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

Chapter Five

Monitoring Competition for Anti-competitive Behaviors

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> *[C]ompetition in the unregulated enhanced services market does nothing to decrease the [Bell Operating Companies'] monopoly power in the basic services market . . . . If anything, increased competition in the enhanced services market simply increases the BOCs' incentive to shift costs so they can engage in predatory price-cutting as a means of maintaining or increasing their share of the market for enhanced services.*[1]

To convert an historically monopoly market into a competitive market, the first step is to authorize competition, by removing legal barriers to entry. The second step is to make competition effective, by "unbundling" competitive services from noncompetitive services and reducing entry barriers. We addressed those steps in Chapters 3 and 4, respectively. A third step remains: monitoring the new competition.

Monitoring is necessary because market imperfections are inevitable, and because imperfections invite misbehavior. To be perfectly competitive, a market must meet four conditions: standardized products, many sellers and buyers, perfect knowledge by all participants, and no entry barriers.[2] Utility industries undergoing conversion from monopoly to competitive market structures will not meet all these conditions. Consider:

- *Standardized products*: In their physical form, electrons, gas molecules and bits are uniform across sellers, but electricity and gas *services* are not. There are short-term and long-term arrangements, deliveries at different voltages and pressures, varying rate structures and payment plans, and sources with different environmental attributes. Telecommunications services are even more differentiated, with a mind-numbing variety of options for prices, contract term length and customer service quality.
- *Many buyers and sellers*: This factor varies by geographic and product market. In energy, it can vary by time of season and even time of day: On hot August afternoons only a few sellers may have reserve capacity available.
- *Perfect information*: The time necessary to master information about sources, pricing, seller viability and contract terms exceeds what the typical retail customer is

1. California v. FCC, 905 F.2d 1217, 1234 (9th Cir. 1990).
2. 2 Alfred Kahn, The Economics of Regulation 114 (1970; 1988); *see also* Darren Bush & Carrie Mayne, *In (Reluctant) Defense of Enron: Why Bad Regulation Is to Blame for California's Power Woes (or Why Antitrust Law Fails to Protect Against Market Power When the Market Rules Encourage Its Use)*, 83 Or. L. Rev. 207, 233–34 (2007) (listing four factors for perfect competition: "(1) [T]he product sold must be uniform across all sellers, or, in other words, consumers are not compelled to choose one producer's output over the other based on product differentiation; (2) there must be many buyers and sellers, such that no one seller's or buyer's actions alone will change the prevailing market price; (3) all agents participating in the market must have perfect information; and (4) no barriers of entry may exist for sellers considering entering the market.") (citations omitted).

willing to invest. Even sophisticated wholesale customers, like municipal electric power systems and local gas distribution companies, often have less information about wholesale markets than the generating companies, pipelines and producers that sell in those markets.

- *No entry barriers*: As illustrated in Chapter 4.C, utility industries have non-physical entry barriers typical of retail markets with a longstanding, dominant player: incumbent branding, advertising costs, customer inertia and long-term contracts.

These imperfections breed misbehavior, such as pricing anti-competitively, tying competitive services to monopoly services, and manipulating market outcomes. (A distinct category of behaviors in developing markets—mergers, acquisitions and other corporate reorganizations—will be discussed in the companion volume.) This Chapter describes these behaviors and the actions regulators take to detect and deter them—if they have the statutory authority.[3] Monitoring also can lead to rethinking, about whether and how to separate the monopolist from its competitive business activities. Examples of such rethinking—and revising policies on separation—close this chapter.

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3. See, for example, the statutes in New Jersey and Connecticut, which make market monitoring mandatory:

> The board shall monitor the retail supply market in this State, and shall consider information available from the PJM Interconnection . . . with respect to the conduct of electric power suppliers. The board shall monitor proposed acquisitions of electric generating facilities by electric power suppliers as it deems necessary, in order to ascertain whether an electric power supplier has or is proposed to have control over electric generating facilities of sufficient number or strategic location to charge noncompetitive prices to retail customers in this State. The board shall have the authority to deny, suspend or revoke an electric power supplier's license, after hearing, if it determines that an electric power supplier has or may acquire such control, or if the electric power supplier's violations of the rules, regulations or procedures of the PJM Interconnection . . . may adversely affect the reliability of service to retail customers in this State or may result in retail customers being charged noncompetitive prices.

New Jersey Electric Discount and Energy Competition Act, § 29(f), 1999 N.J. Laws 23 (1999) (codified at N.J. Rev. Stat. § 48:3-78).

> Upon complaint or upon its own motion, for cause shown, the department shall conduct an investigation of any possible anti-competitive or discriminatory conduct affecting the retail sale of electricity or any unfair or deceptive trade practices. Such investigations may include, but are not limited to, the effect of mergers, consolidations, acquisition and disposition of assets or securities of electric suppliers, as defined in section 16-1 of the general statutes, as amended by section 1 of this act, or transmission congestion on the proper functioning of a fully competitive market.

Substitute House Bill No. 5005 § 20 (b)(1), 1998 Ct. P.A. 28 (1998) (codified at Conn. Gen. Stat. § 16-245u(b)(1).