UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION

REQUEST FOR COMMENTS	)	
ON RETAIL ELECTRICITY	)	**DOCKET NO. V010003**
COMPETITION PLANS	)	

COMMENTS OF NORTHEAST TEXAS ELECTRIC COOPERATIVE, INC., TEX-LA ELECTRIC COOPERATIVE OF TEXAS, INC., AND SAM RAYBURN G&T ELECTRIC COOPERATIVE, INC.

Northeast Texas Electric Cooperative, Inc., Tex-La Electric Cooperative of Texas, Inc., and Sam Rayburn G&T Electric Cooperative, Inc. (collectively, the "East Texas Electric Cooperatives") submit the following comments in response to the Commission's March 6, 2001 Notice Requesting Comments on Retail Electricity Competition Plans.

INTRODUCTION AND SUMMARY

East Texas Cooperatives are generation and transmission cooperatives ("G&T's") that purchase, generate and transmit power on behalf of their distribution cooperative members who, in turn, serve their retail consumer members. East Texas Cooperatives are therefore vitally interested in the development of truly competitive retail electric power markets. The development of these markets and East Texas Cooperatives' participation in them can work to lower the costs of electric power to their members. East Texas Cooperatives operate in both the Electric Reliability Council of Texas (ERCOT) and in a part of Texas located in the Southwest Power Pool (SPP). East Texas Cooperatives welcome this opportunity to provide comments on retail electricity competition and the difficulties that attend its implementation.

In the Executive Summary to its July 2000 Report, *Competition and Consumer Protection Perspectives on Electric Power Regulatory Reform* ("Report"), the FTC Staff observed that "the benefits of deregulating the electric power industry may be deferred—or may not materialize at all – if existing monopoly utilities are left unchecked to exercise market power in a deregulated marketplace." The Report continues, "as regulation is reduced and competition is encouraged, there is a significant potential that these utilities will use their existing market power in generation, transmission and distribution services to deter competition that would benefit consumers." *Id.* at 5. These observations are more apt today than when they were delivered eight months ago.

In the intervening months since the Report issued, evidence has piled up to demonstrate that Staff's concerns were well founded. The potential for using market power to stifle emerging retail competition is demonstrably real. What is particularly disheartening is that this potential has been exacerbated by actions at the state and federal levels. Regulatory approaches designed to promote the transition to competitive retail markets have had the perverse effect of discouraging the development of those markets. In particular:

1. The slow pace of developing Regional Transmission Organizations ("RTO's"), coupled with the failure to fully resolve issues involving pancaked rates and the proper allocation of costs of making necessary transmission upgrades, has worked to retard the development of a truly competitive wholesale power market and, with that, the development of competitive retail markets.
2. The transition provisions required in states that include retail rate caps and provisions for the recovery of stranded costs and deferred charges work to actively discourage the entry of potential competitors to retail markets.

Taken together, these regulatory missteps continue to permit, if not encourage, the use of market power to stifle the advent of competitive markets.

In what follows, we address these state and federal issues as suggested by the Commission's questions. We begin with the problems of providing true open access transmission to create a competitive wholesale market. The Commission hits on the importance of this issue with several of its questions regarding transmission posed under the heading "Market Structure Issues". We then discuss the problems created by state transition regimes that work against retail competition. Several of the Commission's questions posed under the headings of "Retail Supply Issues" and "Retail Pricing Issues" properly bring these problems into focus.

COMMENTS

I. The Slow Development Of Regional Transmission Organizations Has Had A Negative Impact On The Development Of Retail Competition.

The Commission raises important questions involving the development of RTOs under the heading of "Market Structure Issues". This is entirely apt. Properly designed RTOs are critical to competitive wholesale and retail markets.

The importance of properly structured wholesale competitive markets cannot be overemphasized. A significant concern highlighted in last year's Report was "that retail competition would be less robust without effective wholesale competition." (Report at 15.) In practice, the statement does not go far enough. Without effective wholesale competition there can be *no* effective retail competition. Retail market power suppliers must have access to as broad a portfolio of capacity and energy supplies as possible. This

can only occur with an effective wholesale competitive market. An absolutely vital requirement to creating a wholesale competitive market is that there be open, non-discriminatory transmission access. RTOs offer the best hope of getting there.

While RTOs are designed principally in aid of competition for the wholesale markets, they will have important, positive impacts on retail markets as well.[1] RTOs provide the open access, non-discriminatory transmission necessary to accomplish competitive retail sales, providing the means whereby retail customers can chose power suppliers over a large geographic region. And RTOs will affect the development of retail competition indirectly by ensuring that wholesale prices passed through to retail customers will not be unfairly inflated by transmission charges.

A vertically integrated utility or group of utilities can block competition at the wholesale and retail level through the ownership and control of transmission in several ways. One is the practice of "pancaking" rates, *i.e.*, charging for transmission each time the power is moved across a transmission owner's system or control area.[2] Another is to impose complex rules or practices that can work to exacerbate congestion pricing issues

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1 *See generally* Order 2000, Regional Transmission Organizations, FERC Stats. & Regs. ¶ 31,089 at 31,003 - 31,017 (2000) summarizing continuing existence of barriers and impediments to achieving competitive wholesale markets.

2 For a recent case demonstrating the need to respond to pancaked rates in SPP, see East Texas Electric Cooperative v. FERC, 218 F.3d 750, 752 (D.C. Cir. 2000)(describing the problem of utilities charging separate rates for what is single transmission over the system); *see also* Pennsylvania - New Jersey - Maryland Interconnection, et al, Order Conditionally Accepting Open Access Transmission Tariff and Power Pool Agreements, Conditionally Authorizing Establishment of an Independent System Operator and Disposition of Control Over Jurisdictional Facilities, and Denying Rehearings, 81 FERC ¶ 61,257 at 62,249 (1997), *rehg denied*, 92 FERC ¶ 61,282 at 61,951 - 61,952 (2000) (rejecting attempt by GPU operating companies to impose pancaked rates).

that can artificially create "load pockets" and with them monopoly conditions. A third is to refuse to give credit for transmission facilities owned by smaller transmission owners, like cooperatives. As a result, cooperatives' customers can pay twice for transmission service, once across the large utility's system and again for using the cooperative's facilities that, because of how the two are integrated, should have been accounted as part of the large system. A fourth is to fail to properly allocate the costs of making necessary transmission system upgrades by unfairly burdening competitors with costs that should properly be spread over all users of the transmission system.

These are not hypothetical issues. They exist today. Properly structured RTOs can work to resolve each of them. With their independent governing structure, wide geographic coverage and integrated system planning protocols, RTOs can effectively eliminate these problems and with them monopolistic power.

The fundamental problem, however, is that RTO's are not developing fast enough. The Federal Energy Regulatory Commission has made RTO formation voluntary.[3] Given the monopoly benefits that large transmission owners would have to give up in joining RTOs, it is little wonder that so few have come into being.[4]

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3 Order 2000, *supra* at 31,028 - 31,034.

4 The Commission has approved three RTOs pursuant to Order No. 2000. *Alliance Companies*, 94 FERC ¶ 61,070 (2001)(Alliance RTO); *GridFlorida L.L.C.*, 94 FERC ¶ 61,363 (2001)(GridFlorida RTO); *Carolina Power and Light Co., et al.*, 94 FERC ¶ 61,273 (2001)(GridSouth RTO). And the Commission has approved only five ISOs pursuant to order No. 888. *Pacific Gas & Electric Company, et al.*, 77 FERC ¶ 61,204 (1996), *order on reh'g*, 81 FERC ¶ 61,122 (1997)(California ISO); *Pennsylvania-New Jersey-Maryland Interconnection, et al.*, 81 FERC ¶ 61,257 (1997), *order on reh'g*, 82 FERC ¶ 61,047 (1998)(PJM ISO); *New England Power Pool*, 79 FERC ¶ 61,374 (1997), *order on reh'g*, 85 FERC ¶ 61,242 (1998)(New England ISO); *Central Hudson Gas &*

Given the forgoing, we respond to the following questions listed under the Market Structure Issues heading of the request for comments:

How has the development of Regional Transmission Organizations (RTOs) affected retail competition in the state?

As discussed above, RTO's have an important, if not overarching role in developing retail competition. Properly organized, RTOs should work to eliminate the ability of monopolists to make transmission access unavailable or more expensive than it should be. Existing, vertically integrated utilities will attempt to exact monopoly rents for providing transmission services and will thereby effectively remove competition. And East Texas Cooperatives have had direct experience with utility attempts in the SPP to cut them out of joint transmission planning efforts and to charge disproportionately for transmission system upgrades. RTO's can resolve such impediments to competition.

Explain the state's role in overseeing operation of the transmission grid in the state and the extent to which public power or municipal power transmission systems are integrated into this effort.

Within most of the State of Texas – that covered by ERCOT – the state has a controlling role in overseeing the operation of the transmission grid. Under Texas restructuring legislation, ERCOT has become close to an ideal RTO. All transmission owners within ERCOT, including certain Tex-La member distribution cooperatives, have placed their facilities under the control of the ERCOT Independent System Operator ("ISO"). Transmission is defined in ERCOT as everything over 60 kW. As a result,

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Electric Corporation, et al., 83 FERC ¶ 61,352 (1998), *order on reh'g*, 87 FERC ¶ 61,135 (1999)(New York ISO); *Midwest Independent Transmission System Operator, et al.*, 84 FERC ¶ 61,231, *order on reconsideration*, 85 FERC ¶ 61,250, *order on reh'g*, 85 FERC ¶ 61,372 (1998)(Midwest ISO). Taken together, these eight organizations cover only approximately 33% of the nation's transmission grid.

transmission facilities owned by cooperatives are properly accounted for in a fair method of determining system planning and providing for system upgrades. And ERCOT has developed a single, system-wide ("postage stamp") rate that eliminates all pancaking for wholesale and retail consumers.

ERCOT, however, is the unique situation. For the rest of the lower-48 states jurisdiction over transmission and its attendant pricing and access issues resides with the Federal Energy Regulatory Commission under the terms of Part II of the Federal Power Act.

What is the relationship between the state's role and the Federal Energy Regulatory Commission's role in transmission system operation in the state?

Within ERCOT, FERC's role is basically limited to ruling on requests for transmission access made under the special provisions of Section 210, 211, and 212 of the Federal Power Act as amended by the Energy Policy Act of 1992. Within other areas, including the Southwest Power Pool, FERC regulation is much more pervasive, encompassing all transmission except "bundled" retail transmission.[5] For this reason, FERC's efforts to encourage the development of properly designed RTO's are of particular importance.

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5 *See generally* Transmission Access Policy Study Group v. FERC, 225 F.3d 667, 690-696 (D.C. Cir. 2000), *cert. granted sub nom.* People of the State of New York, et al. v. FERC, No.00-568 (February 26, 2001)(discussing and affirming FERC's findings regarding limited state jurisdiction over transmission.). FERC's decision regarding the

II. The Transition Provisions Implemented By Some States Have Worked To Unfairly Raise The Bar For New Retail Market Entrants.

What difficulties have suppliers encountered in entering the market? What conditions/incentives attract suppliers to retail markets? Have suppliers exited the market after beginning to provide retail service? If so, why?

The impact of state efforts to promote retail competition can create perverse incentives. This is particularly true with respect to the state setting or imposing "default" service rates – the rates at which the historical, vertically integrated, monopolist retail power supplier will provide service to those who cannot or do not wish to change suppliers. If the state sets the default rate *higher* than the wholesale market price, then utilities are encouraged to sell power to their retail customers at higher than market prices and enjoy the resulting profits. If the state sets default service rates *lower* than the wholesale market price, then the utilities are encouraged to drain their local distribution companies of profits and to leave them bankrupt. The recent and present experiences of the California utilities illustrates these points.[6] In either case, retail customers end up paying market rates for power in a non-competitive market.[7]

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scope of state jurisdiction over transmission, affirmed by the court, is before the Supreme Court for certiorari review.

6 For a condensed analysis of this phenomena, see Braithwait and Faruqui, "The Choice Not to Buy: Energy Savings And Policy Alternatives For Demand Response," Public Utilities Fortnightly 26, 27 (March 15, 2001).

7 To these competitive disincentives must be added the problem of affiliate abuse. When a generating utility affiliate (GENCO) sells to its distribution utility affiliate (DISCO) at other than competitive market prices, then two kinds of affiliate abuse can arise. First, if the GENCO's price for power is below the market price, then the GENCO subsidizes the DISCO at the expense of the GENCO's captive customers. If the GENCO's price is above the competitive market price, then the DISCO subsidizes the GENCO at the expense of the DISCO's captive customers. What is true for sales of power can also be true with respect to transfers of non-power goods and services between affiliates.

When, as in Texas, the state sets a default service rate, this retail rate cap effectively becomes the market price that an erstwhile competitor must significantly better in order to penetrate the market. In Texas, the default price (the "price to beat") is set by statute as the price the affiliated retail electric provider ("REP"), and in virtually all cases, the default supplier must offer customers who chose not to switch suppliers. It is also the price of the provider of last resort. Any retail competitor must significantly beat this state-set price to have any hope of competing. "Significantly beat," because the competitor's price must also include any transmission or local distribution costs incurred to move the power to the customer. And, it is a fact of life that there is customer inertia that must be overcome. Stated simply: If the state-set cap is below the wholesale market price for a prolonged period, the competitor cannot effectively compete, and even if the cap is above the wholesale market price, if the difference is not more than the wholesale price plus transmission and local distribution charges – also exacted by the incumbent – the competitor cannot afford to enter the market.

States can further impede competition by enacting programs that in effect subsidize incumbent sellers. If the costs of providing retail service exceed the state-imposed rate cap, a state may permit the utility to accrue these as "deferred charges" to be recovered later. If these are guaranteed to be recovered, there will be a state-designed subsidy that a competitor will be hard pressed to beat. When this is added to the burden of permitting the recovery of stranded costs, through a prolonged transition period to "full" retail competition, competition is effectively prevented. It is no answer that

competitors can enter after the transition period. During the interim the existing supplier has gained valuable experience and name recognition.

What factors or measures should the Commission examine in viewing the success of a state's retail electricity competition program? How should these measures be evaluated?

A critical measure must be whether there has indeed been significant market entry by competitors. What should be counted is not just the number of competitors but the number of retail customers who have actually switched their source of supply from their historical suppliers. In addition, the Commission should look to the effective "costs" imposed on entering competitors by state regulation. For example, the complexity of protocols or guarantees that may be required under state regulation may be more burdensome than necessary and thereby unnecessarily handicap market entrants. Such regulatory hurdles can have a major anticompetitive impact.

Respectfully submitted,

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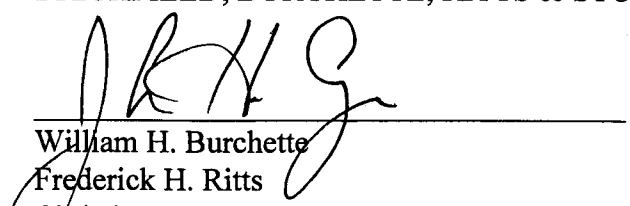

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