UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
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Jeffrey A. Klurfeld
Regional Director

August 23, 1995

Docket Clerk
California Public Utilities Commission
505 Van Ness Avenue, Room 2001
San Francisco, California 94201

Re: Docket Nos. R.94-04-03 and 1. 94-04-032

Enclosed for filing are the original and twelve copies of the Reply Comment of the Staff of the Bureau of Economics of the Federal Trade Commission in this proceeding.

Sincerely,

Jeffrey A. Klurfeld
Regional Director

cc: Commissioners
Administrative Law Judge Kim Malcolm (with disc)
Parties on service list

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the	)	
Commission's Proposed Policies	)	
Governing Restructuring California's	)	R.94-04-031
Electric Services Industry and	)	
Reforming Regulation	)	

Order Instituting Investigation on the	)	
Commission's Proposed Policies	)	
Governing Restructuring California's	)	I.94-04-032
Electric Services Industry and	)	
Reforming Regulation	)	

Reply Comment of the Staff of the Bureau of Economics of the Federal Trade Commission

The staff of the Bureau of Economics of the Federal Trade Commission is pleased to submit this reply comment in the CPUC's consideration of proposals to reform the electric utility industry.(1) The issues raised by the CPUC proposals are similar to those we recently addressed in comments to the Federal Energy Regulatory Commission in connection with its proposals on open access and recovery of stranded costs for the wholesale level.(2) We therefore submit for your information and consideration a copy of our comments to FERC on those issues. The full text is Attachment A; below is a summary of the comments' points.

We fully support the goals that the CPUC and FERC have announced, to promote greater competition in this industry so that the benefits of greater efficiency can promote lower electricity rates for consumers. Our comments address aspects of the particular methods FERC has proposed and assess how variations on those proposals might accomplish the goals more effectively.

Concerning the organization of the industry, the comments state that "operational unbundling," as envisioned by the CPUC proposal and by Commissioner Knight's alternative proposal, would likely be more effective than FERC's proposed "functional unbundling" and less costly than industry-wide divestiture. FERC's proposal, to require vertically integrated utilities to grant open access and equal treatment to their competitors, would leave in place the incentive and the opportunity for some utilities to exercise market power in the regulated system. Preventing them from doing so by enforcing regulations to control their behavior may prove difficult. "Operational unbundling," in which the dispatch of generating capacity and/or the operation of transmission grid would be controlled by an independent entity, could prevent discrimination and achieve the competitive benefits of open access more effectively and efficiently than would an attempt to mandate and regulate access.

The comments also discuss how to assess competitive conditions in generation markets, an issue that is also highlighted in the CPUC's request for comments. The comments find that competition problems in concentrated generation markets must still be addressed under open access. The DOJ/FTC Horizontal Merger Guidelines show how to evaluate likely competitive effects of concentration among suppliers and changes in market contours. Expanding the number of suppliers potentially available is likely to make the electric power system more efficient and more competitive, but there may be circumstances, even under open access conditions, in which dominant suppliers might be able to exercise market power. Competitive conditions among mid- costs plants could be particularly significant.

The comments emphasize that efficient transmission pricing must accompany open access. Pro-competitive reforms in California will not achieve their objectives, and might even prove counterproductive, unless prices and terms for transmission services also provide economically efficient signals about investment and output. Achieving the economic benefits of unbundling will therefore depend strongly upon FERC's concurrent reform of transmission pricing. Transmission pricing based on the market factors should assist in discouraging local transmitting utilities from favoring their own potentially unmarketable generation capacity and reduce their incentives to delay expansion of wholesale transmission capacity.

Finally, the comments discuss issues raised by proposals to recover "stranded costs." We express no view about the net costs and benefits of recovering stranded costs from future, present, or past customers. The comments offer some views about some of the economic effects of methods that might be used if FERC commits to recovery of stranded costs. This discussion may be particularly pertinent to the CPUC's proceeding, because of the magnitude of the costs at the retail level.

We appreciate this opportunity to submit these comments in this proceeding and we hope that you find our comments useful.

Respectfully submitted,

Jonathan B. Baker
Director

John C. Hilke
Economist

Michael O. Wise
Attorney
Bureau of Economics
Federal Trade Commission

August 23, 1995

Attachment A

Comment of the Staff of the Bureau of Economics
of the Federal Trade Commission

submitted to the
Federal Energy Regulatory Commission
in Dkts. RM95-8-000 and RM94-7-001

(1) These comments are the views of the staff of the Bureau of Economics of the Federal Trade Commission and are not necessarily the views of the Commission or of any individual Commissioner. Inquiries regarding this comment should be directed to John Hilke (202-326- 3483) or Michael Wise (202-326-3344).

(2) Federal Energy Regulatory Commission, Docket Nos. RM95-8-000 and RM94-7-001.