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

BEFORE THE
COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

In the Matter Concerning the Participation of Incumbent Electric Utilities in Regional Transmission Entities	**Case No. PUE990349**

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

February 10, 2000

I. Introduction and Summary

The staff of the Bureau of Economics of the Federal Trade Commission (FTC) appreciates this opportunity to present its views to the State Corporation Commission (SCC) on its implementation of provisions of the Virginia Electric Utility Restructuring Act (the Act). The Act requires incumbent electric utilities to (i) join or establish regional transmission entities (RTE) by January 1, 2001, and (ii) seek authorization from the SCC to transfer their transmission assets to such RTEs. Virginia is among a large number of states implementing regulatory reforms, including unbundling electric power transmission services from generation and distribution services, in order to bring more of the benefits of competition in the electric power industry (lower prices, improved service, and increased innovation) to its citizens and businesses.

The FTC is an independent administrative agency responsible for maintaining competition and safeguarding the interests of consumers. The staff of the FTC often analyzes regulatory or legislative proposals that may affect competition or the efficiency of the economy. 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 staff of the FTC has a longstanding interest in regulation and competition in energy markets, including proposals to reform regulation of the electric power and natural gas industries. The staff has submitted numerous comments concerning these issues at both the federal and state levels.(3) Moreover, the FTC has reviewed proposed mergers involving electric power and natural gas utility companies.

The SCC requests comment on the proposed structure and responsibilities of RTEs(4) that Virginia's incumbent electric utilities are required to join. The proposed requirements use the Federal Energy Regulatory Commission's (FERC) recently released Order No. 2000(5) as a starting point for the essential characteristics and functions of an acceptable RTE and then identify additional requirements that an RTE operating in Virginia must meet and perform. The additional requirements concern reliability practices, pricing and access policies, independent governance, consistency with FERC policy, and fair compensation to the transferor.(6)

There is a potential for additional state RTE requirements, above and beyond FERC's minimum requirements, to vary or even be inconsistent, and thus to have the unintended consequence of frustrating the efficient formation of multi-state RTEs. In light of this potential, the SCC may wish to consider delaying adoption of these additional requirements to see whether FERC's minimum requirements work. The SCC could then better determine what additional requirements, if any, are necessary. Following this period of review, if FERC's standards are insufficient to meet the SCC's concerns, the SCC could then enact additional requirements. On the other hand, if the SCC determines to supplement FERC's RTO requirements now, this comment provides three specific suggestions regarding the SCC's proposed requirements as to reliability practices and pricing and access policies.

II. Additional RTE Requirements May Impede the RTE Formation Process and an RTE's Ongoing Operations

All generation and transmission activity within each of the three interconnected areas of the United States(7) affects prices, availability, and reliability within that entire interconnected area. The FTC has stated that fully effective regional transmission organizations hold considerable promise to facilitate competitive wholesale and retail electric power markets by, among other things, reducing discriminatory access to the transmission grid.(8) The staff of the FTC has advocated that RTEs be as large as practically possible to encompass enough generating firms to mitigate possible market power in generation services and to eliminate transmission access discrimination.(9)

Thus, we believe generally that to be fully effective, RTEs must operate across state borders. If states impose differing requirements on an RTE that operates in more than one state, there is a potential to impede or delay the formation of the RTE, restrict its size, and increase its operational costs. For example, three or four states within the same region could each adopt separate requirements (e.g., regarding transmission line loading relief) or interpret similar requirements differently. Some of these individual state requirements might be inconsistent with those in other states or require RTE functions that are not acceptable to other states, thus endangering the RTE formation process. In addition, compliance costs may be unnecessarily increased to meet the differing, and possibly conflicting, state requirements.

The process of forming and implementing RTEs is complicated and, in many respects, still involves many unknown factors. Accordingly, as a first step, the SCC may wish to use FERC's recently released RTO minimum characteristics and functions as the initial standard for an acceptable RTE that Virginia's incumbent electric utilities join. The SCC also may wish to coordinate with other states in the Eastern Interconnect to ensure that conflicting standards are not adopted that could thwart the implementation of a multi-state RTE operating in Virginia. If the SCC determines that the RTE (once operational) is failing to carry out a particular practice or is structured in a way that impedes competition in retail electric power markets, the SCC could act in conjunction with other concerned states and FERC to remedy the situation at that time.

III. Market Forces Can Enhance Reliability

One of the key questions raised by the effort to inject competitive forces into the electric power industry is how to provide market-based pricing and investment signals for the operation and expansion of the transmission grid, which is currently under monopoly control and immune to market forces. Where feasible, an RTE should encourage market approaches to the operation of the transmission grid. A market approach means transmission customers should receive pricing that reflects the consequences of their transmission usage decisions (e.g., transmission of electric power over a congested interface should cost more than the same transaction when the interface is not congested). If an RTE's market approach is successful, decisions as to where, when, and how to relieve transmission congestion (either through expanding transmission or through constructing new generation capacity) will be driven by economic considerations.(10) In light of this potential, it may be unnecessary to provide RTEs with authority to "[p]romote the construction of properly located generation facilities"(11) or "to construct or to compel the construction of needed transmission facilities."(12) These proposed RTE requirements could be interpreted to allow the RTE to second-guess the working of the market and impose its own prescription -- regardless of market effects -- for expanding

transmission and generation capacity. In addition, this type of authority may allow the RTE to discriminate against distributed generation, which is a market-based means to reduce transmission congestion.(13)

IV. Market Monitoring and Information Sharing Requirements

A. RTE Market Monitoring Should Include Analysis of Existing Market Power

The SCC has proposed that RTEs "[p]rovide for effective market monitoring, including serving as a resource to assist the FERC and state regulatory commissions in the identification and resolution of market power abuses."(14) The FTC has noted that market power may be exercised where one or a few generating firms obtain and exploit market dominance in areas of the country where transmission congestion occasionally creates restricted geographic markets for electric energy (load pockets). Market concentrations of electric power generation may be high in some areas, in part because state and federal regulators assumed that rate and service regulation would remain in place indefinitely and thus may have assumed there was no need for antitrust scrutiny to restrain the growth of market power.

As regulations are relaxed for generation and retail trades of electricity, however, existing market power in generation may prevent consumers from realizing the full benefits of competition. The FTC has suggested that attention be given to assessing and remedying existing market power.(15) Accordingly, the SCC may wish to require that the RTE analyze existing market power as part of its market-monitoring responsibilities.

B. RTE Should Share Market Monitoring Information with the Federal Antitrust Authorities

The SCC also may wish to permit market power information developed by the RTE to be made available to the federal antitrust agencies, so that the RTE serves as an "information resource" to the federal antitrust agencies and state attorneys general, in addition to "to reliability councils or committees, potential market entrants, consumers, the FERC and state regulatory commissions."(16) The FTC (and the Antitrust Division of the U.S. Department of Justice) may be able to use such information to enforce more effectively and efficiently the antitrust and consumer protection laws in the markets where the RTE controls and operates the transmission grid. The RTE often will be the first line of defense, and the antitrust authorities (among others) should benefit from the RTE's front-line experience.

V. Conclusion

In developing supplementary rules for RTEs, caution may be appropriate to avoid burdening the RTE formation process. The SCC may wish to delay imposing any additional requirements until the process FERC has established to form RTOs has taken place and the SCC can determine what, if any, requirements it needs to supplement. If the SCC decides to adopt additional RTE standards at this time, the SCC may wish to require RTEs to assess existing market power and to grant the antitrust agencies access to RTE data and research information.

Respectfully submitted,

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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. Inquiries regarding this comment should be directed to John C. Hilke (303-844-3565).

2. Duplicate of Footnote One (webmaster)

3. The staff of the FTC has commented to FERC on electric power regulation in 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); Docket No. PL98-5-000 (merger filing guidelines) (May 1, 1998); 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 staff of the FTC also has submitted comments to various state agencies, including the New Mexico Public Regulation Commission, Utility Case No. 3106 (affiliate codes of conduct) (Dec. 6, 1999); Public Utilities Commission of the State of California, Docket No. R.98-12-015 (distributed generation) (Mar. 17, 1999) (California Distributed Generation Comment); Alabama Public Service Commission, Docket No. 26427 (restructuring in general) (Jan. 11, 1999) (Alabama Competition Comment); Louisiana Public Service Commission, Docket No. U-21453 (affiliate transactions) (Oct. 30, 1998); Public Utility Commission of Nevada, PUCN Docket No. 97-5034 (affiliate transactions) (Sept. 22, 1998); Mississippi Public Service Commission, Docket No. 96-UA-389 (Transco proposal) (Aug. 28, 1998); Louisiana Public Service Commission, Docket No. U-21453 (stranded costs) (Aug. 7, 1998); Michigan Public Service Commission, Case No. U-11290 (electric restructuring) (Aug. 7, 1998); West Virginia Public Service Commission, Case No. 98-0452-E-GI (electric restructuring) (July 15, 1998); Commonwealth of Virginia, Joint Subcommittee Studying Electric Industry Restructuring, SJR-91 (July 9, 1998); Public Utility Commission of Texas, Project Number 17549 (affiliate transactions) (June 19, 1998); Maine Department of the Attorney General and Public Utilities Commission, "Interim Report on Market Power in Electricity" (May 29, 1998); and Louisiana Public Service Commission, Docket No. U-21453 (market power) (May 15, 1998) (Louisiana Market Power Comment). The FTC staff comments are available at: <http://www.ftc.gov/be/advofile.htm>.

4. This comment treats the terms "RTEs" (the term used in the Act) and "RTOs" (the term FERC uses for regional transmission organizations) as the same.

5. Regional Transmission Organizations, Order No. 2000, 65 Fed. Reg. 810 (Jan 6, 2000).

6. For example, RTEs must have pricing and access policies that must: "1. Provide for efficiently priced transmission access to competing generating resources over as broad a region as possible; 2. Use transmission rates that do not discourage economic transactions, and do not encourage uneconomic transactions; 3. Be adaptable for purchasers of electricity at wholesale or at retail; 4. Provide for the efficient relief of transmission congestion through the redispatch, by direct orders or by coordination with customers and generators, of competitively priced generation on an economically efficient basis; 5. Provide for the efficient pricing of transmission transactions between different regional transmission organizations; 6. Ensure that all transmission decisions, including pricing, access, planning and operational decisions, are made transparently; 7. Provide for effective marketing monitoring, including serving as a resource to assist the FERC and state regulatory commissions in the identification and resolution of market power abuses; and 8. Create an environment which facilitates the development of an efficient generation market." 20 VAC 5-320-50(B).

7. The Nation's transmission grid is currently divided into three interconnects: the eastern states (as far west as Colorado), the western states, and Texas. Portions of Canada and Mexico also are part of the interconnects serving the U.S.

8. Letter of the Federal Trade Commission to House Commerce Committee Chairman Thomas Bliley, Analysis of H.R. 2044 at 9 (Jan. 14, 2000) (Bliley Letter).

9. *See, e.g.*, Alabama Competition Comment, *supra* n. 2, at 30.

10. It is important to ensure that these market-based investment signals are not unnecessarily burdened by regulatory obstacles. In the electric power industry, a large impediment to expanding or adding new generation or transmission capacity has been siting issues. The SCC may wish to review the Commonwealth's siting processes, in order to avoid unnecessary regulatory burdens and delays on the path to competition. Such a review may be appropriate regardless of whether the SCC imposes the proposed RTE requirements.

11. 20 VAC 5-320-40 (6).

12. *Id.* at (3).

13. *See* California Distributed Generation Comment, *supra* n. 2.

14. 20 VAC 5-320-50 (B)(7).

15. Bliley Letter, supra n. 7, at 4-6.

16. 20 VAC 5-320-40 (5).