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**COMMISSION
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FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

OFFICE OF THE SECRETARY

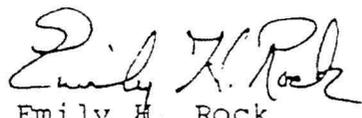
November 15, 1985

Honorable John S. Herrington
Secretary
Department of Energy
James Forrestal Building
1000 Independence Avenue, S.W.
Washington, D.C. 20585

Dear Mr. Herrington:

By letter dated October 8, 1985, Donna R. Fitzpatrick, the Acting Assistant Secretary of the Department of Energy for Conservation and Renewable Energy, sent to the Commission the Department of Energy's annual report to Congress regarding utilities' financing, supply, and installation activities in connection with the Residential Conservation Service Program. Section 215(g) of the National Energy Conservation Policy Act, which mandates this report, also provides that "[e]ach such report shall contain the comments of the Federal Trade Commission." Enclosed are the Commission's comments.

By direction of the Commission.


Emily H. Rock
Secretary

Enclosure

cc: Donna R. Fitzpatrick
Acting Assistant Secretary
Conservation and Renewable Energy
Department of Energy

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COMMENTS OF THE FEDERAL TRADE COMMISSION

The following comments of the Federal Trade Commission (FTC or the Commission) are provided pursuant to section 216(g) of the National Energy Conservation Policy Act. Pub. L. No. 95-619, 92 Stat. 3208, 3217 (1978) (codified as amended by the Energy Security Act of 1980, Pub. L. No. 96-294, § 547, 94 Stat. 611, 741, at 42 U.S.C. § 8217(g)) (hereinafter cited as NECPA or the Act).

WAIVER PETITIONS

With some exceptions, mainly for conservation programs predating the Act (1978), NECPA prohibits public utilities to supply or install energy conservation measures for residential customers. Id. § 216(a), 42 U.S.C. § 8217(a). The Act provides, however, that the Secretary of the Department of Energy (the Secretary) may waive this prohibition if "the Secretary finds, after consultation with the Federal Trade Commission, that such activities would not be inconsistent with the prevention of unfair methods of competition and the prevention of unfair or deceptive acts or practices." Id. § 216(e), 42 U.S.C. § 8217(e).

Since the 1984 report to Congress, the Commission has commented on two utility waiver petitions:

(1) In a letter dated June 1, 1984, the Department of Energy (DOE) requested the Commission's review of a waiver petition submitted by the Green Mountain Power Corporation (Green

Mountain) to permit it to sell water heater insulation jackets to its residential customers. In reviewing this petition, Commission staff learned that the program involved a small cross-subsidy from the general body of ratepayers to purchasers of water heater insulation jackets. However, the Commission determined that the program apparently benefited ratepayers (by tending to reduce rates by decreasing the utility's reliance on higher-cost generating capacity at the margin), had no adverse impact on competition, did not cause a significant misallocation of resources, and, at most, had a de minimis impact on competitors. Thus, in a December 17, 1984 letter to DOE, the Commission reported its conclusion that the program would not constitute an unfair method of competition or an unfair or deceptive act or practice.

The Commission noted, however, that it was possible that alternative conservation programs could achieve the same or greater benefits for ratepayers while causing less or no adverse impact on competitors (e.g., by paying a subsidy to any customer who installed an insulation jacket on an electric water heater, whether bought from the utility or another source). Thus, in a letter to the Vermont Department of Public Service, the Commission encouraged the Department to consider whether such a conservation program could be administered as an alternative to the proposed program.

(2) On November 1, 1984, the Secretary requested the Commission's review of a waiver petition submitted by the United Illuminating Company (United) to permit it to sell and install a

number of weatherization products to its residential customers. In a letter dated July 24, 1985, the Commission informed the Secretary that notwithstanding the existence of a cross-subsidy in the program described by the petition, the program was "not inconsistent with the prevention of unfair methods of competition and the prevention of unfair or deceptive acts or practices." With respect to its consumer protection mandate, the Commission determined that there was no indication that the program presented consumers with misleading or inaccurate information. With respect to its competition mandate, the Commission reasoned that while the presence of a cross-subsidy could possibly facilitate predatory pricing of energy conservation devices by United, the absence of any barriers to entry in the energy conservation business would preclude successful predation.

In the process of reviewing this petition, Commission staff learned that United's marginal cost of generating electricity was less than its average total cost. Therefore, in a letter to the chairman of the Connecticut Department of Public Utility Control, the Commission pointed out that, at least in the short run, conservation efforts in United's service territory would tend to increase United's average total cost and thus its rates. However, because of the limited size of the subsidy and scope of the program, the Commission noted that this appeared to be more of a theoretical, rather than a practical concern. The Commission also suggested that if the Connecticut Department of Utility Control determined that conservation benefits ratepayers, that it consider alternative means of implementing the

conservation program that would not entail cross-subsidies, or that would achieve the same or greater net benefits to ratepayers but reduce or eliminate the possible adverse effect on competitors.

UTILITY COMPETITION IN RETAIL
MERCHANDISE AND SERVICE MARKETS GENERALLY

Regulated utility diversification into unregulated sectors of the economy (e.g., sales of conservation measures, and sales and service of household appliances) has grown and received increased attention in recent years. In response to complaints by small businesses and congressional interest, FTC staff is conducting a study of this phenomenon. Bureau of Competition staff is investigating the activities of several diversified utilities to determine whether they are subsidizing the sale of unregulated products by revenue received from utility ratepayers. Bureau of Competition staff is also assessing the public policy implications of such cross-subsidization, and considering if and when it would constitute an antitrust violation. Bureau of Economics staff is conducting an econometric study to determine whether there is any relationship between utility diversification into unregulated markets and regulated rate levels. Both projects should be completed by early 1986.