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The American
Antitrust Institute

American Antitrust Institute Third Annual Energy Roundtable Workshop

"Getting from Here to There – Transitional Competition Issues in U.S. Electric Industry Restructuring"

January 21, 2003

Summary of Proceedings

Introduction

On January 23, 2003, the American Antitrust Institute (AAI) held a day-long workshop on transitional issues in electricity market restructuring at the headquarters of the National Rural Electric Cooperative Association (NRECA) in Arlington, Virginia.[1] The workshop was by invitation only and AAI greatly appreciates the participation of approximately thirty-five government officials, academics, consumer and business representatives. We are especially grateful to those who made presentations, who asked questions or made statements in the workshop, and who took the time to provide detailed feedback after the event.

This was AAI's third annual workshop on electricity and competition policy.[2] Diana Moss, AAI Vice President and Senior Research Fellow[3] prepared the workshop agenda,

[1] AAI appreciates NRECA's valuable assistance in making the workshop possible.
[2] A summary of the previous workshop may be found at http://www.antitrustinstitute.org/recent2/166.cfm. The first workshop, held in September, 2000, is briefly described at http://www.antitrustinstitute.org/recent/83.cfm.
[3] Dr. Moss was formerly a high ranking economist at FERC. Her e-mail address is dmoss@antitrustinstitute.org.

presided over the discussion, and prepared the following observations about the proceedings. The proceedings themselves were off the record and not transcribed. Prepared presentations are attached to this document by permission of their authors, as well as the workshop agenda. The following observations represent only one participant's perspective on the more important themes to emerge from the presentation and discussion.

Proceedings

Speakers: Speaker presentations marked with " * " are attached.

1.* **Alan Richardson, President and CEO, American Public Power Association**
2.* **Michael Dworkin, Chairman, Vermont Public Service Board**
3. **Peter Fox-Penner, Chairman, Brattle Group**
4.* **Richard O'Neill, Chief Economic Advisor, Federal Energy Regulatory Commission**
5. **Nora Brownell, Commissioner, Federal Energy Regulatory Commission**
6. **Mozelle Thompson, Commissioner, Federal Trade Commission**
7.* **John Kwoka, Finnegan Professor of Economics, Northeastern University**
8.* **Scott Hempling, Attorney, Law Offices of Scott Hempling**

General Observations

The purpose of AAI's third workshop on electricity restructuring was to bring together various stakeholders and perspectives on the transitional problems in U.S. electricity restructuring. Two years ago, the rountable's theme was antitrust priorities. One year ago, the roundtable focus was on market monitoring, which was looking like a "catch as catch can" interpolation of antitrust and regulation, with few patterns and few successes. There is now growing consternation that the restructuring process is going badly and that even partial mid-course reversals would be difficult (e.g., "You can't put the toothpaste back into the tube").

Bert Foer and Diana Moss recently co-authored a paper on transitions from antitrust to competition, in which they hold out the prospect that transition from more regulated to less regulated markets may be a more or less permanent state. While there are models of regulation and models of competition, there are no models for transition. What we do know is that the "political economy" of electricity restructuring is critically important but in hindsight, efforts have not paid sufficient attention to the "political" factor in devising workable policy solutions that make transition less difficult. Hopefully, we can find experiences to draw on, but we should be willing to look beyond electricity and beyond the U.S.

For example, telecommunications restructuring has gone on for a full generation, and is still a mess, having brought us innovations and lower long distance prices, but also service problems and a variety of serious puzzles relating to local monopolies. But are we ready for laissez faire, the aim of the current FCC chairman? Airline deregulation has also been at work for a generation. It has been characterized by increased volume, relatively low prices, and a hum of consolidation. There is a workable interplay between antitrust and regulation, but we may never reach a point where the DOT can bow out. Electricity is the largest deregulation effort and the most complex, with the most elements of government intervention and dire consequences of failure. Several events have brought into sharp focus the difficulty inherent in restructuring, including the Enron debacle, loss of investor confidence, conundrum of state/federal jurisdictional issues regarding market design and infrastructure, and a general perception that there is no one at the "restructuring helm".

The roundtable discussion made clear that restructuring is turning out to be a long and protracted process, fraught with difficult economic, legal, and institutional problems.

Predictions for an easy transition from regulated to market-based commodity have been replaced with acceptance that electricity is not just another "commodity." While economic models may accurately predict outcomes of market-based trade, these outcomes are not necessarily palatable for consumers or investors. Price volatility and returns that do not generate sufficient investment are good examples. Market power, its identification and remediation, remains the most troublesome problem in restructuring.

Themes in the Roundtable Discussion

Several themes in the restructuring debate emerged during the course of the roundtable. These themes should be considered as integral to any mid-course correction strategy.

- **Ongoing restructuring that acknowledges a permanent mix of regulation and competition--rather than a transition that ends in something resembling a free market--appears to be a realistic expectation.** But even with this needed adjustment in perspective, many problems remain. [4]
- **The peaceful coexistence of different business models is critically important for restoring investor confidence in the industry.**[5] Financial markets have fully revealed the extent of the restructuring crisis, as we can see from capital flight and high risk

[4] Ongoing regulatory oversight and monitoring is central to making a mix of regulation and competition work. Without proper infrastructure and policy choices, such a mix could have serious implications for efficiency (e.g., sellers with market-based rate authority operating in the same market as sellers without market-based rate authority).
[5] Business models include regulated entities that operate in bilateral markets vs. unregulated entities that operate in centralized day-ahead and real-time auction markets.

premiums.[6] Restructuring policy must therefore grapple with the uncomfortable nexus between market power and the ability to attract capital (i.e., the fact that investors like monopolies).

- **Restructuring efforts are targeted at individual levels of the vertically-integrated industry but state/federal coordination should cultivate a more holistic approach.** This includes recognizing the linkages between different segments of the industry but at the same time considering how entry, concentration, and consumer preferences differ markedly between them.
- **Market power, its identification and remediation will continue to be a problem absent large-scale policies directed toward eliminating it.**[7] Unilateral market power is particularly important in electricity but the antitrust agencies are disinclined to pursue it, leaving FERC and the states to assume the burden.[8]
- **Relying on the demand-side of electricity markets to solve current problems may be of limited value.** This is particularly true when incentives to raise price through withholding remain strong. Consumers do not seem to be interested in restructuring and there is little potential for demand responsiveness to discipline markets.[9]

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[6] This brings into question whether high risk premiums potentially outweigh the benefits of market discipline.
[7] AAI filed comments regarding market power and other issues in response to FERC's proposed rulemaking on standard market design (see: http://www.antitrustinstitute.org/recent2/216.cfm).
[8] Antitrust enforcement would be too slow to effectively remedy strategic withholding. But, a better-equipped FERC is needed (e.g., the FTC could give valuable input and FERC needs more guidance on developing market-based rate policy).
[9] At this point, policy-making should probably recognize the mediocre response to retail access for consumers' revealed preference against having to choose. Even with real-time pricing, demand elasticity is likely to remain low; it is difficult to feed price preferences back to suppliers in time to avoid needless dispatch and resource additions.

- **Risk is endemic to markets, so price volatility will not disappear.** The policy question is deciding how much risk is acceptable and how it should be allocated when the market produces unpalatable results.[10]
- **Revoking PUCHA would be removing needed protections.** Many of PUCHA's provisions apply directly to issues that are ripe in the industry today.
- **Expanded coordination among state and various federal agencies would be useful.** Antitrust plays a role in competition policy, even in markets where regulation and competition coexist. Looking for competition-based solutions to problems highlights the importance of the consumer. It would be useful if the FTC, whose expertise covers both competition policy and consumer protection, were to become more of a leader in the development of transition policy in the electricity industry.

[10] Shifting risk through hedging, however, will not make markets any more stable when incentives to exercise market power remain.