UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Before the
United States of America
Federal Energy Regulatory Commission

Interconnection Standards

Docket No. RM02-1-000

Comment of the Staff of the
Bureau of Economics and the Office of the General Counsel
of the Federal Trade Commission(2)

December 21, 2001

I. Introduction and Summary

The staff of the Bureau of Economics and the Office of the General Counsel of the Federal Trade Commission (FTC) appreciates this opportunity to present its views concerning the Federal Energy Regulatory Commission's (FERC) proposed new standards for interconnection of new generation facilities that would be applicable to all public utilities that own, operate, or control transmission facilities. Under the proposal, the interconnection standards used by the Electric Reliability Council of Texas (ERCOT), as supplemented and modified by various "best practices" identified by FERC, would form the basis for nationwide interconnections used by FERC.

We support FERC's consideration of interconnection standards using the ERCOT standards as a benchmark. Based on our recent experience in developing an interconnection regime for a natural gas local distribution system, FERC may wish to consider approaches that create incentives for grid owners and operators to provide prompt and low-cost interconnections to the transmission grid.(3)

The FTC is an independent administrative agency responsible for maintaining competition and safeguarding the interests of consumers. In this industry, the staff of the FTC often analyzes regulatory or legislative proposals that may affect competition or the efficiency of the economy 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 staff applies established principles and recent developments in economic theory and empirical analysis to competition issues. The Commission has issued two Staff Reports (July 2000 and September 2001) on electric power market 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.(4) 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.(5)

FERC has concluded that interconnection standards for new generation facilities to the transmission grid are a critical aspect of effective competition in wholesale electric power markets. Indeed, antitrust analysis focuses on whether entry of new competitors in a market is timely, likely, and sufficient to deter or counteract potential market power effects of proposed mergers.(6) Without actual entry, the full extent of the benefits of competition in the electric

industry may not occur.(7) Moreover, many entrants may offer customers (wholesale customers in this case) new and innovative terms and services to differentiate themselves from existing generation owners in an area.

The competitive concern is that a vertically integrated transmission owner has incentives to favor its own generation operations by delaying and raising the costs of interconnection for competing independent generators. In most situations, interconnection with the transmission grid is essential for independent generators to serve their actual or potential customers.(8) The objective of interconnection standards is to reduce or eliminate anticompetitive delays and excessive costs associated with interconnection of independent generators to the transmission grid.

II. It Is Appropriate and Timely to Develop Nationwide Interconnection Standards Based on Existing Interconnection Standards

In light of FERC's broad program seeking to promote competitive wholesale electric power markets, FERC's focus on grid interconnection issues is timely and appropriate. Interconnection delays and costs are an important component of entry conditions in wholesale electric power markets. Entry is a key aspect of the competitive response that may aid consumers by constraining the exercise of market power and by displacing outmoded generation technologies. Vertically integrated suppliers with both generation and transmission assets in the same area may have the ability and incentive to stifle competition by delaying interconnection or increasing the costs of interconnection. Delaying and raising the costs of interconnection for competitors may either enhance the profitability of limiting supply or shield inefficient generation assets owned by the vertically integrated supplier. Both are likely to harm consumers by increasing electricity prices relative to the prices that would have prevailed absent the anticompetitive behavior.

In initiating its review of interconnection issues, FERC has elected to use interconnection standards already in place within ERCOT as a benchmark for further development with certain "best practices" designated by FERC. We commend FERC for taking the approach of starting with an established standard and working to improve it, rather than "starting from scratch." The ERCOT standard is the first effort to develop reasonable interconnection procedures based on a consensus among stakeholder groups that has been implemented. To the extent FERC improves the standards based on certain identified "best practices," these practices should rely on objective criteria and fixed deadlines, with little or no administrative discretion to alter them, and sufficiently large and certain penalties to deter parties from failing to comply. Such actions have the ability to focus the parties on preparing to compete in these competitive markets, rather than on seeking to thwart a competitive market.(9) Moreover, this approach offers potential advantages such as lower decision-making costs and quicker resolution of important issues to the public and to interested parties.(10)

III. Creating Incentives to Comply with Interconnection Standards

In developing and implementing interconnection standards, two competitive concerns are raised: (1) the effectiveness of the standards in curtailing anticompetitive behavior; and (2) the cost of enforcing the standards. Our recent experience in negotiating interconnection elements of a local gas distribution system easement agreement prompted us to encourage FERC to consider interconnection standards that create incentives for the incumbent vertically integrated firm to make such interconnections promptly and at reasonable costs. Such provisions can increase the likelihood of compliance and reduce enforcement costs.

The specific context of the easement agreement was the proposed acquisition of MichCon, the local natural gas distribution company serving the Detroit area, by DTE, the local electric power distribution company.(11) The competitive concern was that MichCon's incentives to develop and promote onsite generation using natural gas and other forms of electricity displacement load (EDL) would be curtailed if MichCon were owned by DTE. The combined DTE/MichCon would find it less profitable to encourage growth of EDL because doing so would reduce profits in the electricity distribution portion of DTE.(12) EDL customers in the Detroit area likely would face higher prices and later availability of onsite generation and other technologies as a result. By creating an easement within the MichCon system owned by an independent firm, the settlement sought to preserve competition and its associated benefits for EDL customers in the area.

Exelon, the buyer of the easement within the MichCon local distribution system, was concerned about potential delays and excessive costs in the connections and system enhancements that Exelon might need to serve its new retail customers. Exelon sought assurance that MichCon would not jeopardize Exelon's ability to compete by delaying interconnection work or charging excessive prices for such work. Uncertainty with regard to either the timing or cost of interconnection could make it unprofitable for Exelon to seek to serve some potential EDL customers.

In response to these concerns, the parties agreed to include terms in the easement agreement that created incentives for MichCon to perform customer interconnection and system expansion work promptly and at reasonable cost.(13) For example, if MichCon's proposed schedule and prices for customer interconnection and system expansion work appear suspect to Exelon, Exelon has the option of doing the work itself and recovering the difference between MichCon's bid and Exelon's actual costs from MichCon.(14) Similar concerns arose about system maintenance decisions of MichCon that might cause customer dissatisfaction with Exelon. The easement agreement seeks to avoid this possibility by requiring MichCon to provide advance notice of anticipated system maintenance operations to Exelon.(15)

We recognize that interconnection issues and remedies may differ between industries. The advantages, however, of increased certainty and reduced enforcement costs likely associated with creating compliance incentives in interconnection standards, warrant consideration by FERC.(16)

IV. Conclusion

FERC's concern about incentives of vertically integrated transmission owners to delay and increase the costs of interconnection for competing generators is reasonable. It is also timely, given FERC's ongoing efforts to increase competition in wholesale electric power markets. We commend FERC for seeking to address these issues and for utilizing an existing interconnection standard as a baseline for discussion. Doing so is likely to speed the process and reduce the costs of developing effective interconnection standards. In designing such standards, FERC may wish to consider provisions that create incentives for vertically integrated transmission owners to provide prompt, low-cost interconnection for independent generators.

Respectfully submitted,

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Endnotes:

1. See endnote 2.

2. This comment represents the views of the staff of the Bureau of Economics of the Federal Trade Commission and the staff of the General Counsel's Office of Policy Studies. They are not necessarily the views of the Federal Trade Commission or any individual Commissioner. The Commission has, however, voted to authorize the staff to submit these comments. Inquiries regarding this comment should be directed to John C. Hilke, Economist and Electricity

Project Coordinator in the Bureau of Economics (801-524-4440 or jhilke@ftc.gov) or Michael Wroblewski, Assistant General Counsel for Policy Studies (202-326-2155 or mwroblewski@ftc.gov).

3. Although we generally support structural remedies to eliminate possible discriminatory behavior, in this circumstance, a structural remedy would leave intact incentives to discriminate and, therefore a behavioral approach is reasonable. If transmission owners divested themselves of generation, there would remain the potential for transmission owners to discriminate against the interconnection of distributed resources. Distributed resources have the potential to reduce usage of the transmission grid and therefore, revenues to the transmission provider. Thus a behavioral approach, although less than ideal, should be crafted to create incentives to comply such that it would be self-enforcing and reduce FERC's monitoring and enforcement burden. See discussion in Section III infra.

4. FTC Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform (Jul. 2000) http://www.ftc.gov/be/v000009.htm. This report compiles previous comments that FTC Staff had provided to various state and federal agencies. For example, FTC Staff has commented to FERC on electric power regulation in Docket No. RM01-10-000 (standards of conduct for transmission providers) (Dec. 20, 2001); Docket No. EL-95-000 (remedies for California wholesale electric markets) (Nov. 22, 2000) (California Remedies Comment); Docket No. RM99-2-000 (regional transmission organizations) (Aug. 16, 1999); Docket EL99-57-000 (Entergy transco proposal) (May 27, 1999); Docket RM98-4-000 (Sept. 11, 1998) (merger filing guidelines); Docket No. PL98-5-000 (May 1, 1998) (ISO Policy); Docket Nos. ER97-237-000 and ER97-1079-000 (New England ISO) (Feb. 6, 1998); Docket No. RM96-6-000 (merger policy) (May 7, 1996); Docket Nos. RM95-8-000 and RM94-7-001 (open access) (Aug. 7, 1995). The FTC staff comments are available at: http://www.ftc.gov/be/advofile.htm

5. FTC Staff Report: Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform, Focus on Retail Competition (Sep. 2001) http://www.ftc.gov/reports/index.htm.

6. See Section 3, Entry Analysis, U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, issued Apr. 2, 1992, rev'd Apr. 8, 1997.

7. See September 2001 FTC Staff Report, Chs. II and IV. Moreover, FERC's recent retrenchment on the ability of utilities to use market-based rates indicates a heightened awareness of the possible abuses of market power in existing wholesale markets. See FERC, Order on Triennial Market Power Updates and Announcing New, Interim Generation Market Power Screen and Mitigation Policy, Dockets Nos. ER96-2495-015, et al. (Nov. 20, 2001).

8. Although FERC's interconnection standards are likely to find clearest application to interconnection of relatively large generators with the high voltage transmission lines traditionally regulated by FERC, important interconnection issues may also apply to interconnection of small-scale onsite generators to lower voltage transmission and distribution lines that have traditionally been regulated primarily by the states. Because onsite generators may contribute substantially to increasing the price sensitivity of retail demand, which will, in turn, increase competition in wholesale markets, FERC may wish to encourage the states to adopt interconnection standards appropriate for interconnection of small-scale generators to lower voltage transmission and distribution portions of the grid. *See* September 2001 FTC Staff Report, Chapter III for discussion of the relationships between wholesale and retail competition.

9. John E. Kwoka Jr., "Twenty-Five Years of Deregulation: Lessons for Electric Power," presented at the Competition, Consumer Protection, and Utility Deregulation Conference, Loyola University Chicago School of Law, Institute for Consumer Antitrust Studies Program (Nov. 2, 2001). (paper on file with the authors).

10. We recommended a similar approach of FERC adopting a reasonable standard, even if slightly imperfect, to provide certainty to the market and then improving that standard as conditions warrant. *See* California Remedies Comment, *supra*. n. 3.

11. In the Matter of DTE Energy Company and MCN Energy Group, Inc., File No. 0010067, Analysis of the Proposed Consent Order and Draft Complaint to Aid Public Comment www.ftc.gov/os/2001/03/dreanalysis.htm.

12. For additional description and analysis, see www.ftc.gov/opa/2001/03/michcon.htm and John C. Hilke, "Convergence Mergers: A New Competitive Settlement Model from Detroit," Electricity Journal (Oct. 2001) at 13-18.

13.Amended and Restated Easement Agreement, Attachment D., Section 5. This section also contains other examples of the types of incentives that FERC may want to consider as it identifies and adopts best practices in this area.

14. Subject to compliance with system safety and reliability requirements, including inspection and testing.

15. Amended and Restated Easement Agreement, Attachment D., Section 6.

16. *See also* Kwoka at 13-14, *supra* n. 8.