

Electric Reliability – Implications for Regulation and Antitrust

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About the American Antitrust Institute

The American Antitrust Institute (AAI) is an independent Washington-based non-profit education, research, and advocacy organization. Our mission is to increase the role of competition, assure that competition works in the interests of consumers, and challenge abuses of concentrated economic power in the American and world economy. We are, broadly, post-Chicago centrists dedicated to the vigorous use of antitrust as a vital component of national and international competition policy. The AAI is an entrepreneurial proponent of the position that competition serves the most vital interests of the American public by (1) assuring competitive prices, (2) fostering innovation and efficiency so that consumers get the choices that a free market should provide to them, and (3) protecting opportunities for small and medium-size businesses to compete on the merits in ways that do not undermine efficiently operating markets.

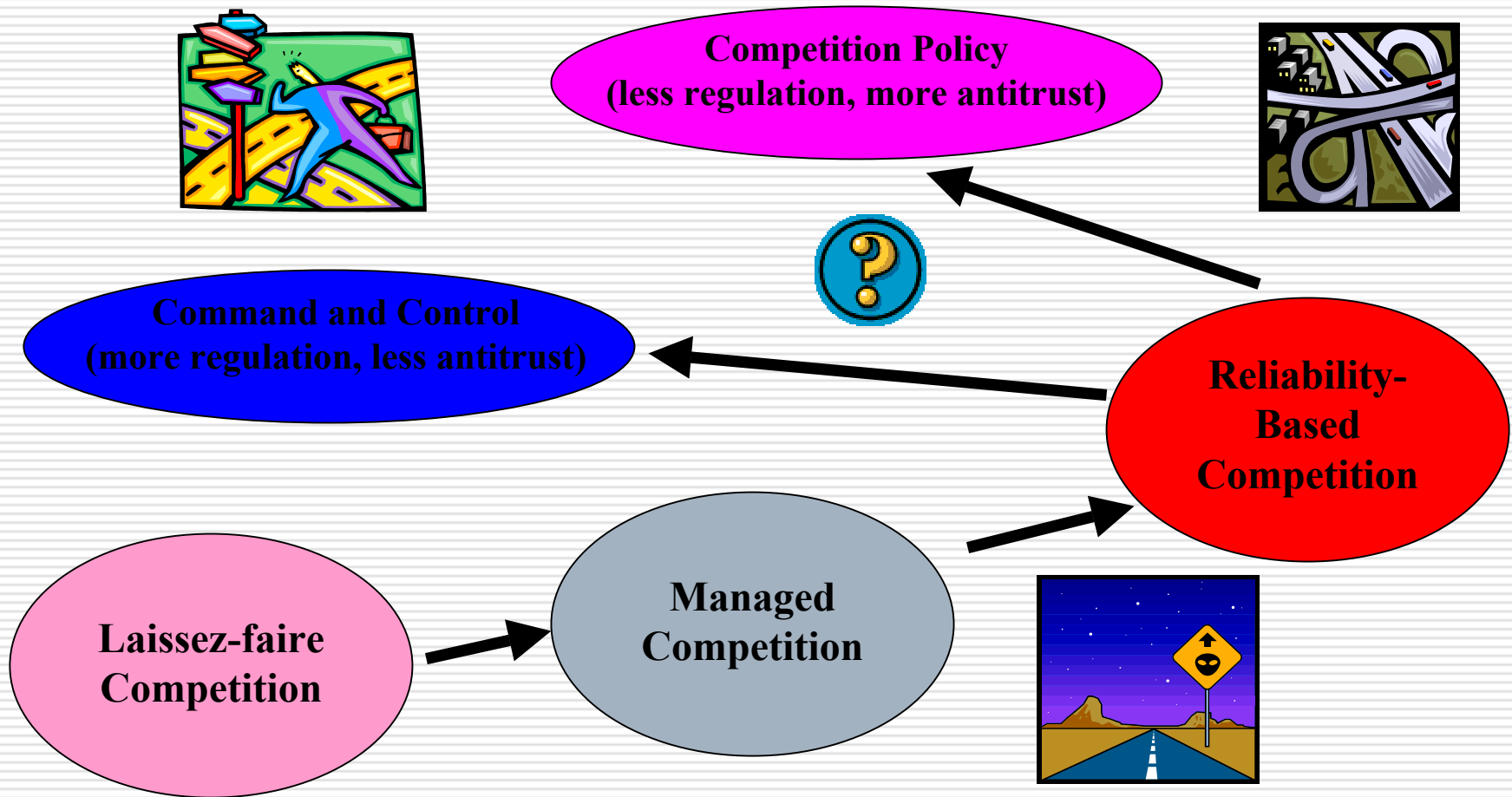
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Overview

- The “fork” in the restructuring road**
 - Product quality in electricity vs. other markets**
 - Reliability policy agenda items**
 - Choice of instruments -- command-and-control vs. competition policy**
 - Relative emphasis of regulation and antitrust -- comparative advantage and compatibility**
 - Approach to market analysis -- the DOJ/FTC Guidelines, consistency, and simulation models**
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Reliability and the “Fork” in the Restructuring Road



Product Quality in Electricity and Other Markets -- **Consumer Choice**

Other markets

- Key element of non-price competition, or
- Consumers pay for the preferred level of quality, or
- Money-back guarantees, when quality is not known

Electricity

- Under competitive model, command-and-control reliability + transmission bottleneck renders the system blind to quality-based competition
 - Consumers are assumed either to (1) value reliability the same or (2) be “unsegmentable” due to technical or institutional reasons
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Product Quality in Electricity and Other Markets -- **Standard-Setting**

□ *Other markets*

- Need arises when costs of *not* having them are high (e.g., drugs, construction, environmental, securities, etc.)
- Coordination among firms may be socially beneficial, if it produces superior outcomes (some high technology cases)
- In most cases, standards administered and enforced by external, independent, governmental or quasi-governmental bodies

□ *Electricity*

- Standards galore, but outages have demonstrated the high economic and political costs of an outdated, inappropriate approach
 - Coordination better than atomistic competition but minimum, unenforceable command-and-control standards with unresolved supplier liability issues reflects vested interests of stakeholders
 - System of voluntary, non-independent self-regulation is ineffective
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Reliability Policy Agenda Items

- *Choice of instruments* -- command-and-control vs. competition policy
 - *Relative emphasis of regulation and antitrust* -- comparative advantage and compatibility
 - *Approach to market analysis* -- the Guidelines, consistency, and simulation models
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Command-and-Control vs. Competition

Policy Instruments

- ***Recognizing Policy Equivalency*** -- for every command-and-control instrument, there is an equivalent competition policy instrument(s) that promotes structurally competitive electricity markets through lower concentration, easing of entry, and increased demand response
 - ***Reducing Bias Toward Command-and-Control*** -- historical engineering-based approach, expediency, and political factors create a bias toward command-and-control
 - ***Avoiding Interim or Stop-Gap Policy***
 - Need to continuously match supply and demand makes reliability and competition highly interdependent
 - Co-existence of behavioral rules and structural reforms is possible, but lack of policy “commitment” delays benefits of the latter
 - Any mix of command-and-control and competition instruments should reflect economic, legal, engineering, and institutional market characteristics
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Elements of Command and Control-Based Reliability

- ❑ ***Transmission Loading Relief*** -- affects non-involved consumers, increases risks of regional transfers, reduces incentives to build low-cost generation, increases chances of discriminatory curtailments, and increases prices through higher costs and reduced competition
 - ❑ ***Competitively Sensitive Information Disclosure Requirements*** -- indiscriminate revelation of buyer/ seller identity in transmission contracts enhances potential for discrimination
 - ❑ ***Bid Caps*** -- distort consumption decisions and investment incentives, repress development of new technologies, requires ongoing fine-tuning, and may ignore small market problems
 - ❑ ***Engineering-Based Variation in Regional Reliability Standards*** -- ignores economic differences for tailoring standards to regional characteristics, creating inter-regional tensions and perverse investment incentives
 - ❑ ***Resource Adequacy Requirements*** -- complex approach for creating incentives by eliminating free-riding, wrong planning window for entry may allow the exercise of market power and encourage inefficient investments
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Elements of Competition-Based Reliability

- ***Demand Response*** -- Real-Time Pricing provides incentives to curtail consumption during periods of high demand, programs can be bid into ancillary services market as a form of reserves
 - ***Locational Marginal Pricing*** -- improves investment signals, increases efficiency of grid operations and requires curtailment only as “back-up”
 - ***Hybrid-Model RTOs (absent vertical separation)***, -- independent governing board that determines and enforces market rules + for-profit operation of the grid
 - ***Information Disclosure Requirements*** -- protects consumers from adverse affects of reliability by free-riding LSE’s with inadequate reserves
 - ***Property rights, liability, and reserves access pricing*** -- better ways than resource requirements to exclude free-riding LSEs from sharing in pooled reserves
 - ***Network Access Service*** -- eliminates preference for native load and thus reduces discrimination, harmonizes inter-state differences
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Roles of Regulation and Antitrust

- *Identifying and Prosecuting Exercise of Market Power*
 - Antitrust can do much about exclusion (discrimination, refusals to deal), but little about classical market power (withholding), leaving it to the FERC and the states, which will struggle with lack of analytics, inconsistency and small, non-punitive penalties
 - *Managing Split Over Structural Reforms vs. Behavioral Rules*
 - FTC Staff has frequently noted the benefits of structural reforms while Congress and FERC have steadfastly pursued compulsory access
 - Absent vertical separation of generation and transmission, governance of regional reliability organizations and RTOs must be independent of underlying suppliers and buyers
 - *Maintaining Coherent Merger Review*
 - Proposed “reliability impact” in merger review jeopardizes coexistence of the “public interest” and “no harm” standards and creates bias for regulatory approval of anticompetitive mergers
 - Antitrust experience in gas and coal-electric merger challenges provide useful insights for regulatory merger review
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Approach to Market Analysis

- ❑ ***Resolving Inconsistencies in Analytical standards*** -- for market analysis across Section 203, Section 205, and proposed market monitoring
 - ❑ ***Adoption of DOJ/FTC Guidelines*** -- provides consistent approach based on sound economic principles for assessing competitive effects
 - ❑ ***Use of Simulation Models*** -- better account for load-flows, loop-flows, effects of new generation and transmission, new technologies, and fuel prices
 - ❑ ***Performing Ongoing Market Analysis*** -- structural or non-structural market assessment will provide needed information on entry, congestion, and likely market outcomes
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