Aug. 23 1999

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

Notice of Proposed Rulemaking on Regional Transmission Organizations	)))	Docket No. RM99-2-000

COMMENTS OF THE U.S. DEPARTMENT OF JUSTICE

The U.S. Department of Justice (Department) submits these comments in response to the Notice of Proposed Rulemaking (Notice) published by the Federal Energy Regulatory Commission (Commission) in the above-captioned docket (64 *Fed. Reg.* 31,390 (May 13, 1999)). The Department supports the Commission's efforts to encourage the formation of well-functioning, independent Regional Transmission Organizations (RTOs). The Department agrees with the Commission's judgment that RTOs can provide an efficient and effective means of fostering competition in wholesale electric power markets by ensuring open and equal access to the transmission network.

The Department expects RTOs to be highly procompetitive institutions, and the Proposed Rule and review by the Commission generally should ensure that RTO formation will not lessen competition. There is, however, a potential for abuse that the Commission should not lose sight of and that the Department will focus on in carrying out its enforcement responsibilities under the antitrust laws. It is possible for an RTO to be structured in a way that makes it much less procompetitive than it could be, or even in a way that results in a net lessening of competition. An RTO could be structured in a way that preserves market power rather than eliminate it, for example, by giving incumbent transmission entities veto power over grid expansion. There is also a danger that utilities forming an RTO will use the occasion to reach other agreements that are

unrelated to legitimate RTO activities and that unreasonably restrain trade. In the event of such situations, the Department is prepared to bring an enforcement action; however, RTOs that further the Commission's procompetitive policies have nothing to fear from the Department.

The Notice makes a strong case for mandating RTOs, but the Proposed Rule does not do so. Rather, it solicits comment on "what actions might be appropriate if a utility fails to voluntarily join an RTO." In particular, the Notice asks "whether market-based rates for generation services could continue to be justified for a public utility that does not participate in an RTO," and "whether a merger involving a public utility that is not a member of an RTO would be consistent with the public interest" (64 *Fed. Reg.* 31435).

The Department recommends that carrots and sticks be carefully designed to *reasonably guarantee complete* voluntary compliance, rather than merely *promote greater* voluntary compliance. It would be undesirable to create an incentive structure in which some utilities elect to forego efficient market-based pricing systems or cost-saving mergers because they find that RTO participation would cost them more than the efficient-pricing systems or mergers would benefit them. Utilities would make such choices because they are able to use their strategic control over transmission to limit competition, which is the situation RTOs are intended to remedy. Moreover, collective action is necessary to implement an RTO, and the use of some possible carrots and sticks (e.g., denial of merger applications) could induce certain utilities (e.g., all but the merger applicants) to hold out because they calculate that the carrots and sticks would disproportionately harm competitive rivals.

The Department generally supports the Commission's "open architecture" policy, which imposes only minimal constraints on RTO structure, organization, and function. Nevertheless, the Department believes that § 35.34(i) of the Proposed Rule may be inadequate to ensure the independence of RTO decisionmaking. Proposed § 35.34(i) prohibits control of an RTO by "any market participant or class of market participants." The Rule does not, however, achieve the clean break contemplated by the Notice, which lists as one of the benefits of an RTO that "the control of transmission operations is

cleanly separated from market participants" (64 *Fed. Reg.* 31409). The Commission should consider barring all "market participants" from any decisionmaking roles within an RTO. At minimum, the Commission should require that a majority of the voting members on an RTO's board of directors (and committees vested with decision making authority) have no relationship with any "market participant," and that voting rules not allow a minority to veto majority rules.

Without a clean structural break between RTO control and market participants, the Commission must continue to patrol the border between regulated transmission and competitive generation markets. To prevent "control" by a "class of market participants," the Commission would have to engage in ongoing monitoring of board composition; otherwise, the board might become a cartel of incumbents using the grid to maintain the status quo. To ensure that a board was truly representative of all market participants would require even greater pains to see that new entrants and new kinds of entrants are represented as markets change. In either event, the Commission would be substituting one kind of monitoring for another, rather than accomplishing the clean structural solution it espouses and which the Department supports. Moreover, a truly representative board could consist of warring factions and result in decisionmaking paralysis, and prevent an RTO from responding procompetitively to changes in market conditions or new information.[1]

The Proposed Rule appears to be silent on how RTOs are to deal with one another and on trades across RTO borders. While the great bulk of trade may be intra-RTO, patterns of trade over recent years indicate that a significant volume of transactions will flow into and out of RTO regions. The open-access concerns that animate the Notice should apply not only within, but also across, RTO borders. While § 206 of the Federal Power Act (16 U.S.C. § 824e(a)) already prohibits rates and treatments that are "unduly discriminatory," the Department suggests that the Commission consider adding a provision to the Proposed Rule that addresses the issue directly. One possibility would

[1] As a general matter, the Department does not believe that profit making status of an RTO fundamentally affects any of the foregoing. The antitrust agencies regularly examine and sometimes challenge mergers of not-for-profit companies. *See, e.g.*, United States v. Rockford Memorial Corp., 898 F.2d 1278 (7th Cir. 1990).

be to require an RTO to establish procedures and tariffs for inter-regional transmission with other, interconnected RTOs.

At several points (e.g., 64 *Fed. Reg.* 31401, 31416, 31422–23) the Notice discusses the issue of "rate pancaking," and the Proposed Rule (§ 35.34(j)(1)(ii)) addresses this issue by requiring that: "The Regional Transmission Organization Tariff must not result in transmission customers paying multiple access charges to recover capital charges for transmission service over facilities that the Regional Transmission Organization controls (i.e., no pancaking of transmission access charges)." Eliminating unreasonable pancaking, of course, is a desirable feature of efficient transmission pricing, which RTOs should foster. But efficient pricing is the goal, not the elimination of pancaking, and efficient pricing may have an element of pancaking.

Over the long-run, it is important, and probably essential, that the buyers and sellers of electricity benefitting from particular transmission facilities pay for them, and that each buyer and seller pay in relation to its usage of those facilities. Even within the region of a single RTO, it is possible that usage of transmission facilities is not roughly proportional to generation or load. For example, loads at the end of a peninsula could use transmission disproportionately as compared with loads not on the peninsula. If capital charges did not account for actual transmission usage, socially inefficient locational decisions would be made by generators and loads.

There should not be inefficient, regulatory restrictions on the design of any capital charges necessary to pay for past or future investments. Some sort of zone system might make sense in a particular situation. Loads could be assessed transmission charges on the basis of their location and on the location of the generation resources on which load-flow studies indicate that they principally rely. The Proposed Rule, however, seems to prohibit such a system. If the problem described here is substantial, the Proposed Rule would tend to reduce the size of RTO regions, which the Notice clearly indicates is something the Commission does not want.

The Proposed Rule (§ 35.34(j)(6)) requires that RTOs "monitor markets for transmission services, ancillary services and bulk power to identify design flaws and

market power and propose appropriate remedial actions." The Department supports the concept of market monitoring but has two concerns about the Proposed Rule.

First, the scope of the market monitoring obligation is determined by whether the RTO itself "operates" "markets for ancillary services and bulk power." This makes sense, since the RTO cannot reasonably be expected to monitor activities with which it has no involvement. However, it could mean that there is dramatically less market monitoring in some regions with RTOs than in others, depending on what functions the RTO has undertaken and what functions are undertaken by separate trading institutions. This does not appear to be what the Commission's various orders on individual ISOs contemplate. The Proposed Rule also could discourage RTOs from operating "markets for ancillary services and bulk power" when it otherwise would be efficient for them to do so. The Commission should consider requiring both each RTO and each separate electric power trading institutions to monitoring any markets it "operates."

Second, the Department believes that RTOs, as well as separate trading institutions like California's Power Exchange, should have carefully circumscribed market monitoring functions. Trading institutions should ensure market integrity and efficient functioning. If, for example, the trading institution establishes an auction mechanism, it should ensure that all bidders are treated equally, that established bidding procedures are followed, that the established price is that which clears the market (according to established procedures), and that costs of trading are not excessive. Trading institutions should determine whether established procedures are working properly, and when problems with their own procedures are identified (i.e., when opportunities to game the system are identified), trading institutions should change those procedures. And trading institutions also should play a role in information collection and dissemination.

The Department doubts, however, that RTOs and separate trading institutions should be responsible for detecting exercises of market power and making recommendations for correcting market power problems. Such institutions lack experience in such matters, and there is no shortage of interested persons ready and willing to analyze the data for evidence of market power and other indications of market performance. The Department opposes any form of punishments being meted out by

trading institutions for exercises of market power.

Respectfully submitted,

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