

**UNITED STATES OF AMERICA**  
**BEFORE THE**  
**FEDERAL TRADE COMMISSION**

**V01003**

**COMMENTS REGARDING RETAIL ELECTRICITY COMPETITION**

**COMMENTS OF**  
**MG INDUSTRIES**

## INTRODUCTION

MG Industries (“MG”) hereby submits Comments in response to the Federal Trade Commission’s (“FTC” or “Commission”) “Notice Requesting Comments on Retail Electricity Competition Plans” (“Notice”).

MG Industries is a leading manufacturer and provider of industrial and specialty gases, primarily oxygen, nitrogen, argon, and carbon dioxide, with over thirty production facilities located across the United States. MG’s production facilities are located in every region of the country, and serve various industrial, commercial, medical and agricultural and food processing consumers throughout the United States. For a producer of industrial/specialty gases, reliable, competitively priced electricity is essential, because electricity is, by far, MG’s largest cost of production.

MG Industries commends the FTC on its decision to investigate the implementation of electricity supply competition in the various states. We understand that one of the purposes of this inquiry is to identify areas where additional regulatory or legislative action may be necessary to address both reliability and containment of unwarranted cost increases due to flawed market structures and the exertion of market power.

Our comments will focus primarily on market structure and market power issues. Since all wholesale transactions have essentially been deregulated, we believe that ultimate responsibility for both generation reliability and effective management of market

protection for consumers is primarily a federal, not a state responsibility. While state actions are required in certain areas, no state action can prevent market abuses, which originate at the wholesale level. Electric power markets function in close correlation to the physical supply grids in each region. The physical networks are regional in nature and straddle state borders. It is impossible for any state (with the possible exception of Texas) to act independently and adequately police market participants, insure the safe and reliable operation of the physical system or insure that sufficient capacity exists to provide for reliable regional supplies. Therefore, MG believes that the most critical remedies are required at the wholesale level.

### **RECOMMENDATIONS**

MG respectfully requests that the FTC act to insure that federal and state agencies with regulatory responsibility for electricity markets take actions to create functional wholesale power markets in every region. Specifically MG recommends that the FERC act to:

1. Establish a consistent set of market rules across all regions to prevent arbitrage from rules differences. Such arbitrage will only create chaos during periods when the electricity supply system is stressed as suppliers scramble to access the moment's most favorable administrative rules.
2. Require each regional market administrator to implement mechanisms to provide price responsive load behavior with equal ease as that provided to supply side services. The validation of the adequacy of the implemented mechanisms in each market shall be the acceptance of offers in that regional market for decremental loads of at least 10% of that market's system peak energy requirements.

3. Establish ISO/RTO governance structures that are balanced between providers of supply side services and consumer/load interests (50/50 voting).
4. Establish interim transition rules, which require all generation in interstate commerce to be priced on a cost plus basis until it is demonstrated that all critical aspects of the regional markets are operational and effective.

Additionally, MG recommends that the States act to require all regulated supply side service providers to implement price responsive load response programs and require that they provide the maximum portion of load curtailment benefits to the responding loads. This can be accomplished by applying the traditional reimbursement of incurred costs with a reasonable profit to the activities of regulated utilities. Additionally, measures need to be taken to ensure that regulated providers implement these programs effectively. Furthermore, MG believes that state utility commissions should consider a competitive providers load response program offerings and participation when considering that provider's application for a license in those states that license competitive providers of electricity.

## **BACKGROUND**

Currently, the most obvious concerns with electric reliability and pricing are in California, however, little public attention has been paid to several important wholesale power market structure design flaws, or the impacts of dysfunctional wholesale power markets in many other areas.

- 1. The impact of wholesale deregulation on the price of purchased power for utilities including those utilities remaining under regulated status at the retail/state level.**

For both capacity short and utilities needing short-term power during unit outages, purchased electric power costs have significantly increased. While the direct cost of fuel has impacted this trend, wholesale power-cost increases have exceeded what would reasonably be expected from fuel price increases alone. Additionally, under current pricing structures such as last priced auctions, fuel diversity benefits, which were previously available under regulated regimes, are no longer used to benefit consumers.

- 2. Substantial generating capacity is still controlled by a limited number of suppliers, even in states that forced full or partial utility divestiture.**

Limited market suppliers, along with current market pricing schemes, allow for the tiering of bids to manipulate prices. The Wall Street Journal (in July of 2000) documented such actions in the PJM System and recent FERC actions indicate that similar price manipulating actions have occurred and may still be occurring in the California/western market. While this situation may remedy itself in time as new participants add generation over the next ten years, one must question at what level of

economic harm and over what time frame will consumers be subject to price abuse while market corrections take place. In fact, MG believes that the so-called remedy of added capacity will self-destruct as normal load growth/building cycles create renewed market imbalances.

Examples such as the current PJM capacity market trend since January 1, 2001 underscore that this is not just a California or any single state issue. Recent refunds of alleged overcharges, ordered by the FERC, are inadequate steps towards reducing potential market power abuses. The FERC's actions are insufficient because a market power abuser has a very good chance of going unpunished and reaping financial gains from price gouging. On the other hand, an abuser, in the rare case that they are caught as recent FERC actions might suggest, is merely required to refund the overcharged amounts. If bank robbers when caught were similarly penalized by having to only give back the money, MG is convinced that the incidence of attempted bank robbery across the country would increase significantly. Similarly, MG believes that the current relaxed oversight and lack of penalties actually encourages and rewards market power abuses. Market power abusers must be penalized severely enough to discourage future temptation to abuse their market power. If competitive wholesale markets are to evolve, jurisdictional agencies, particularly those responsible for anti-trust law enforcement, must pay closer attention to the functioning of existing wholesale markets and take action to place abusers at a high level of risk. Severe, punitive penalties, such as treble damages, are likely to be a better deterrent of future actions.

**3. The lack of development of significant amounts of price responsive load.**

Perhaps the most significant shortcoming nationally has been the consistent implementation of market mechanisms on the supply side without creation of needed checks and balances of load response mechanisms. This situation cannot be called a balanced or functional market. Without specific actions to balance the market power of generation owners, existing wholesale market structures will never bring about effective competition. Even with the turmoil of rolling blackouts in California, no broadly available mechanism for loads to benefit from behavior modification has been implemented. The same is true in every other region of the country. The FERC, as well as many noted economists, point out that one of the more critical aspects required in a functional market is price responsive load. Yet in most of the few severely limited load response experiments that have been implemented to date, loads face significant potential penalties, that are actually designed to be punitive, for missing even a small portion of the projected load reduction. Compare this situation to the rewards that supply side providers reap from attempts to exert market power, as described more fully above, and the Commission can readily see why load response programs are disadvantaged by the market's structural biases. MG believes that in all aspects of wholesale electricity markets, consistent application of opportunity and benefits to both suppliers and consumers is required, if there is to be any chance of competitive markets working.

## CONSISTENT MARKET RULES

In the western region of the country, California operated under distinct and different rules from other states in the region. As such, California's efforts to remedy reliability and pricing anomalies were frustrated as suppliers took advantage of the arbitrage between the neighboring states and California. With the possible exception of Texas, such arbitrage/gaming will always result from efforts to control market power abuses by a single state. This is why the FERC must act to remedy the situation.

As another example, the market rules for PJM require a capacity commitment with an energy price cap at \$1,000 per MWH. Areas immediately to the west of PJM require no capacity obligation but have uncapped energy prices. Such rules differences create a generator's utopia through "market rules arbitrage". This market rules arbitrage creates **both reliability and price volatility risks for both regions**, as peak period supply is actually **encouraged** to jump from market to market. These movements are not based on reasonable economic or physical supply needs, but rather on the opportunity of suppliers to "skim the cream" of the most advantageous administrative rules available at the moment, while in the process creating the risk of real capacity deficiencies in one region or the other. The FERC needs to insure that regional markets are operated with consistent rules and do not administratively reward uneconomic behaviors. Broad regional power markets need to be established with consistent market structures.

## **PRICE RESPONSE PROGRAMS FOR LOAD REDUCTIONS**

A central theme in considering market structures is the consistency of treatment between generators and loads. MG believes that in all aspects of the electricity market, the checks and balances required for a market to exist in a form that protects both suppliers and consumers will require consistent application of opportunity and benefits to both suppliers and consumers. This contrasts sharply with the existing inconsistent treatment between supply side resources and demand side resources. Whether it is in the market opportunities available to the resource, the rules to participate or in the administrative mechanisms such as penalties or price caps, supply side resources are heavily and consistently favored in every regional electricity market.

The FERC has left the development of demand responsiveness to the states and ISO's. The states and ISO's have generally left it to the suppliers, and the suppliers have left it out of the equation. In recognition of this fact and the problems that it exacerbates, some ISO's have been tinkering in a very limited fashion with demand response programs. Unfortunately these programs are of severely limited nature and scope and will have little benefit to the functioning of the markets. This is not surprising considering that most of the existing ISO's are dominated by generation owners who are actually encouraged to "foot drag" and prevent development of such programs, which would potentially decrease their ability to opportunistically gouge the market at times critical to system reliability. Just like a generator who offers supply increments, loads who offer load decrements should be paid to curtail, based on the market pricing schemes in place in each region.

End-users can and do (in the few limited load response programs available today) function in the same manner as supply side resources by effectively selling back their energy to the market, enhancing regional reliability. Unfortunately, incumbent generators have laden the programs with unreasonable restrictions and stalled broadening of these programs, effectively preventing the load responsive actions needed as a check and balance of supplier market power abuses. The FERC must insure that loads have the same opportunity to offer load decrements as generation owners offering supply increments, without the extra restrictions, penalties and roadblocks that have heretofore been erected by the providers of supply side services.

### **ISO/RTO GOVERNANCE STRUCTURES**

Based on the previously cited evidence, it is clear to MG that the ISO/RTO's that are currently operating the regional markets, (PJM, the NYISO and ISO-NE) have failed to create wholesale markets that are free from the exertion of market power by the incumbent providers of supply side services. MG believes this failure is due to their having been overly influenced at the time of their creation by the incumbent providers of supply side services, since they were the primary (and sometimes only) stakeholders at the table when the ISO/RTO's initial rules and procedures were being developed. These incumbent providers of supply side services include:

- Generation owners who are often affiliates of former or existing integrated utilities
- Transmission owners who are also often affiliates of former or existing integrated utilities or generation owners

- Other suppliers who are also often affiliates of former or existing integrated utilities or generation owners
- Electric distribution companies who are also often affiliates of former or existing integrated utilities or generation owners

In addition to the bias toward incumbent providers of supply side services that has been inherent at the onset of ISO/RTO formations, the ongoing governance of the existing ISOs is such that effectively eliminating that bias is virtually impossible. Incumbent providers of supply side services have an incentive to “foot drag” in any collaborative process aimed at addressing market structure flaws, and the ISO/RTO’s management has limited authority to unilaterally address the flaws, thereby having little leverage to expedite the change process. There have been a few examples of ISO’s acting unilaterally to correct market flaws, but this is a difficult and risky undertaking for a well intentioned ISO. The result is a system where generators (providers of supply side services) can exert market power and reap windfalls for years without risk, while appearing to work with the ISO/RTO to address each specific market power abuse concern as such concerns are raised. At the same time, incumbent providers of supply side services have effectively blocked any attempt at developing meaningful load responsiveness that would act as a brake on their ability to exert market power. The FERC must insure that ISO/RTO governance includes equal representation and voting power between supply service providers and consumers.

## INTERIM COST BASED PRICING OF WHOLESALE TRANSACTIONS

MG seeks FERC action to temporarily revert to traditional cost of service pricing in wholesale power markets until each regional market can demonstrate that it has developed mechanisms that will produce functional markets. Some of the minimum criteria would include equal voting power between providers of supply side services and loads, equal and non-discriminatory processes and opportunities for supply and demand side resources, and consistent market rules between regions so that rules arbitrage opportunities do not create price volatility and supply reliability risks. One measure of the existence of a balanced market that MG strongly suggests is the existence of offers within a given regional market for load decrements of at least 10% of that market's system peak energy requirements.

As referenced earlier, the FERC has ordered refunds due to generators allegedly overcharging during high cost hours in California and the nation's leading business paper has cited other examples of market power abuse. Certainly the existing rules and lack of punitive damages heretofore offers no disincentive to the exercise of market power by supply side providers. How much economic harm must consumers suffer before the various agencies of the federal government step in and take action? MG Industries believes that the original promises of competitive electricity markets can become a reality. In the meantime, however, interim transitional protections for consumers are essential. While we are still experimenting, consumers need to be protected from market power abuses such as we are currently experiencing nationally.

## CONCLUSION

MG Industries would like to close with the following observations. Effective retail competition in any state is dependent upon the development of an efficient and functional wholesale power market or markets within each region. The solution clearly is federal action rather than state action, since the implementation of wholesale power markets is a federal jurisdictional issue crossing almost every state line. The FERC must address the structural flaws in the existing wholesale markets, and provide for balanced implementation of those markets. This action should be immediate to prevent further damage to our national economy.