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

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION
DEPARTMENT OF ENERGY
WASHINGTON, D.C.

Inquiry Concerning the Commission's Policy on Independent System Operators
Docket No. PL98-5-000

Comment of the Staff of the Bureau of Economics of the Federal Trade Commission(1)

May 1, 1998

The staff of the Bureau of Economics of the Federal Trade Commission ("FTC")(2) appreciates this opportunity to respond to the Federal Energy Regulatory Commission's ("FERC") Inquiry Concerning the Commission's Policy on Independent System Operators ("ISOs"). FERC also has invited interested parties to submit comments addressing topics discussed at its ISO Conference held April 15-16, 1998. Our comment primarily concerns the question addressed by Panel 6 of the conference: "Should ISOs have monitoring and sanctioning functions?" The purposes of this comment are to identify issues of general applicability to all ISOs that we addressed in a previous comment to FERC on market monitoring by the New England Power Pool ("NEPOOL"), and to provide related observations arising from the ISO Conference. (3)

We have four principal concerns about market monitoring proposals in general. Although there are likely to be important differences among ISOs in different regions of the country, these differences do not appear to eliminate the concerns that we addressed initially in the NEPOOL Comment. First, many exercises of market power are likely to be difficult to detect and document (NEPOOL Comment at 5). The need to balance supply and demand in electricity markets continuously and precisely makes electricity trades vulnerable to subtle and short-lived anticompetitive actions that are likely to make fully effective monitoring complex and costly. Second, FERC-imposed behavioral rules for ISO market power mitigation will not eliminate incentives to exercise market power (id. at 6) and, therefore, are likely to be ineffective. Third, market power monitoring and mitigation rules create a risk that certain competitive behavior will be misidentified as anticompetitive, thus chilling competition and increasing administrative and litigation costs (id. at 5). Fourth, focusing on behavioral remedies may divert attention from structural remedies that have the potential to address market power with greater certainty and lower costs to consumers (id. at 6). FERC may wish to consider the broader relevance of these concerns in formulating its policy for market power monitoring and mitigation by ISOs.

In addition, FERC has requested comment on discussions held during the ISO Conference. Panel

6 was charged with addressing the question: "Should ISOs have monitoring and sanctioning functions?" The plan under consideration would allow ISOs that detect market power to be able to mitigate that market power by applying behavioral constraints. Each member of that panel voiced serious reservations about detailed market power policing by ISOs.(4) We believe that the views expressed in our NEPOOL Comment are consistent with this testimony. We also emphasize the related views expressed in our 1995 Open Access comment(5) that received additional attention at FERC's ISO Conference: 1) increasing the size of ISOs may assist in reducing generation market power by expanding the relevant geographic market; and 2) efficient transmission pricing must accompany open access transmission rules (functional unbundling) and ISOs (operational unbundling) if consumers are to obtain the full benefits of electric industry restructuring.

In conclusion, FERC may wish to reconsider the likely costs and benefits of requiring ISOs to attempt intensively to monitor and mitigate market power through behavioral rules. These rules are not likely to address adequately the ability and incentives of market participants to exercise market power and thereby dampen competition.

Respectfully submitted,

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Bureau of Economics

1. This comment represents the views of the staff of the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Federal Trade Commission or any individual Commissioner.

2. This comment represents the views of the staff of the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Federal Trade Commission or any individual Commissioner. Inquiries regarding this comment should be directed to John C. Hilke (303-844-3565).

3. Our NEPOOL comment was filed February 6, 1998 in response to FERC's Notice of Filing "In The Matter of New England Power Pool," Docket Nos. ER97-237-000 and ER97-1079-000 ("NEPOOL Comment"). The NEPOOL Comment is attached.

4. The participants on Panel 6 were Frank A. Wolak, Associate Professor of Economics, Stanford University (on behalf of the California ISO Market Surveillance Committee); Frank Felder, Economics Resource Group (on behalf of Sithe Energies, Inc.); William Hieronymus, Putnam, Hayes & Bartlett, Inc. (on behalf of the members of the New York Power Pool); David B. Raskin, Steptoe & Johnson LLP (on behalf of U.S. Generating Company and the PJM Supporting Companies); and Gregory J. Werden, Director of Research, Economic Analysis Group, Antitrust Division, U.S. Department of Justice (appearing pro se).

5. In The Matter of Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities; Proposed Rulemaking and Supplemental Notice of Proposed

Rulemaking, Docket Nos. RM95-8-000 & RM94-7-001, filed August 7, 1995.