrust view is that antitrust enforcement against anticompetitive agreements among competitors does not require proof of intent.[29] In particular, naked agreements to fix prices or divide markets are generally treated as per se violations of the antitrust laws.[30] Per se treatment of such agreements between competitors rests on a presumption that such agreements almost always harm competition.[31]

The example forbids collusion only with respect to prices. The antitrust agencies have found that agreements between competitors may harm consumers by diminishing forms of competition in addition to price competition. Examples may include competition with regard to capacity, quality, variety, innovation, or service.[32] Agreements between competitors that raise

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[29] *See* Competitor Collaboration Guidelines, *supra* note 20, § 3.31 at 16, n. 35 ("Anticompetitive intent alone does not establish an antitrust violation, and procompetitive intent does not preclude a violation. . . . But extrinsic evidence of intent may aid in evaluating market power, the likelihood of anticompetitive harm, and claimed procompetitive justifications where an agreement's effects are otherwise ambiguous.").

[30] *See* Herbert Hovenkamp, Federal Antitrust Policy: The Law of Competition and Its Practice 144-45 (1999). For a discussion of the development of per se treatment of overt collusive agreements, *see* W. Kip Viscusi, John M. Vernon, and Joseph E. Harrington, Jr., Economics of Regulation and Antitrust, Ch. 5 (MIT Press, 3d ed. 2000).

[31] "Per se rules always contain a degree of arbitrariness. They are justified on the assumption that the gains from imposition of the rule will outweigh the losses and that significant administrative advantages will result. In other words, the potential competitive harm plus the administrative costs of determining in what particular situations the practice may be harmful must far outweigh the benefits that may result. If the potential benefits in the aggregate are outweighed to this degree, then they are simply not worth identifying in individual cases." *United States v. Container Corp. of America*, 393 U.S. 333, 341 (1969) (Marshall, J., dissenting).

[32] For example, in the FTC's *Detroit Auto Dealers* case, the administrative complaint charged that the respondents agreed among themselves and with others to limit competition in the sale of new motor vehicles in the Detroit, Michigan area in violation of

rivals' costs may also harm competition.[33]

Another instance in which Market Behavior Rule #2 may conflict with antitrust principles is in the use of the term "without a legitimate business purpose." Antitrust usually applies the term to single-firm exclusionary conduct. The standard for exclusionary conduct articulated in the *Aspen Skiing* case[34] is that the conduct not only must tend to impair the opportunities of rivals, but also must either not further competition on the merits or do so in an unnecessarily restrictive way.[35] In some instances, antitrust has asked whether an agreement had a "legitimate business purpose" as a way of inquiring into whether the agreement has a

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Section 5 of the Federal Trade Commission Act, by adopting and adhering to a schedule limiting hours of operation for the sale or lease of motor vehicles in the Detroit area. The alleged agreement limited weekday evening hours to Mondays and Thursdays and eliminated Saturday hours altogether, except for occasional special sales. The Commission's Final Order, among other provisions, prohibited the dealers from conspiring in any way to fix hours of operation. *Detroit Auto Dealers Ass'n, Inc.*, 111 F.T.C. 417 (1989), *aff'd in part and rev'd in part*, 955 F.2d 457 (6th Cir.), *cert. denied,* 506 U.S. 973 (1992). Charges against the respondents were resolved in a series of settlements.

[33] *See* Oliver Williamson, "Wage Rates as a Barrier to Entry: The Pennington Case in Perspective," 82 Q. J. Econ. 85 (1968). Williamson describes the economic incentives involved in *United Mine Workers v. Pennington,* 381 U.S. 657 (1965). In that case, operators of large coal mines were found to have agreed with each other and with the United Mine Workers to exclude operators of small coal mines from the market. The key conditions for the operation and profitability of this agreement were that uniform wage rates would prevail across all mines, that small coal mining operations were more labor-intensive than large coal mining operations, and that prices could be raised profitably if small coal mines left the market. Because of these three conditions, operators of large coal mines would collectively find it advantageous to offer higher wages than they would individually offer because an increase in wages, when applied across all mines, would disproportionately increase the costs of their smaller rivals and either prevent additional entry or cause the operators of small coal mines to exit. Without the competition from small coal mines, the operators of large coal mines would be able to raise prices by more than enough to offset the higher wages they had agreed to pay.

[34] *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 608, 610-11 (1985).

[35] *Id.* at 605 n.32.

procompetitive justification, as by creating efficiencies sufficient to make the market more, rather than less, competitive. More commonly, however, antitrust jurisprudence now inquires directly into whether and to what extent efficiencies are likely from an agreement.[36]

In light of these observations, we note that conduct that would violate the antitrust laws also is likely to violate the FPA's "just and reasonable" standard as interpreted by FERC. On the other hand, conduct that violates the FPA's "just and reasonable" standard may not violate the antitrust laws. Thus, to avoid potential conflicts identified above in policing anticompetitive behavior, FERC may wish to reaffirm in its general rule that sellers with market-based rate authority are prohibited from engaging in conduct that would violate the antitrust laws. This revision would prohibit conduct that violates the antitrust laws and leads to unjust and unreasonable rates, without creating marketplace confusion. FERC also may wish to identify those circumstances in which it will refer such anticompetitive conduct to the antitrust agencies.

In the next section we discuss how conduct that does not violate the antitrust laws, but nonetheless may lead to unjust and unreasonable rates, may be identified more precisely based on competition policy and consumer protection principles.

B. Conduct that May Not Violate the Antitrust Laws but Nonetheless Leads to Unjust and Unreasonable Rates

As mentioned above, competition policy differentiates between unilateral and joint conduct. In identifying conduct that leads to unjust and unreasonable rates, but may not violate the antitrust laws, FERC may wish to differentiate between these two broad categories of action (unilateral and joint) as it crafts appropriate rules of the road for sellers. For example, of the five

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[36] *See Three Tenors*, *supra* note 22, at 33-35.

examples cited in the proposed rule, "paper trades," "false trade," and "misrepresentation" (subsections B, C, and E) involve unilateral (single-firm) conduct, while "wash trades" and collusion (subsections A and D) involve joint action.

FERC's proposed general rule presumes that actions or transactions that "manipulate" prices, conditions, or rules automatically lead to unjust and unreasonable rates, without determining whether unjust and unreasonable rates result from the conduct. This is an open-ended standard that may prohibit procompetitive or competitively neutral agreements.

To avoid the situation in which Market Behavior Rule #2 curtails efficient market operation, FERC may wish to identify more accurately the specific conduct that leads to unjust and unreasonable rates. We note that in each of the unilateral action examples (subsections B, C, and E), an essential element of each "manipulation" includes falsehood, fraud, or misrepresentation. Example (B) prohibits a seller from submitting false information to entities responsible for operating the transmission network; example (C) prohibits a seller from creating false congestion; and example (E) prohibits misrepresenting the operational capabilities of a generation unit. Because of the significance of falsehood and deception in each example, if FERC determines that such conduct is likely to lead to unjust and unreasonable rates, it may wish to revise its general rule so that a seller of wholesale electricity is prohibited from falsely representing its capabilities or scheduled trading in the relevant market.

FERC also may wish to examine the FTC's Deception Statement for the principles that guide an FTC determination of whether a statement is deceptive, so as to assist FERC in defining

false or deceptive information in the electric power markets.[37] Although the Deception Statement applies to consumer advertising, the underlying analysis of deceptive statements can be adapted to the wholesale electric power market by changing the focus of the examination from the consumer to the entity subject to the deception, which in this case could be the transmission grid operator. Under the Deception Statement, a statement is considered deceptive if it contains a representation or omission that is likely to mislead consumers acting reasonably under the circumstances, and the representation or omission is material (*i.e.*, is likely to affect consumers' decisions regarding purchase or use of a product). By analogy, a deceptive or false statement in wholesale electricity markets may be one that contains a representation or omission that is likely to mislead the transmission grid operator, and for which the misrepresentation is material (*i.e.*, is likely to affect the operator's operation of the grid).

Likewise, in the joint conduct context, if FERC believes – based on evidence presented in the Western Markets Report – that "wash trades" have resulted in unjust and unreasonable rates, it should determine whether all or only some such trades are likely to have such *effects*.[38] By limiting its prohibitions to conduct likely to result in unjust and unreasonable rates, FERC may be able to avoid inadvertently banning procompetitive behavior that benefits consumers.

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[37] The FTC's Deception Statement is attached to *Cliffdale Associates, Inc.*, 103 F.T.C. 110 (1984).

[38] The antitrust laws prohibit, among other things, unreasonable restraints of trade between competitors. The "rule of reason" is the touchstone for evaluating challenged conduct. In applying the rule of reason, courts evaluate the impact of challenged behavior upon competition, *i.e.*, whether the restraint has anticompetitive effects by diminishing output or increasing prices. The courts have recognized, however, that not all trade restraints require the same degree of fact-gathering and analysis. Some restraints are so inherently and predictably unreasonable that a court can dispense with an elaborate analysis of the restraints' anticompetitive effects and condemn them as illegal per se.

Antitrust teaches that if the conduct is not likely to result in anticompetitive *effects*, prohibition of the conduct may lead to less efficient market operation. By analogy, prohibition of conduct that does not lead to unjust and unreasonable rates may lead to less efficient market operation.[39]

C. Disgorgement for Violations of Market Behavior Rule #2

FERC proposes to order a seller to disgorge unjust profits gained through conduct prohibited by Market Behavior Rule #2. The FTC recently released a Policy Statement on Monetary Equitable Remedies in Competition Cases that discusses when disgorgement and other equitable remedies are appropriate for antitrust violations.[40] FERC may wish to evaluate whether the three principles outlined in the FTC's Policy Statement apply to FERC's enforcement under the FPA.

First, the Commission will seek disgorgement in competition cases only when the violation is clear – when, based on existing precedent, a reasonable party should expect that the challenged conduct would likely be found to be illegal. One possible application of this factor in the context of Market Behavior Rule #2 (as reworked as noted above) might mean that conduct not specifically prohibited in the rule would not be subject to disgorgement.

Second, the Commission must have a reasonable basis for calculating the amount of disgorgement. Third, the Commission will consider disgorgement when it anticipates that other

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[39] Care should be taken to adjust the definition of just and reasonable rates to account for changes in the quality or other characteristics of service. For example, collaboration that results in a higher quality of service may benefit consumers but may also have a higher price. This price might be higher than the previous price in nominal terms but lower on a quality-adjusted basis.

[40] Federal Trade Commission, Policy Statement on Monetary Equitable Remedies in Competition Cases (July 2003), *available at* <http://www.ftc.gov/os/2003/07/disgorgementfrn.htm>.

remedies are likely to fail to accomplish the purposes of the antitrust laws or when disgorgement may provide important additional benefits. FERC may wish to evaluate whether these criteria are met if it decides to order disgorgement based on violation of Market Behavior Rule #2.

IV. Efficacy and Efficiency Concerns About Market Behavior Rules # 3 (Communications) and # 4 (Reporting)

Market Behavior Rule #3 requires sellers to provide "complete, accurate, and factual information, and not submit false or misleading information, or omit material information" to FERC, market monitors, RTOs, ISOs, or similar entities. The proposed rule does not consider the costs of providing the information or the confidential treatment of this information by the requesting agencies. To avoid situations in which the costs of providing information exceed the expected benefits, FERC may wish to indicate criteria that it will apply in enforcing this proposed rule. Materiality and confidentiality are two criteria that FERC may wish to reference. Without such limitations, we are concerned that this proposed rule could result in unwarranted regulatory compliance costs[41] or public disclosure of commercially sensitive information that would diminish investment and innovation incentives and facilitate collusive behavior.[42]

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[41] We generally encourage use of a cost/benefit framework in evaluating alternative regulatory approaches. It is difficult for a proposal to be justified within this framework if the compliance costs have the potential to be quite large.

[42] Often the incentives to undertake investment projects, invent new processes, or introduce new products depend upon the profits that a supplier can accumulate before other market participants emulate the first mover. Early disclosure of a firm's plans in any of these categories is likely to diminish incentives to carry out these projects. As a result, some projects may no longer be sufficiently attractive to undertake. Another potential concern is that rapid disclosure of price and quantity information to these public entities by all market participants will result in rapid public disclosure of the price and quantity involved in a high proportion of all individual transactions. Such rapid, inclusive disclosures in a market may facilitate monitoring

Market Behavior Rule #4 requires that sellers that elect to report data used to compile price indices "shall provide complete, accurate and factual information to any such publisher."[43] Although accurate price indices can be essential to efficient operation of commodity markets, imposing a highly exacting standard for reporting may actually lead to less accurate (rather than more accurate) indices. If the standard imposes high reporting costs, some firms may decide not to submit any data to the index publishers.[44] If enough transactions are not included in a price index, its accuracy with respect to price may suffer along with its accuracy with respect to volume.[45]

In some instances, a strict standard may force one or more firms to withdraw from reporting. For example, in some markets, fully accurate transactions prices are not known at the time of the sale because the transaction price includes cumulative discounts that remain unknown until the end of the year or another date in the future.[46] Absent a strict requirement for

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of a collusive agreement and make collusion more likely in that market.

[43] We assume that complete, accurate, and factual reporting to private publishers does not necessitate disclosure of individual transaction prices and volume or, alternatively, that such information will be held in confidence by the publisher if it is disclosed by individual suppliers. We encourage FERC to avoid any requirement that would tend to result in rapid disclosure of individual transaction data that could facilitate monitoring compliance with a collusive agreement among suppliers.

[44] Each firm in the market is likely to make its own cost/benefit assessment of contributing data. If the costs of doing so rise sufficiently, one or more data contributors are likely to cease participating.

[45] Unlike a situation in which a small, random portion of transactions data may be used with statistical confidence to report on the characteristics of all transactions, here the sample would not be random, and estimates for the whole population of transactions might well be biased.

[46] Whether or not such discounts already exist in electricity supply contracts, they may be advantageous to customers and may become more common in electricity supply

reporting complete and accurate price data, a supplier could contribute to the accuracy of price indices by reporting its price and volume for known transactions, its expected volume discounts, and the volume covered by such discounts. FERC may wish to provide some leeway for reporting best estimates of prices.

V. Conclusion

FERC proposes new behavioral rules to curtail anticompetitive behavior identified in its investigation of wholesale electricity prices in western markets during 2000 and 2001. Despite its present focus on additional behavioral rules, we encourage FERC to emphasize efforts to create structurally competitive markets. We believe that structurally competitive markets offer a more certain and effective remedy for existing market power than additional behavioral rules. Efforts by FERC and the states to expand geographic markets by implementing efficient RTOs, to remove entry impediments, and to increase the price responsiveness of demand are all important elements in creating structurally competitive markets.

We are concerned about FERC's use of the terms "collusion" and "legitimate business purpose" in proposed Market Behavior Rule #2. We encourage FERC to confirm that a seller's violation of the antitrust laws also violates Market Behavior Rule #2. FERC also may wish to specify that deceptive conduct can lead to unjust and unreasonable rates that violate the FPA, even if it does not run afoul of the antitrust laws. Moreover, FERC may wish to incorporate the concepts of materiality and confidentiality into proposed Market Behavior Rules # 3 and 4. Such clarifications are warranted because excessively detailed rules that conflict with established

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contracts in the future.

norms for competitive behavior, as defined by the antitrust laws, may distort investment, output, and pricing decisions and result in serious harm to consumers.

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