Regulating Public Utility Performance:
The Law of Market Structure, Pricing and Jurisdiction

Chapter Four

Making Competition Effective

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[P]ipelines continue to possess substantial market power; . . . they have exercised that power to deny their own sales customers, and others without fuel-switching capability, access to competitively priced gas; and . . . this practice has denied consumers access to gas at the lowest reasonable rates. . . . [D]iscrimination in transportation has denied gas users, and the economy generally, the benefits of a competitive wellhead market.[1]

[Transmission owners have engaged in] refusals to wheel, dilatory tactics that so protracted negotiations as to effectively deny wheeling, refusals to provide service priority equal to native load, or refusals to provide service flexibility equivalent to the utility's own use.[2]

It is easy to see why a company that owns a local exchange . . . would have an almost insurmountable competitive advantage not only in routing calls within the exchange, but, through its control of this local market, in the markets for terminal equipment and long-distance calling as well.[3]

Chapter 3 addressed the legal steps necessary to authorize competition. It is necessary to remove statutory exclusivity, grant entry rights to new competitors and address incumbents' sunk costs. But authorizing competition does not promise effective competition—a market structure which rewards merits, not market power. After defining "effective competition," this Chapter 4 describes the three steps necessary to create it. Regulators must "unbundle" the incumbent's competitive services from its monopoly services, grant all entrants access to the monopoly facilities on non-discriminatory terms and reduce non-facility barriers to entry.

Once a market is made potentially competitive, there still is the risk that sellers will behave anti-competitively, weakening the competitive forces that policymakers have authorized. We turn to anti-competitive behavior and its prevention in Chapter 5.

4.A. Effective competition: Definitions, goals and metrics

4.A.1. Definitions of competition

"Competition" has two dimensions: seller behavior and market structure. Businesses vying for customers tend to focus on behavior. They define competition as rivalry, as having

1. Associated Gas Distribs. v. FERC, 824 F.2d 981, 1010 (D.C. Cir. 1987).
2. Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 75 FERC ¶ 61,080, App. C (1996) (citing intervenors' allegations).
3. Verizon Commc'ns v. FCC, 535 U.S. 467, 490–91 (2002).

competitors. For them, competition is "a conscious striving against other business firms for patronage perhaps on a price basis but possibly also (or alternatively) on non-price grounds."[4]

Economists, removed from competition's daily pressures, focus more on market structure. They define pure competition as a market in which "the number of firms selling a homogeneous commodity is so large, and each individual firm's share of the market is so small, that no individual firm itself is able to influence appreciably the commodity's price by varying the quantity of output it sells."[5] Some economists describe market structure by focusing not on the number of players, their sizes and market shares, but on presence or absence of entry barriers. In this view of structure, even a monopolist can perform like a competitor if competition is a threat; that is, if potential competitors can enter easily.[6]

4.A.2. Goals of competition

Whether competition in a particular market is effective depends on one's goals. Defining those goals is difficult:

> [T]he most severe stumbling block in evaluating industrial performance is likely to be securing agreement on what is considered good or bad attributes of performance. Conflicting value judgments concerning performance attributes and their weights undoubtedly underlie many disputes as to the proper public policy toward monopolistic business enterprises.[7]

Some view competition's purpose as "lower prices"; they judge its success on that dimension alone. Doing so misses much richer purposes. Scherer and Ross would ask: Does the market display "greater responsiveness to consumer demands and generate more potent incentives for the frugal use of resources," compared to the predecessor monopoly market?[8] Alfred Kahn argues that competition aims to produce performance that is "*positively good*—efficient, progressive, risk-taking, innovative."[9] Consistent with Kahn, one can view competition as a progression of breakthroughs:

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4. Frederic M. Scherer & David Ross, Industrial Market Structure and Economic Performance 16 (1990).
5. *Id.*
6. *See* William J. Baumol, John C. Panzar & Robert D. Willig, Contestable Markets and the Theory of Industry Structure (1982). The authors provide a "formal analytic structure" to support the insight that "potential competition, that is, the *mere threat* of entry, can . . . affect the behavior of firms significantly and beneficially" (emphasis in original). *See also* Ala. Power Co., 13 NRC 1027, 1061 (1981) (reasoning that "the existence of a potential [wholesale] competitor may have an effect on the actions of another distributor"), *aff'd*, Ala. Power Co. v. NRC, 692 F.2d 1362 (11th Cir. 1982).
7. Scherer & Ross, *supra* note 4, at 55 (crediting Adam Smith).
8. *Id.* at 54.
9. 2 Alfred Kahn, The Economics of Regulation: Principles and Institutions 18 (1970, 1988) (emphasis in original).