

**Federal Trade Commission
VO10003 - - Comments Regarding Retail Electricity Competition**

Submitted by the Air Conditioning Contractors of America

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Thank you for the opportunity to address the issue of competition in the electric utility industry as it evolves from a monopolistic to competitive environment. The Air Conditioning Contractors of America (ACCA) have been directly involved in this issue for several years since one of the foremost energy-related services is the design, installation, maintenance and service of heating, ventilating, air conditioning, and refrigeration (HVACR) systems for residential and commercial/industrial users.

ACCA is the nation's largest trade association of those who perform this work. Our antecedents date to 1914 with the formation of the National Warm Air Heating and Air Conditioning Assn. Our mission is to assist and enable ACCA members to acquire, serve and satisfy their customers by providing, among other tools, the highest quality technical and management information and services, as well as promoting good business ethics and sound business practices.

ACCA members work in a very competitive environment. The U.S. heating, ventilation, air conditioning and refrigeration industry has revenues approaching \$70 billion a year and employs close to 600,000 people. About 70% of the employees work for small contractors who employ less than 50 people and almost half are in firms of ten or fewer employees. The industry pays high wages, averaging about \$17 per hour. It provides an independent livelihood to over 53,000 small business owners and their families.

Our purpose with these comments is to advocate solutions to potential market power abuses during the transition to a fully competitive energy market. We appreciate the opportunity to express our concerns about market power abuses and fair competition.

Good business ethics and sound business practices go to the heart of our thesis. For many years, we partnered with utilities in aiding our common customers to not only maintain their equipment in ideal condition but to upgrade to more energy efficient systems. The emergence of deregulation over the past few years has strained that partnership in much of the country.

The utilities are getting into our business. For whatever reason, either to bond with their customers by bundling as many services as they can in preparation for a competitive market, or because they think they can make money in this arena, many utilities have established unregulated affiliates to compete against independent contractors, and it isn't just in our business. At last count, approximately 25% of the utilities offered some type of communications service – either Internet or telecom, they are also active in outdoor lighting, plumbing, remodeling, etc. One even owns the second largest realtor in the country.

We don't object to the competition as long as it's fair. As small companies, our members compete against the largest contractors or retailers, such as Sears and Home Depot. Unlike the utilities, however, those companies can not subsidize their products and services with quasi-public funds.

In a report prepared for the National Association of Regulatory Utility Commissioners, the researchers stated "utilities are motivated by profits to pass through undetected and unauthorized costs to their captive customers in a deregulated, competitive market and can gain the upper hand over competitors." (An Economic Analysis of Marketing Affiliates in a Deregulated Electric Power Industry, National Regulatory Research Institute as reported in The Energy Report - 03/02/98)

The Study cites four specific, regulatory concerns: cross-subsidization, cost shifting, discriminatory self-dealing and informational advantages.

By virtue of their current monopoly status, utilities enjoy substantial market advantages over their competitors. They use tangible and intangible assets and resources from the regulated side of the utility business and paid for out of the rate base to benefit their non regulated business activities. This support for their affiliates may include customer and marketing information; "name brand" recognition; and shared equipment, tools, trucks and employees, such as lawyers, accountants, human resource managers, researchers and customer representatives. Additionally, the affiliate can obtain financing if needed at very favorable rates because of the holding company's borrowing power. The utility often supplies customer lists and data, entitles the affiliate to purchasing discounts available because of their combined size, provides customer referrals and financing. Two blatant and obvious examples of cross subsidization are monthly bill stuffers that promote non-utility services, such as appliance repair, and web sites that promote regulated as well as non-regulated services.

Increasingly, many of these preexisting utility monopolies are using these ratepayer-based assets as a "transition strategy" to increase their advantage as deregulation looms large.

Our members have experienced this "competition" first hand.

For example, a former employee of one of our Michigan members went to work for Michigan Consolidated Gas Co. In the fall and winter, he performed appliance service work. In the summer he repaired gas mains. The utility could switch his payroll from the unregulated business to the ratepayer. Independent contractors enjoy no such advantage! They have no guaranteed fair rate of return. They charge their customers what the service is worth, which is sufficient to cover costs including developing and maintaining a viable work force. There is no base of ratepayers to subsidize their work. Consumers Power Company, another Michigan gas electric utility, advertises their non-regulated services on the sides of their vehicles. Those vehicles are paid for by the ratepayers and used in the regulated side. The non-regulated business is getting free use of a ratepayer asset.

In August of 1988, this same Michigan contractor in conjunction with other small businesses in Michigan filed a lawsuit against Consumers Power Co. for anti trust and consumer fraud. For years, the utility had claimed there was no cross subsidization. Our member argued that it was impossible for the utility to offer their annual service plans at such a low cost without subsidization. The Michigan Public Service

Commission (MPSC) had never conducted a detailed audit. As part of the fact finding, the Michigan Circuit Judge requested that the small business coalition file a formal complaint with the Michigan Public Service Commission (MPSC) to determine possible cross subsidization. Both the MPSC and an independent auditor hired by the coalition found almost a million dollars of cross subsidization for the 1989 plan year alone.

Another expert witness, economist Dr. Michael Ileo testified that cross subsidization would continue to occur and increase as the program grew. Even with this evidence to prove cross subsidization, the MPSC claimed it did not have jurisdiction over non regulated utility ventures. This case against one utility took almost eight years and approximately half a million dollars to conclude. Consumers Power Company was found guilty of consumer protection act violations but the anti-trust section of the case was never completed. It became obvious that a legislative solution to cover all Michigan utilities was needed.

We found it ironic that Michigan utility executives testifying at deregulation hearings used phrases like, "level playing field and fair competition" when talking about out of state competitors. These are the same phrases that ACCA and other contractors used for years in decrying the utility practices.

In a report titled "Staff Market Power Discussion Paper" filed by the Michigan Public Service Commission Staff on June 5, 1998, the authors identified one of the factors highlighting market power advantages enjoyed by incumbent utilities as the "potential to use revenue from captive or regulated business activities to subsidize competitive ventures." The MPSC staff recommended the following actions be expeditiously considered for adoption:

*Establish a clear separation of regulated business operations from generation and other competitive enterprises and assure Commission access to utility and relevant affiliate books and records.

*Establish a "code of conduct" governing the relationship between utility companies and their affiliates.

In testimony before a congressional committee three years ago, the same ACCA Michigan contractor asked the members how they, as legislators, would feel if they had to make a campaign contribution every month to the candidate running against them. That is how he, as a contractor, felt every time he paid his utility bill.

Even after efforts to separate affiliate activities from the parent company, a 1997 California PUC study found that cross-subsidies in California alone were approaching \$100 million per year. Projecting this to the nation at large would mean a consumer loss of over \$2 billion per year with a short-term job loss to existing workers in small firms of 60,000.

As you know, FTC Chairman Robert Pitofsky said that in enforcing antitrust laws, "(cross-subsidization) is one of the most difficult issues to deal with in antitrust enforcement, because the books are in the hands of the person who is doing the cross-subsidizing, and the allocation problems are enormously difficult." In testimony before committees of Congress, the Justice Department has concurred with this assessment.

A report by the U.S Small Business Administration (SBA) dating back to March of 1984 states that, under current law, utility service and installation programs cannot be effectively regulated to eliminate improper subsidies and other competition problems.

Such unregulated activity by the utility provides no significant public benefit, and any limited benefits are overwhelmingly outweighed by the hazard to competition and the cost of regulatory oversight. The SBA has recommended that utilities not be permitted to engage in this activity. This report states, and others have agreed, there is extreme danger in the co-mingling of funds between the regulated and non-regulated activities of the utilities. It becomes enormously difficult for the regulatory commission to oversee both effectively.

Protection of the private sector economy and fair competition is vital to the nation's growth and development. Small businesses have a hard enough time surviving when the competition is fair. When it is unfair, chances of survival are greatly diminished.

Restructuring of the electric utility industry to bring competition and lower energy costs is a very important but complex and difficult task. The states can't do it alone. Freshman and veteran state legislators are inundated with stacks of material from various interest groups. The solutions are difficult, but the need remains.

Largely, through our efforts and that of allies, we've convinced several state legislatures and public utility commissions that if competition is to succeed in their state, it must be on a fair basis. Approximately two dozen have responded with legislation and/or regulation to curtail cross-subsidization and other abuses. Several have enacted Codes of Conduct which in one form or another, attempt to curtail the market power of the utilities. Unfortunately, their effectiveness often fails when it comes to the enforcement stage. As a result, this patchwork of state actions is insufficient to control a significant national problem, fueled by the growing consolidation of holding companies that operate across state, and in some cases, national borders. Individual state authorities are quick to point out that they don't have the resources or often even the authority to monitor and/or prohibit market abuses. It will take federal action if we're to have true competition and all the rewards it promises.

Given these problems, we still believe restructuring holds the promise of increased choice of service providers and lower electricity costs for American consumers and businesses. We believe that members in our 60 chapters across the country will also share in the benefits of this increased competition. However, cross subsidization or "efficient use of resources" as the utilities term it, threatens to undermine the pro competitive goals of electric deregulation.

Not only must federal actions prohibit cross subsidization, they must spell out appropriate remedies in order to guarantee competition that is truly free and fair.

SUMMARY

How Cross-subsidization Harms Competition

Among the detrimental effects that flow from cross-subsidies are:

- **Harm to Competition:** Cross-subsidization creates inefficiencies that retard true competition both in the market for retail electricity and in adjacent energy service markets such as HVACR contracting. Potential new entrants in the market for retail sales of electric power are harmed because ratepayer-based assets are being used to support unregulated affiliates whose services are then "bundled" with those of the incumbent utility to discourage new entrants.

Competitors in adjacent energy services markets are also unfairly disadvantaged as these cross-subsidies allow the affiliates to make uneconomic decisions. Because the affiliate's costs are lower than other market participants or potential new competitors, the affiliates can use this cost advantage to undercut bids and drive out incumbent competitors or prevent new entries.

- **Harm to Consumers:** While cross-subsidies may initially allow the utilities' unregulated affiliates to offer a lower cost of service, prices will invariably rise in that market once existing competitors have been driven out. The threat of such price undercutting will be sufficient to discourage new entries into the market.
- **Harm to Small Business:** Small and medium-sized businesses will be disproportionately harmed by cross-subsidization. Adjacent energy service markets, such as HVACR contracting, are dominated by small business. While the competition in these markets is vigorous, these small businesses will be the first to be eliminated by the below cost pricing allowed by cross-subsidization.

The Solution

ACCA strongly supports definitive language prohibiting cross-subsidization in any federal legislation or regulation dealing with the deregulation of the retail sales of electric power. Such actions must include a definition of cross-subsidization sufficient to capture transfers of both tangible assets (i.e. shared tools and equipment) as well as intangible assets (i.e. shared logos and trademarks). At the very least, ACCA believes that federal actions must condemn cross-subsidization as contrary to the goal of fair and open competition, and provide specific examples of inefficient cross-subsidies to guide state commissions in their consideration of the many issues surrounding electric deregulation.

Addendum

The Michigan coalition proposed the following Standards of Conduct;

*All business of the utility, other than the providing of power, must be conducted through an affiliate.

*The affiliate and the utility shall operate from physically separate locations. The affiliate must maintain inventory and equipment separately from the utility parent's inventory, vehicles and equipment.

*The utility affiliate may submit a proposal on utility sponsored or state or federally mandated DSM or energy conservation programs, but will receive no preferential treatment evaluation and contracting terms as a non-affiliated bidder. The utility shall not purchase from the affiliate or provide the affiliate with any nontariff services.

*Utility personnel and assets, including corporate officers, directors, and equipment, shall not be used to perform analysis or provide other services for the affiliate, unless the affiliate is charged the full fair market value cost of the analysis or service, and similar services are offered to non-affiliate at similar terms.

*The utility may not disclose to its affiliate any information obtained in connection with providing utility services to a customer or potential customer (i.e. usage information, special circumstances, mailing lists, etc).

*The utility must offer the same discounts, rebates, fee waivers, penalty waivers or guarantees to all non-utility affiliated suppliers or customers of its affiliate (i.e. heat pump rebates, maintenance contracts).

*The utility shall process all similar requests for regulated utility services in the same manner and within the same period of time, whether requested on behalf of competitive activities or a third party; provided that this provision shall not in any manner be construed to limit the utility's ability to carry out its public service obligation as it deems necessary.

*Joint calls of any sort are forbidden. A customer may arrange to have a utility representative call separately to advise on technical matters unrelated to sales, but such representatives may not make joint sales calls with affiliate representatives.

*Joint promotions between the utility and the affiliate are prohibited, such as inclusion of flyers for the affiliate in the utility's bills or any similar access to billing information. The utility shall not allow its affiliates to utilize its name in any manner such that the customers can reasonably imply that; the distribution services provided by the company are of a superior quality when power is purchased from an affiliate; and /or the power purchased from a competitive supplier may not be reliably delivered. This prohibits the display of the utility's brand name logo on personnel uniforms, company vehicles, or in body tattoos of affiliate of the utility.

*The utility shall not provide sales leads to its affiliate and must refrain from giving the appearance that the utility speaks on behalf of its affiliate. If a customer requests information about equipment suppliers or providers of conservation or other services sold by affiliates, to the extent the utility responds to the request, the utility shall provide a list of all suppliers in the area and shall not promote the affiliate. Furthermore, no employee of a public utility who has responsibilities in the areas of system planning, system operation, power services, and/or customer services shall also be an employee of any affiliated company, or serve in any capacity therefor.

*Non regulated affiliates should not be allowed to market the benefit of buying their products through financing provided by the utility parent. Financing of purchases in the competitive marketplace on the utility bill shall be made available to all qualified competitors and their customers, if such services are made available to any affiliate, at the same terms and rates.

*Any transaction or activity offered by the utility to the affiliate must be offered to all competitors under the same terms and conditions.