

For Distribution
Remarks of
Commissioner James J. Hoecker
Federal Energy Regulatory Commission

**"Bulk Power Market Issues
Now Before FERC"**

The Western Electric Power Market
Functional Unbundling of the WSCC

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C. Market Power

Open access has interesting implications for the pricing of power. The NOPR asked parties to comment on whether implementation of non-discriminatory tariffs would eliminate market power in generation (both installed and new). Currently, the Commission requires utilities to demonstrate that they do not have market power in existing generation before they or their

affiliates are allowed to charge market-based rates. However, the Commission determined in a recent case that there is no generation dominance in new (unbuilt) generation. Kansas City Power & Light Co., 67 FERC ¶ 61,183 (1994). Most commenters other than IOUs think it would be premature for the Commission to permit market-based rates for installed capacity unless there is a persuasive showing of no market power in individual cases. Many transmission-dependent generators argue that market power abounds for both new and old generation and that there is no basis for drawing a distinction between the two. EEI and many member utilities argue, on the other hand, that existing generators simply could not possess market power under open access tariffs. EEI therefore recommends that all markets be declared competitive by a date certain after the Final Rule.

DOJ and DOE urge the Commission to continue to examine actual market concentration and competitive conditions on a case-by-case basis. DOE is concerned that mergers could increase concentration in generation

markets unless the new entity sells or spins off some of its generation assets. State regulators, power marketers, and even some utilities share the concern that it would be premature for the Commission to drop its market-power analysis of existing generation.

At this juncture, and particularly in light of EEI's claims about the curative powers of open access, I ought to say at least a few words about the Commission's approval of utility mergers, which promise to increase in number. Mergers (that is, the combination of vertically integrated companies) offer tremendous opportunities for more efficient coordination and dispatch, cost-savings in planning and administration, and scale economies. They also, at least at first blush, appear to be the antithesis of an increase in competition.

In a joint statement a few months ago, Commissioner Massey and I raised general concerns about the suitability of the Commission's existing merger review standards under section 203 of the Federal Power Act.

I admit that a final rule which fosters greater open access will curb the ability of any utility to exercise market power in transmission or generation. But there may be more to it than that.

In the past, the Commission seldom set eyes on a merger application it came to dislike. FERC's regulatory job was pretty simple, partly because of a highly deferential standard of review, which allows companies to claim net benefits from a merger with ease. The mergers we have approved (which have been subject to an open access condition since Pacificorp) have proven themselves to be in the public interest. Yet, after open access becomes the norm, a merger between two large integrated utilities would likely result in an increase in the concentration of generation resources, not the decrease we have come to rely on when open access was first enforced. Does this matter? The answer is complex.

Inherent in utility mergers is the horizontal consolidation of generation and transmission resources,

perhaps even on a regional level. This may be good strategic preparation for possible corporate reorganizations in the future -- i.e., disaggregation -- which may become more appealing in the competitive open access environment. It remains to be seen, however, whether the inevitable reduction in the number of competing generating companies as a direct consequence of merger is a problem.

Certainly, the assumption that open access will allow all suppliers to compete for all markets may be defensible in many cases, based on traditional measures of market power. But that automatic assumption may be indefensible in other cases if the newly merged transmission systems have serious constraints at their interfaces or other kinds of congestion that prevent non-affiliated generators from selling power wherever they can out-compete the utility or its affiliated genco. Perhaps those constraints and the transmission system as a whole can be administered so as to disadvantage no one; but I think that may imply the need for an independent system operator.

Numerous comments on our proposal suggest that we reevaluate the Commission's merger policy, particularly in light of the new competitive environment. Some contend that the Commission should distinguish between efficient mergers and inefficient mergers; some want us to employ the DOJ merger guidelines, which net out any potential benefits attainable by means other than merger; some even advocate divestiture. Whether the Commission will ever tackle this issue in the context of the Giga-NOPR or in merger cases remains to be seen.