UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

In The Matter of:		*
Inquiry Concerning Commission's	*	**Docket No. RM96-6-000**
Merger Policy Under the Federal	*	
Power Act		*

COMMENTS OF

CONSOLIDATED LOW-INCOME REPRESENTATIVES

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May 7, 1996

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Executive Summary

These comments are submitted on behalf of representatives of low-income consumers from around the country. Virtually every region of the country is represented. The concern of the low-income representatives is that electric policy development today fails to adequately take into consideration impacts on low-income households. The proposals advanced by the comments below are in support of the following five propositions:

First, low-income customers tend to be disproportionately adversely affected by electric policies. While low-income customers tend to use less electricity than the average residential customer, the burden which electric bills represent as a percentage of income is far greater. As a result, in considering the public interest aspects of FERC's jurisdiction, incorporating a concern about the impacts of proposed mergers on universal service is necessary and appropriate.

Second, most analysts today tend to view the propriety of proposed mergers in terms of the impact of such mergers on competition. In turn, the impact on competition is viewed almost exclusively from the perspective of the firm. In reality, however, whether or not competition exists in a particular market is affected as much by customer characteristics as by characteristics of the firm. A consideration of competition in the context of a proposed merger, therefore, must take into account the

impacts of customer characteristics.

Third, the entire purpose of ensuring a competitive market is to ensure that competitive protections (*i.e.*, those consumer protections supported by a competitive market) continue to exist after a merger. Whether competitive protections exist for small users, however, depends upon whether the small user consumer has both a choice of suppliers and the ability to exercise that choice.

Fourth, in assessing competition within the context of a proposed merger, FERC must bear in mind that industries are not competitive, markets are. Moreover, companies are not competitive, markets are. In assessing the impacts of a merger on competition, therefore, FERC must first identify the relevant markets which will be affected. A determination that a merger will not have anti-competitive impacts must be made for each discrete market.

Finally, mergers are often "sold" as being the vehicles through which the applicants can achieve cost savings and, by extension, thus generate reduced rates. The "efficiencies" which underlie claims of cost savings, however, frequently do not represent true efficiencies, but instead represent reductions in service. These reductions in service often disproportionately redound to the detriment of low-income consumers. Claimed cost savings resulting from a merger should not be considered if they do not result from efficiency improvements, but instead represent reductions in service.

In sum, FERC should use its authority under the Federal Power Act's public interest provisions to condition mergers on de-integration of vertical structures, or such other actions as are necessary to lessen market power, to reduce adverse impacts on low-income customers.

Description of the Parties

The attached comments are submitted on behalf of the following constituent-based organizations:

1. The *Alliance for Affordable Energy* is a New Orleans-based organization which represents low-income consumers on issues involving the affordability of energy throughout Louisiana.
2. The *Appalachian Peoples' Action Coalition* is a nonprofit corporation with its principal place of business in Athens, Ohio. APAC's purpose is to serve as an advocacy organization for lower-income residents of the district. These actions include seeking redress of problems inhibiting the economic, social and health well-being of the residents, and the implication of avenues to alleviate these problems.
3. The *Community Education and Protection Association* is a nonprofit corporation representing low-income consumers in the City of Philadelphia. CEPA routinely represents its membership in utility proceedings involving natural gas, electric, water/sewer and telecommunications services.
4. The *Energy Cents Coalition* is a non-profit corporation located in Minneapolis, Minnesota. The mission of the Energy Cents Coalition is to promote affordable utility service for low- and fixed-income people, to ensure the basic necessity of energy to all citizens, and to encourage

the participation of low- and fixed-income citizens in energy-related decisionmaking.

5. The *Legal Environmental Assistance Foundation* is a non-profit corporation based in Tallahassee, Florida working on environmental justice issues in Florida, Georgia and Alabama. In Florida, LEAF works on energy issues, including the effects of energy policy on low-income persons.

6. The *Policy Initiatives Group, Inc. (PIGI)* is a nonprofit corporation based in Portland, Oregon. PIGI provides education and advocacy on behalf of low-income and residential consumers on issues involving energy, public resources, and the environment.

7. The *Pennsylvania Utility Law Project* is a nonprofit corporation located in Harrisburg, Pennsylvania. PULP is organized to provide statewide advocacy and representation for low-income households on issues involving home energy, telecommunications and water/sewer costs.

8. The *Salt Lake Area Community Action Program* is a nonprofit corporation based in Salt Lake City Utah serving the low-income households in the county. Amongst the services provided are low-income weatherization, housing services, and Head Start.

9. The *Vermont Energy Investment Corporation* is a nonprofit corporation formed to provide energy advocacy and energy efficiency services to low-income households. VEIC has been active as a member of the team of advocates and technical representatives working with and through the Vermont Department of Public Service to consider and help formulate appropriate public policy responses to electric restructuring in that state.

10. The *Vermont Low-Income Advocacy Council, Inc.* is a nonprofit corporation formed in 1973 to advocate generally for low-income Vermont residents with state and federal governmental

bodies whose actions affect the lives of the poor. Members of the Council are nominated by local Community Action Agencies and/or through regional caucuses of low-income persons, and represent poor Vermonters from every region of the state. VLIAC has participated as an intervenor or *amicus curiae* in a number of cases before the Vermont Supreme Court and the Vermont Public Service Board, including telecommunications cases and low-income energy issues.

These organizations will collectively be referred to below as the Consolidated Low-Income Representatives.

Discussion

PART I:
INTRODUCTION

The representatives of low-income consumers identified above (hereinafter, Consolidated Low-Income Representatives) are submitting comments in this proceeding because of the potential for substantial harms to be visited upon their constituency by mergers in the electric industry. Regulation often stands as a barrier between the electric industry and the oppression of particularly vulnerable customer classes. The vulnerability of the class may arise because of attributes of the customers, because of attributes of the industry, or because of market failures.

The belief of the Consolidated Low-Income Representatives is that FERC review of merger proposals today takes place without adequate consideration of the impacts on residual electric markets. Residual markets are those markets for which little or no effective competition exists. In these markets, consumers are "rationed": their demand for services exceeds the supply available to them. In such circumstances, it is not possible for their market sector to control or "regulate" the supplier. Consumers take what is available.

In the electric industry, the residual market is the residential market generally and the low-

income residential market in particular. This market needs public protection. Even if competition exists, in other words, the members of the public may have neither the resources nor the ability to make competition work for them. Even more often, however, the markets are such that no sellers are engaged in active rivalry for the business of these customers. Accordingly, the abuses which such power portends is controlled in large part by public regulation such as that represented by FERC oversight of merger proposals.

In addition, the Consolidated Low-Income Representatives submit that inadequate attention is paid to the impacts of *electric* policy on low-income households. Instead, the focus of attention for most low-income public policy initiatives today seems to be on low-income *heating* needs. This focus is misplaced. Low-income electric *non*-heating consumption represents roughly 35 - 40 percent of low-income usage and 60 - 65 percent of low-income bills. This is true nationwide as well as for each region of the country.

Heating Usage as Percent of Total Home Energy Usage and
Heating Bills as Percentage of Total Home Energy Bills
National Data

	Usage (mmBtu)			Bills ($$$)		
	Total	Heating	Percent	Total	Heating	Percent
All Households	103.9	56.5	54.4%	$1,255	$406	32.4%
Low-Income Households	90.9	50.6	55.7%	$1,062	$364	34.3%
LIHEAP Recipients	98.7	59.9	60.7%	$1,067	$412	38.6%

SOURCE:

Low-Income Home Energy Assistance Program Report to Congress for FY 1993, at 17 and 20 (Oct. 1994).

As can be seen, even for low-income households, who have less discretionary electric consumption than the population as a whole, heating bills are only roughly 35 - 40 percent of total energy bills. What happens to the price of electricity is thus important to low-income consumers.

Indeed, in many ways, what happens to the price of electricity is even more important to low-income consumers than to other residential consumers. Low-income consumers have less of an ability to withstand fly-ups in price as a result of a public failure to restrain the market power of merged utilities. The mean income for households eligible for LIHEAP based on March 1991 Current Population Survey (CPS) data was $10,172. The mean household income for LIHEAP recipients (as opposed to those eligible to be recipients) was only $8,257.[1] Given the home energy bills cited above, these households had home energy burdens of 10.5 percent and 12.9 percent respectively, significantly exceeding the roughly four percent burden for residential consumers generally.

In sum, low-income consumers are particularly vulnerable to increases in electric prices. These consumers depend upon public oversight to keep prices within reasonable bounds. To the extent that proposed mergers of electric companies would threaten to result in increased prices, low-income consumers would be harmed. The discussion below will explain why mergers constrained only by a review based on whether "competition" remains in the electric industry will not provide the needed protection. Indeed, the discussion will explain why residential and low-income customers in particular would be harmed if such a policy were adopted by FERC. The discussion below finally makes recommendations as to specific criteria appropriate to use in judging whether proposed electric utility mergers should be approved as consistent with low-income interests.

PART II:
A MERGER SHOULD BE JUDGED BY MORE THAN THE PRESENCE OF COMPETITION

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[1] ***Low-Income Home Energy Assistance Program Report to Congress for FY 1993***, at 28 and 29 (Oct. 1994).

The Commission is to consider merger proposals pursuant to Section 203 of the Federal Power Act. That Section provides that "if the Commission finds the [proposed merger] will be consistent with the public interest, it shall approve the same." According to a Ninth Circuit court decision, this section provides that there be no "detriment to consumers or investors or to other legitimate national interests."[2] A merger approval standard that seeks merely to examine the extent to which a proposed merger will affect competition fails to meet either this "public interest" or "no detriment" standard. Even assuming that a proposed merger being considered by FERC will have no adverse impacts on competition, the further conclusion that the merger is thus consistent with, let alone promotes, the public interest does not *a priori* follow. Moreover, concluding that a merger has no detrimental impact on competition does not necessarily yield the further conclusion that a proposed merger will have no "detriment[al impacts] to consumers. . .or to other legitimate national interests."

In this respect, the Consolidated Low-Income Representatives endorse the comments of FERC's antitrust advisor in 1988, when she stated:

> . . .I found that there was a body of very clear federal court precedent, right up to the Supreme Court, mandating that FERC must consider antitrust policy on its own initiative and balance those antitrust considerations in exercise of its public interest jurisdiction. Its public interest jurisdiction involves such concepts as "just and reasonable," "undue discrimination," and "undue preference" --embodying a broad fairness concept, as well as consumer protection.
>
> . . .in weighing antitrust policies in the public interest determination, the courts have also made clear that the antitrust considerations need not always prevail; they can be outweighed by other legitimate public policy considerations.[3]

The Consolidated Low-Income Representatives agree with each of the propositions that: (1) antitrust

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[2] ***Pacific Power and Light Company v. Federal Power Commission***, 111 F.2d 1014, 1016 (9th Cir. 1940).

[3] "Deregulation and Exclusionary Conduct: A Panel Discussion," 57 ***Antitrust Law Journal*** 723, 734 (1988).

considerations are not the exclusive grounds upon which FERC should base its decisionmaking; (2) that FERC's jurisdiction includes also a "broad fairness concept, as well as consumer protection"; and (3) that these "fairness" and "consumer protection" considerations are not only to be balanced against an antitrust analysis, but sometimes can outweigh the competitive analysis in reaching a decision.

Part A: The "Public Interest" is Made Up of More Than Those Factors Which a Competitive Market Will Consider.

Limiting a review of proposed electric utility mergers only to the impact of the merger on competition does not adequately account for the non-economic factors that regulators should consider. These are impacts that might not be of direct concern to business investors, since the business investor does not pay the cost or receive the benefit. These are impacts that might have no easily quantifiable economic value. Some of the impacts that may well be ignored under a merger approval framework which relies solely upon an "impact on competition" decision rule as the touchstone of acceptability include:

1. **Universal service:** The provision of service to each household is a social goal for essential public services. As a reasonably affluent society, the determination has been made that every household should have services such as housing, telephones, energy, water, banking and insurance. Moreover, there is a value to society as a whole from ensuring universal service. The failure to have such services, in other words, imposes a cost on the public unrelated to the service itself. A competitive firm will not *ipso facto* take the impacts on universal service into consideration in a merger proposal, let alone seek to ensure that universal service is promoted,

or at least not harmed, by a merger proposal.

The impacts of a failure to have universally affordable service arise with respect to home energy bills as well. One recent study of more than 800 households with Head Start children in Missouri found that unaffordable utility bills force low-income households into a pattern of frequent mobility, having significant adverse impacts on educational attainment and giving rise to a host of social consequences.[4] The study found that almost 40 percent of these households were "frequent movers," over half of whom, in turn, cited unaffordable utility bills as being a primary cause for their most recent move.

According to the study, "the educational impacts of this frequent mobility are dramatic." Amongst the findings cited in the report were:

- Overall, third-graders who have changed schools frequently are 2.5 times as likely to repeat a grade as third-graders who have never changed schools.
- Frequently mobile students were 1.5 times more likely than students who have not moved to be low-achievers in reading, and twice as likely to be low-achievers in math. "Low-achievers" means below grade level.
- Finally, when children changed schools four or more times, they are more likely to drop out of school.

According to the report, the problems of a lack of adequate education are, not surprisingly, immense. The report cited research which found that "the consequences of [educational] failure follow them for their whole lives. These children are more likely to drop out of school,

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\4\ Colton (1995). ***A Road Oft Taken: Unaffordable Home Energy Bills, Forced Mobility, and Childhood Education in Missouri***, Fisher, Sheehan & Colton, Public Finance and General Economics: Belmont, MA.

for example, and high school dropouts are more likely than high school graduates to be arrested and to become unmarried parents." These educational impacts, however, are *precisely* the types of external adverse impacts which, while arising from a lack of universally affordable home energy service, would not be considered by a competitive electric industry. The benefits do not accrue to the industry while the costs are not imposed upon the industry.

2. **Consumer input:** One goal that a FERC merger evaluation based solely on an "impact on competition" decision rule would not consider is the impact of mergers on the democratization of the decisionmaking process. The need for public participation has become even greater as the stakes in this decisionmaking have increased: the offer of services to entire segments of the population; the commitment of billions of dollars to one economic endeavor rather than another. The decisions made by electric utilities affect all of society, including all of its diverse constituent parts. The board of directors of a private electric utility has neither the incentive nor the ability to consider these diverse interests. Whether "economic efficiency" should be sacrificed to some extent (or to what extent) in order to provide high quality rural electric service to an Indian tribe in Utah, for example, is a decision *not* best left to middle class white executives sitting in New York or Atlanta. Mergers are likely to further separate the impacts of decisions from the locus of decisionmaking and, in addition, make public participation in decisionmaking even more difficult than it is today.[5]

This separation of decisionmaking from the persons who are affected by the decisions

[5] The Consolidated Representatives endorse the statement of Jerry Petr in this regard: "* * *those who experience the consequences of policy are expected to be the determiners of whether policy meets acceptable standards of performance in addressing the needs and concerns that led to the policy formation." Petr, "Fundamentals of an Institutionalist Perspective on Economic Policy," 18 ***Journal of Economic Issues*** 1, 10 (March 1984).

will most likely adversely affect low-income consumers. As decisionmaking is concentrated in remote forums, consumers (and particularly *low-income* consumers) have less opportunity to have any say in the processes which affect their lives. The political power of low-income customers is slim under the best of circumstances promoting participation. This is an empirically demonstrable fact, not merely a political observation. Substantial research shows that political involvement, efficacy, and a sense of "public self" decreases dramatically for those lower in the spectrum of socio-economic status.[6] Lower socio-economic groups are the least likely group not only to get involved politically, but to speak out --even on their own behalf-- or to be involved in a utility regulatory process. Mergers which further separate the location of decisionmaking both geographically and socially from the affected low-income population create even more insurmountable barriers. Even if no particular merger completely removes electric industry decisionmaking from public accountability, taken together, merger decisions will remove the ability of consumers to affect the decisions of their electric providers.[7]

PART B:
RECOMMENDED MERGER CRITERIA.

Given this discussion above, the Consolidated Low-Income Representatives recommend that

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[6] *See e.g.*, Hess and Torney, ***The Development of Political Attitudes of Children***, Chicago: Aldine, 1967; Litt, "Civic Education, Community Norms, and Political Indoctrination," ***American Sociological Review***, Vol. 28 (1963), pp. 69 - 775; Jones and Grant, ***Political Behavior: Choices and Perspectives***, St. Martin's Press: NY (1974); Hirsch ***Poverty and Politicization: Political Socialization in an American Sub-Culture***, Free Press: NY (1971); Greenberg, "Orientations of Black and White Children to Political Authority," ***Social Science Quarterly***, vol. 51 (1970).

[7] This is what Don Kanel has referred to as the "tyranny of small decisions." Kanel, "Institutional Economics: Perspectives on Economy and Society," 19 ***Journal of Economic Issues*** 815, 826 (Sept. 1985).

FERC adopt two Rules addressing the impacts of mergers on low-income consumers. The first Rule would institutionalize a commitment to universal service, in a manner similar to the recent report of Rhode Island collaborative on electric industry restructuring.[8] The Rule would state:

> **<u>Proposed Rule 1</u>:** Electricity is an essential product which must be available to all customers. Existing special rates, payment programs, and protections regarding customer service and shutoffs for low-income customers should be included in any merger proposal. Further developments of such rates, programs, and protections to address the goals of universal service should continue after merger.

The second Rule would create an enforceable obligation that no approved merger would adversely affect the attainment of universal service. The Rule would state:

> **<u>Proposed Rule 2</u>:** No merger shall result in an adverse impact on attaining or maintaining universal service in the territory served by the applicant. Each application must contain an explicit assurance that in the event an adverse impact on universal service occurs subsequent to a merger approval, the applicant will, within 180 days of a finding of such an impact, develop and implement an Action Plan reasonably directed toward reversing the adverse impact.

Through this Rule, FERC adopts the policy stance that the merged utility is the entity which is ultimately responsible for whether or not it moves toward ensuring universal service in its service territory. While particular public initiatives can help a utility attain that goal, it should be the merged company that bears the ultimate responsibility. The company has (or should have) the knowledge, the

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[8] ***Report of the Rhode Island Electric Industry Restructuring Collaborative to the Rhode Island Public Utilities Commission*** (February 9, 1996).

incentive, the marketing capability, and the technical capability to move toward universal service. Outside whatever basic programs the company might be required to implement by state regulators, the company will be free to implement whatever programs it deems reasonably necessary to achieve the goal of universal service.

The intent behind this Rule is to have several outcomes. First, it will impose upon a merged company an ongoing obligation to devote resources to ensuring universal service to the same extent as it devotes resources and marketing to other aspects of its business. Second, it will impose upon a merged utility an ongoing obligation to assess whether its actions drive the price of electric service beyond the financial means of low-income households. If service becomes unaffordable and low-income penetration accordingly begins to fall, the merged company will be required to develop a scheme to offset the impacts on the poor. Finally, it frees up the merged utility's management to address any ongoing failure to provide universal service in the same fashion as the requests of many merged utilities for alternative regulation are intended to free up those companies in the competitive marketplace. Rather than micromanaging the company's efforts to promote universal service, the Rule is saying that merged electric companies will be judged by the outcome, rather than by the effort.

A similar issue was addressed in the *Universal Service Questionnaire Results of the Universal Service Project of the Staff Subcommittee on Communications of NARUC*, presented at the NARUC annual meeting in New York on November 14, 1993. Question 12(a) of that questionnaire asked "In the future, should penalties be considered by regulators for companies who are remiss in the provision of universal service?" Regulators approved of penalties by an 88 percent yes/12 percent no margin.

PART III:

EVEN WHEN EVALUATING A MERGER'S IMPACT ON COMPETITION, FERC SHOULD CONSIDER MORE THAN SIMPLY THE PERSPECTIVE OF THE FIRM

In considering the impacts of a proposed merger on competition within the service territory of the merged company, FERC should consider more than the perspective of the firm. In so doing, FERC should adopt merger criteria that go beyond most analysts, who rely almost exclusively on the multiplicity of firms and the implications of such multiplicity in support of their evaluation of whether a proposed merger will result in an adverse impact on competition. Moreover, the FERC merger criteria should go beyond the Rulemaking Petition by the American Public Power Association (APPA) and the National Rural Electric Cooperative Association (NRECA) which also focused its attention on issues analyzed from the perspective of the firm.[9] The need for this expanded criteria, as well as proposed model language for criteria taking into account consumer-side characteristics, is set forth below.

Part A: Consumer-Side Characteristics.

An exclusive focus on the perspective of the firm in assessing what impact a proposed merger will have on competition in the service territory of the merged company is inappropriate. Indeed, determining whether workable competition exists sufficient to support a proposed merger depends *as much* on an examination of consumer-side characteristics as it does on structure-conduct-performance issues, the analysis of which is undertaken from the perspective of the firm. Consider, for example, the following:

\9\ ***Joint Petition of the American Public Power Association and the National Rural Electric Cooperative Association for a Rulemaking Proceeding to Revise the Commission's Standards Applicable to the Merger of Public Utilities Under § 203 of the Federal Power Act*** (filed January 17, 1996).

1. **Elasticity of Demand:** The entire efficacy of arguments that any given market is workably competitive is predicated upon the assumed elasticity of consumer demand. It is this elasticity through which one can measure the extent to which the market offers close substitutes.[10] In this inquiry, it as much the cross-elasticity of demand that is in question as it is a simple price elasticity.[11]

Elasticity can serve as a surrogate measure for a number of different situations. It can indicate a lack of meaningful alternatives.[12] It can indicate the presence of high search costs associated with gains of uncertain magnitude or duration.[13] It can indicate brand loyalty, habit buying or significant product differentiation.[14] It can indicate genuine indifference as to price.[15] It is, in other words, extremely difficult to determine whether an inelastic consumer demand is evidence of price indifference or whether it is evidence of some other market failure.[16]

In addition, it is also extremely difficult to determine whether price inelasticity is the

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\10\ Cochrane and Bell, ***The Economics of Consumption***, at 329 (New York 1956).

\11\ See, Note, "The Market: A Concept in Antitrust," 54 ***Columbia Law Review*** 580 (1954).

\12\ *See e.g.*, Pace, "Relevant Markets and the Nature of Competition in the Electric Utility Industry," 16 ***Antitrust Bulletin*** 725, 728 - 734 (1971). (Residential energy users lack meaningful alternatives).

\13\ *See e.g.*, Hanson, *et al.*, ***Monitoring Competition: A Means of Regulating The Property and Liability Insurance Business***, at 124 - 125, National Association of Insurance Commissioners (May 1974). (hereafter Hanson). (search costs for least-cost property and casualty insurance are high.)

\14\ An excellent example of price inelasticity attributable to brand loyalty is the inelasticity associated with airline "frequent flyer" programs. *See*, U.S. General Accounting Office, ***Airline Competition: DOT's Implementation of Airline Regulatory Authority***, at 16 (June 1989).

\15\ For example, business airline flyers whose firms pay fares are less responsive to lower fares or improved service.

\16\ *See e.g.*, Hirshleifer, ***Price Theory and Applications***, at 147 - 149 (2d ed. 1980).

cause or the effect of the lack of competition. Do alternatives not exist because consumers are indifferent to price changes or are consumers indifferent to price changes because there are no alternatives? This inability to identify the causal direction of market factors has been found in other aspects of economic analysis.[17] Whatever the direction of the cause-effect relationship, and whether or not a more inelastic demand is indicative of "genuine" consumer price indifference or is evidence of an unrelated market failure, an inelastic consumer demand, by definition, is associated with a less competitive market.

2. **Consumer Size:** In addition to having a multiplicity of sellers in a market for it to be considered workably competitive, each *buyer* in the market must be so small as to be unable to affect price for a workably competitive market to exist.[18] Unquestionably, the size of the buyer affects the substitutes which are available to that buyer and, therefore, the price elasticity of demand.[19] As a result, a seller will tend to cater to the large buyers by offering special considerations. To the extent that large buyers can obtain significant special considerations, competition is reduced.[20] Special considerations can take the form of rebates, special credit terms, free additional services, and the like.

Without the condition that buyers, as well as sellers, must be small, the market will not

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[17] *See e.g.*, Weiss, "Factors in Changing Concentration," 45 ***The Review of Economics and Statistics*** 70 (Feb. 1963).

[18] Some text books generalize by saying that each "participant" must be so small as to be incapable of affecting the market. *See e.g.*, Mansfield, ***Macroeconomics: Theory and Applications***, at 249 (3d ed. 1979).

[19] *See*, ***Pace***, *supra*, at 728 - 729 and 735.

[20] Ferguson, ***A Macroeconomic Theory of Workable Competition***, at 193 (1964).

respond to demand alone as the factor determining price.[21] Consumer demand has been likened to an economic "vote."[22] No market participant should have a disproportionate share of voting power. If a buyer in the market can wield substantial power, that buyer could, for example, demand discounts that redound to the detriment of the remaining small volume users. Under the circumstances of buyer power, the lack of competition will redound to the detriment of the small user, low-income consumers.

3. **Consumer Hurdle Rates:** One final consumer-side characteristic that interferes with the operation of a competitive market is the existence of high hurdle rates for consumer purchases, particularly among low-income households. Neoclassical price theory assumes that a competitive market operates in a frictionless environment. When price changes occur at the producer level, consumer reaction to those changes is assumed to be instantaneous. Moreover, there is assumed to be no constraint on the consumer's reaction.

In reality, of course, there are substantial constraints on consumer reactions to price changes even when consumers know of the changes and understand their significance. Even setting aside such issues as nonprice competition, habit buying, product differentiation, and the like, and assuming that the consumer knows and wishes to act upon a full knowledge of the extent and implications of a price change, constraints exist. The issue, therefore, is whether these constraints are so significant as to interfere with workable competition.

Information "costs" the consumer time, money, or effort to obtain. When a consumer

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[21] *Id.*, at 197.

[22] Adams, "Competition and Consumer Sovereignty," at 245, in D. Watson (ed.), ***Price Theory in Action*** (3d ed. 1973).

initially considers a purchase ("I think I should buy a car"), he or she is probably unaware of the various prices offered. The ensuing search is not costless, and the consumer must weigh the potential benefits of seeking the information against the costs. In theory, the larger the dollar amount of the purchase and the greater the range of prices, the more the consumer will search. In neoclassical theory, the consumer will search up to the point where the gain from further searching equals the incremental cost of the search.

A consumer's decision to change electric companies involves weighing the costs of the search against the amount of the gain. In one sense, incurring the costs of the change involves the consumer in making an investment in the new electric provider in order to gain a lower priced service. That is the essence of the argument for competition: if one firm in a workably competitive market unreasonably raises its rates, consumers will move to a lower priced firm. Against the investment in the new firm, the consumer must weigh the potential savings. The consumer will only make the investment if the savings results in a desired rate of return. The rate of return necessary to prompt consumer investment in a measure designed to save money is generally referred to as the "hurdle rate." The difference between the current electric service provider and the least-cost provider, in other words, must be sufficient (*i.e.*, must have a substantial enough spread) to meet the customer's hurdle rate. Unless this exists, no consumer action will occur.

The competitiveness of various markets can be determined in part by the class hurdle rate for new investments. No research has been undertaken on consumer hurdle rates for different providers of electric services. On energy *savings* expenditures, however, the residential class has a significant and generally recognized higher hurdle rate than commercial

customers. Moreover, even within a customer class, hurdle rates may differ. Most empirical research on consumer discount rates has examined the effects of income on the discount rate. Universally, the research shows that discount rates fall as income increases.[23] Lower income households generally have less education than higher income households. Not surprisingly, Cambridge Systematics found that low-income households were more likely to respond "I don't know" to the question, "how much would you have to be able to save in energy costs per year before you would be willing to invest $100 in an energy saving device." According to the report, "low-income households are generally estimated to have higher discount rates because a larger proportion of them are unable or unwilling to determine whether an investment is advantageous.[24]

This analysis holds many implications for FERC decisionmakers who are asked to determine whether sufficient competition exists to approve merger proposals. Decisions by FERC regarding whether or not to approve a proposed electric utility merger require a determination of whether workable competition exists in the service territories of the affected companies. Unfortunately, decisions to date have been based on a substantially incomplete analysis, looking only at the firms that supply electric service. In fact, determining whether workable competition exists cannot take place in isolation from a detailed examination of the *consumers* who make up the market as well. While unquestionably the characteristics of the firms must be considered, to examine *only* those characteristics is to ignore much of the available relevant information upon which to make a considered decision.

\23\ Cambridge Systematics, ***Implicit Discount Rates and Consumer Efficiency Choices***, at 34 (Sept. 1982).

\24\ *Id.*, at 39.

An analysis that looks at consumer characteristics complements rather than supplants other currently used analyses. This supplemental approach introduces into the analysis consumer-side characteristics that are too often "forgotten," or in any event underemphasized, in analysis of competition. Implicit in this introduction is an identification of shortcomings in the contemporary argument over electric industry competition that results from the failure to consider consumer-side issues, not as a political consideration, but as a critical factor in determining the presence or absence of workable competition. These shortcomings should be addressed and redressed in the FERC merger rulemaking.

PART B:
RECOMMENDED MERGER CRITERIA.

Given this discussion above, the Consolidated Low-Income Representatives recommend that FERC adopt the following Rule:

> **Proposed Rule 3:** In determining whether workable competition exists in any product or geographic market in which electric energy or capacity is offered for sale to wholesale or retail customers, applicants shall provide documentation of such competition for each discrete customer class that is identifiable by characteristics of the customers in that class. This documentation shall identify the customer characteristics that might interfere with the operation of a competitive market and contain an evaluation of the impacts of those customer characteristics on competition.

PART IV:

A CONSIDERATION OF THE IMPACTS OF A MERGER ON COMPETITION SHOULD CONSIDER ALL STRUCTURAL CONDITIONS AFFECTING COMPETITION RATHER THAN LOOKING SIMPLY AT THE MULTIPLICITY OF FIRMS

An examination of how a proposed merger will affect workable competition in any discrete geographic area, or of whether workable competition exists sufficient to justify approval of a proposed merger, should incorporate a time-action focus rather than relying upon a simple static analysis. It is insufficient to determine whether an industry is competitive now. Rather, an informed consideration must look also at where the industry has been and where it is headed. If factors are present which make it increasingly difficult for new firms to enter the market, the evaluation should look at how competitive the market will remain.

An excellent example of the failure of policymakers to consider changes over time is the deregulated airline industry. As the U.S. General Accounting Office recently noted, significant changes have occurred in the domestic airline industry since deregulation. In the early years of deregulation, GAO said, "competition intensified."[25] The GAO later concluded, however, that "industry experts both inside and outside [the Department of Transportation] believe that the airlines' competitive environment has been altered by changes in the airlines' marketing and operational strategies."[26] The GAO concluded that "taken together, these changes give airlines the opportunity to dominate an airport or region and charge monopolistic prices on some routes."

So, too, with the electric industry, a static analysis looking at the number of firms, without

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\25\ U.S. General Accounting Office, ***Airline Competition: DOT's Implementation of Airline Regulatory Authority***, at 14 (June 1989). (hereafter ***DOT Authority***).

\26\ *Id.*, at 35.

looking at past and future trends, is an inadequate means of deciding upon the competitiveness of the industry. Emphasis must be placed not only on the trends that currently exist, but on trends that become newly apparent in the future as well. In addition, an examination of workable competition must look carefully at the operation of the commercial and regulatory institutions within which decisions, both producer and consumer, are made. Rather than being made up of market clearing prices set by supply and demand, the factors affecting whether competition exists consist of actual institutions and transactions.[27]

Part A:
In Assessing the Impacts on Competition, FERC Should Consider the Anti-Competitive Impacts of Long-Term Contracts

The competition in which FERC has the most interest when reviewing electric merger proposals is competition at the wholesale level. Even if the electric generation industry is competitive at some point in time as claimed by proponents of a specific merger proposal, it is not clear that a wholesale electric market can be expected to *operate* in a competitive fashion over the long-term. One major flaw in the theory of a wholesale competitive industry involves institutional arrangements which flow from the mandate that local retail distribution utilities provide reasonably adequate service. This mandate requires that retail systems *guarantee* the availability of electricity at the time, and to the extent, demanded by their retail customers.

Because of this mandate, it is impossible to completely separate the retail market from the wholesale market. Retail companies will be unlikely to exclusively (or even primarily) rely upon spot

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[27] *See*, Howe and Rasmussen, ***Public Utility Economics and Finance***, at 175 (1982).

market purchases to meet the energy demands of their retail customers. To ensure the availability of power at all times, what might well develop is a "competitive" wholesale market *not* involving constant bargaining for least-cost power at any given time, but rather a "competitive" wholesale market that is marked by the negotiation of long-term contracts.

Long-term contracts have historically been considered to be amongst the contractual forms that can possibly be viewed as exclusionary. And a variety of electric utility characteristics support the notion that the electric industry will be marked by long-term contracts:

- **High transaction costs:** These costs involve the costs of using the market, and include the costs of search and the costs of negotiation of the terms of transactions. Perhaps at some point in the future these transaction costs will not serve as the basis for long-term contracts. But whether, when and to what extent that point is ever reached for electricity is entirely speculative at this time. Within the natural gas context, one commentator has noted that "common carriage, in combination with spot and futures markets for natural gas, removes the transaction costs justification for contracting between pipelines and producers."[28] The situation described therein,[29] however, simply does not now exist for electricity. While the existence of spot and

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[28] Doane and Spulber, "Open Access and the Evolution of the U.S. Spot Market for Natural Gas," 37 ***Journal of Law and Economics*** 477, 507 (1994).

[29] "An important feature of commodity spot markets for natural gas is the reduction in transaction costs. Prices are established through multiple trades. The spot prices serve as benchmarks that reduce the need for bilateral negotiations between producers and pipelines. Moreover, the spot market serves as a foundation for the futures market. Commodity futures markets reduce transaction costs of long-term contracting. . .Contracts are standardized and thus are easily transferable. With an organized futures market, no bilateral negotiations are needed: prices are established through market trades. Individual firms can assemble portfolios of buy and sell contracts that reflect their needs, without being tied to multiyear forward contracts. Thus, the need for bilateral multiyear forward contracts is reduced by the establishment of spot and futures markets." *Id.*

futures markets might alleviate the need for long-term contracts, such markets certainly do not exist yet in the electric industry.

- o **<u>Market Power</u>:** Long-term contracts are often used to secure market power as well. As one commentator has noted: "[s]afe in the knowledge that gas cannot be bought by others if it reduces take from a particular well, a pipeline granted an exclusive purchasing right in a field market is insulated from competitive pressure even if market power could not be exercised as the basis of horizontal dominance."[30] Even persons who have found empirically that market power was not established under the unique conditions of the natural gas pipeline industry concede that "[o]ne view of the role of contracts in the natural gas industry is that such arrangements were used to extend the market power of the producer."[31] The same role can be ascribed to the electric industry today.

- o **<u>Risk Sharing</u>:** Long-term contracts are often used as a mechanism to risk share. Long-term contracts provide consumers with an assurance of supplies, free from the risks of spot purchases. Similarly, such contracts assure producers of long-term sales. Long-term contracts allocate the risks of market price fluctuations. Again, while a well-developed formalized spot market and futures market can serve to reduce this need for long-term contracts, these developments have not yet occurred in the electric industry.

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[30] Broadman, "Elements of Market Power in the Natural Gas Pipeline Industry," 7 ***Energy Journal*** 119, 123 (1986).

[31] Mulherin, "Complexity in Long-Term Contracts: An Analysis of Natural Gas Contractual Provisions," 2 ***Journal of Law, Economics and Organization*** 105, 113 (1986).

- **Financing Investment:** Finally, long-term contracts are often used to secure financing for investment in new facilities. "The investors were assured that the investment would earn a competitive rate of return given appropriate contract terms. This justification for long-term contracts involves elements of the risk-sharing aspect of contracts since reducing the risk for the producer or pipeline lowers the risk of investment in facilities."[32]

FERC's review of merger proposals should take into account whether conditions are conducive to the establishment and maintenance of anticompetitive long-term contracts. Modelled upon the terms of Section 3 of the Clayton Act, FERC should assess whether: (1) the effect of existing or reasonably anticipated long-term contracts involving the merged company may be to "substantially lessen competition"; or that (2) as a result of such contracts, competition has been foreclosed in a substantial share of the line of commerce affected.[33]

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[32] ***Doane and Spulber***, *supra*, at 511.

[33] *See generally*, ***Standard Oil Company of California v. United States***, 337 U.S. 293, 314 (1949).

PART B:
A CONSIDERATION OF THE IMPACTS OF A MERGER ON COMPETITION MUST TAKE INTO ACCOUNT THE ABILITY AND INCENTIVE TO ENGAGE IN ANTI-CONSUMER BEHAVIOR

Because a variety of harms and benefits may arise to low-income households (and other small users) from mergers within the electric industry, the next step in a merger approval analysis is to evaluate under what circumstances those various harms are most likely to arise. The tools that will be used in assessing the potential for harms to arise to low-income customers involve three steps:

(1) to identify the ends-in-view which might arise through a merged electric company;

(2) to determine whether the firms that have submitted a merger proposal for approval have both the incentive and the opportunity to allow the impacts to arise; and

(3) to assess how the identified harms might be operationalized into specific decisions by a merged electric company.

Each of these steps is explained below.

Competitive Protections as the Goal to be Sought

Each electric merger proposal to FERC must be assessed to determine whether the proposal is sufficient to provide competitive protections to small user, low-income customers. Competitive protections arise when three factors exist: (1) the number of firms providing service is sufficient, (2) the institutional arrangements which arise as a result of the market structure are adequate, and (3) the consumer characteristics are appropriate, to prevent members of the low-income customer class from being subject to abuse or imposition. In order for a proposed merger to be approved, competitive protections must exist. For competitive protections to exist, low-income consumers must have both

the choice of alternative suppliers *and* the ability to exercise that choice. To translate this inquiry into criteria to be applied by FERC in a merger approval proceeding, it is next necessary to engage in a two-fold inquiry.

Incentives and Opportunities

The first inquiry assesses both incentives and opportunities. On the one hand, would the electric industry in a post-merger situation have the *incentive* to bring about the results sought to be effected or avoided (either the harm or the benefit) in the post-merger environment? On the other hand, would the electric industry have the *opportunity* to bring about those results? These two factors do not march in lock-step. There can, in other words, be the incentive to perform an action without the opportunity to do so or *vice versa*. For consumer harms and/or benefits to arise, both factors -- incentive and opportunity-- must exist.

This "incentive and opportunity" framework is not unique to the electric industry. Indeed, the concerns over the potential of cross-subsidies in the competitive telecommunications industry were often evaluated using this approach. There was substantial concern, for example, regarding cross-subsidies between basic and non-basic services.[34]

The Operationalization of Harms and Benefits

It is not likely that any merged electric utility would affirmatively decide to bring about "harms" to particular customer classes. No utility, in other words, would decide to impose "unaffordable rates"

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[34] Spulber, "Deregulating Telecommunications," 12 ***Yale J. on Reg.*** 25 (Winter 1995); Sullivan, "Developments in Computer III and the Modification of the Final Judgment," 328 ***PLI/Pat*** 371 (1991).

on low-income customers as a result of a merger. What will happen, instead, is that a series of decisions will be presented to the merged utility which will, in the long- or short-term, have an impact on the affordability of rates. The utility will, through its decisions to do or to avoid doing certain activities, manifest its competitive position on the importance of affordable rates to low-income customers.

Given this analytic framework, three questions march forward in the identification of the activities through which a merged utility may manifest its competitive position on harms and benefits to low-income consumers:

- What do utilities do today, which they will have the incentive and opportunity to *stop* doing?
- What should utilities do in the future, which they will have the incentive and opportunity to avoid or prevent doing? and
- What should utilities avoid doing in the future, which they will have the incentive and opportunity to do?

In sum, the broad conceptual strokes of evaluating the impacts of a proposed electric utility merger on low-income customers involve a determination of whether the post-merger industry is capable of providing "competitive safeguards" to this class of customers. To make this determination, FERC must examine whether the post-merger industry has both the incentive and the opportunity to bring about particular harms and/or benefits to low-income customers, not through generalized policies but rather through specific decisions and actions. Moreover, FERC must take into consideration the impacts of long-term contracts on competition.

PART C: RECOMMENDED MERGER CRITERIA.

Given this discussion above, the Consolidated Low-Income Representatives recommend that FERC adopt the following Rule regarding the impacts of proposed mergers on consumers. The Rule would state:

> **Proposed Rule 4:** Each application must contain an assessment of the competitive protections provided to small user customers. Whether competitive protections exist will depend upon whether small user consumers have both the choice of alternative suppliers and the ability to exercise that choice.

PART V: EVEN WHEN CONSIDERING THE IMPACTS OF THE MULTIPLICITY OF FIRMS, FERC SHOULD CAREFULLY DEFINE WHAT MARKETS ARE SERVED BY THE MERGED COMPANIES AND DETERMINE WHETHER THERE IS COMPETITION IN *EACH* MARKET

Whether the merger evaluation criteria which FERC uses to examine whether "competition" exists appropriately defines the relevant "market" to be considered is of concern to the Consolidated Low-Income Representatives. Consider that one primary level of inquiry in an analysis of the presence or absence of competition is a market definition. According to one commentator, "a market simply defined is an area within which a group of sellers compete for the patronage of a common group of buyers."[\35\] As this points out, the first two fundamental characteristics involve: (1) that there is a rivalry for the purchase decisions of buyers; and (2) that there be a commonality amongst the sought-

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\35\ Pace, "Relevant Markets and the Nature of Competition in the Electric Utility Industry," 16 ***Antitrust Bulletin*** 725, 725 (1971).

after buyers.

Flowing from this observation is the conclusion that a "service" offered by an electric utility and a "market" to be served by that utility are not the same. Residential consumers and business consumers using "the same" electric service nevertheless likely represent two different electric markets. Indeed, one of those markets may be competitive while the other is not, even though the service in both is provided by the same firm. In such circumstances, the extent to which there might be workable competition in the business market has no relevance to whether there might *also* be workable competition in the residential market. In order to assess whether workable competition exists, workable competition must be tested in each.

Part A: Business and Residential Customers Served by the Same Utility May Nonetheless Represent Different Markets, One of Which is Competitive and the Other Which is Not

A number of factors distinguish the business from the residential markets in the electric industry, all of which can affect the degree to which, if at all, there is workable competition. These include the sophistication of search; a difference in the needs served by the electric usage; differences in the willingness to switch; and differences in the purchase cycles, including the point at which a decision is made on whether or not to switch. Differences in the availability of competitors is another major difference between residential and non-residential markets. Residential and non-residential customers often take electricity from the grid at different voltage levels.

The delineation of an economically relevant market involves an assessment of the degree of product substitutability. A market is an "area of trading," which can be defined geographically or in

terms of product differential.[36] A market is the "scene, or scope, of operations and economic forces that determines the character and amount of the product and the terms on which it is disposed of."[37] For goods or service to be in the same "product market," they must be reasonably interchangeable in price, use and quality.[38]

The most common method of determining market limitations is to consider the cross-elasticities of demand.[39] If products are in different markets, a price change in "the" good does not affect the amount used of any other good and *vice versa*.[40] A different method of delimiting markets is to define "distinctive product or geographic gaps in the chain of production."[41] Those "gaps" indicate product and geographic "boundaries."

Market definition is not uncommon to decisionmakers who work with regulated firms. For example, market definition is crucial to antitrust analysis. Whether it be a claim of monopolization or a challenge to an allegedly anticompetitive merger, to assert that competition has been either lessened or eliminated depends upon a determination of in what market the competition was to occur in the first instance.

\36\ Clarke, ***Competition as a Dynamic Process***, at 105 (1961).

\37\ *Id.*, at 104 - 105.

\38\ Lipson, "Monopolization: Traditional Standards and Future Directions," 47 ***Antitrust Law Journal*** 1115, 1117 (1978).

\39\ See generally, Kaldor, "Mrs. Robinson's 'Economics of Imperfect Competition'," 1 ***Economica*** 335 (1934); Pfouts and Ferguson, "Market Classification in Theory and Policy," 26 ***Southern Economics Journal*** 111 (1959).

\40\ Shepherd, "Anatomy of a Monopoly: (I) Excess Capacity and the Control of Price," 11 ***Antitrust Law and Economics Review*** 103, 110 (1979).

\41\ ***Pace***, *supra*, at 725, 760.

A leading antitrust case defining the relevant "market" is *United States v. E.I. DuPont De Nemours.*[42] In *DuPont*, the United States charged the company with monopolizing or attempting to monopolize in the cellophane industry. While DuPont produced almost 75 percent of the cellophane in the country, cellophane constituted less than 20 percent of all "flexible packaging material" sales.[43] The government asserted in *DuPont* that cellophane and other wrapping materials were neither "substantially fungible nor like priced."[44] The U.S. Supreme Court disagreed. The relevant market, the Court said, "depends upon the availability of alternative commodities for buyers: *i.e.*, whether there is a cross-elasticity of demand between cellophane and the other wrappings." The interchangeability, the Court continued, "is largely gauged by the purchase of competing products for similar uses considering the price, characteristics and adaptability of the competing commodities."[45] A "market," the Court concluded, is "composed of products that have reasonable interchangeability for the purpose for which they are produced--price, use and qualities considered."[46]

In sum, in assessing whether competition exists in the electric market or markets served by electric companies proposing to merge, FERC must first devote its attention to a market definition.[47] A market is to be defined first by whether there is rivalry; second by whether there is a common group of buyers; and third, by whether there exist closely substitutable products or services. The primary

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[42] 351 U.S. 377 (1956).

[43] *Id.*, at 379.

[44] *Id.*, at 380.

[45] *Id.*, at 380 - 381.

[46] *Id.*, at 404.

[47] *See e.g.*, **Hanson**, *supra*, at 122.

means to determine whether substitutes are "close enough," either from a product or from a geographic perspective, to constitute the "same" market is to look at cross-elasticities. If a change in the price of one product will significantly affect the demand for the other, the products are to be deemed to be in the same market. More generally, decisionmakers are to determine whether products are "fungible" or whether they are "complete substitutes."[48]

The proposed merger criteria rules set forth by APPA/NRECA[49] do not consider the different types of markets that might exist. And, it is the belief of the Consolidated Low-Income Representatives that the market most likely to be that market in which no competition exists, irrespective of the number of electric firms overall, will be the market involving residential customers generally and low-income residential customers in particular. There needs to be some attention paid to ensure that "market" is not defined to be the sale of electricity generally rather than the sale of electricity to particular customers with particular characteristics.

In assessing the propriety of a proposed merger, it is inappropriate to discuss whether workable competition exists in the electric industry as a whole. The presence of workable absence of competition must instead be determined for particular markets. FERC's merger approval criteria should require a finding that the merger will not adversely affect competition in all of the markets served by the merged companies.

\48\ ***Lake***, *supra*, at 226. A different commentator speaks of the "fungibility" of products. Garfield, "Regulation, Competition and Your Local Power Company," 1974 ***Utah Law Review*** 785, 790 (1974).

\49\ ***Joint Petition of the American Public Power Association and the National Rural Electric Cooperative Association for a Rulemaking Proceeding to Revise the Commission's Standards Applicable to the Merger of Public Utilities Under § 203 of the Federal Power Act*** (filed January 17, 1996).

Part B: Recommended Merger Criteria

Given this discussion above, the Consolidated Low-Income Representatives recommend that FERC adopt the following Rule regarding the impacts of proposed mergers on consumers. The Rule would state:

> **Proposed Rule 5:** A determination that a merger will not have anti-competitive impacts must be made for each discrete market served by the applicant(s).

PART VI: WHEN EXAMINING THE "FINANCIAL SAVINGS" CLAIMED FROM A PROPOSED MERGER, FERC SHOULD DETERMINE WHETHER THE SAVINGS ARE "REAL" SAVINGS OR WHETHER THEY ARE GENERATED BY REDUCTIONS IN SERVICE

The Consolidated Low-Income Representatives have a final concern about the focus of attention in the existing and proposed merger criteria on the reduction of costs without regard to the impacts which such cost reduction might have on the quality or level of service provided. In advancing merger proposals before FERC (and state regulators as well), the electric utility industry has advanced the unspoken (or written, or even *sung*) assumption that *cost reduction, by definition, is ipso facto good and right!* Cost reduction, the reasoning goes, is good and right because it allows the company to reduce rates.

Part A: Cost Reductions Advanced in Merger Proposals Should Not In Fact Represent Reductions in Service

The Consolidated Low-Income Representatives take exception with this assumption. The Consolidated Representatives instead submit that cost reduction is good and right only if customer service is not reduced, regardless of the effect on rates. A two-dimensional model of the interaction of rates and services provides some insight into this conclusion.[50] This model recognizes that reductions in rates in a mergers and acquisition environment must be balanced by the impacts of such reduced rates on the services which are provided. In the event that such a balancing finds a negative impact on consumers, then no compensating factor will be found to justify the proposed merger. In the event that such a balancing finds a positive impact, then the merger will be approved from the perspective of this particular inquiry.

There are situations, however, where a balancing based on the "average" customer provides inadequate information. Thus, for example, in the matrix below, it might be that an increase in services, accompanied by an increase in prices, would *not* be "neutral" from the perspective of all customers.

From the perspective of low-income households, the attractiveness of the enhanced service is irrelevant if the price makes the service unaffordable.[51] At the opposite end of the spectrum, even reduced rates may not be an appropriate compensating factor in the event that services are reduced. Again, from the perspective of low-income customers, for example, reduced rates accompanied by reductions in the availability of customer service centers, deferred payment plans, and the like, may not be an acceptable trade-off.

\50\ This model was adapted from S.D. Colton (1996). ***A Model for Assessing the Interaction of Price and Customer Service Changes in a Mergers and Acquisitions Environment***, Accounting Insights: Plymouth, MN.

\51\ The classic example of this cell involves many of the "enhanced services" in the telecommunications industry.

The appropriate model to use in assessing the interaction of changes in rates and services is set forth below:

Interaction of Changes in Rates & Services

	Rates Decrease	Rates are Unchanged	Rates Increase
Services Decrease	(1) neutral	(2) negative	(3) negative- negative
Services are Unchanged	(4) plus	(5) neutral	(6) negative
Services Increase	(7) plus-plus	(8) plus	(9) neutral

As this model shows, both rates and services can have one of three possible states: (1) increase; (2) decrease; or (3) remain unchanged. The cells of the model contain the projected benefits for customers. They can be positive, negative or neutral. A "Plus-Plus" indicates a higher level of benefit than simply a "Plus."

Utilities who propose a merger accompanied by some type of "rate freeze" seek to sell the merger as cell #5 in the short-term. Rates are unchanged during the period of the freeze and services are unchanged. Companies generally tend, at a minimum, to sell mergers as cell #4 over the long-term. Rates decline and services are unchanged. While the short-term cell #5 has a neutral impact on customers, the long-term vision of cell #5 is positive.

Experience shows, however, that electric utilities in a competitive world believe in cell #1 as

well. In that situation, rates decline and services decline as long as overall customer satisfaction is at acceptable levels for the average customer. The fallacy in this approach, however, is two-fold: (1) not all consumers are "average"; and (2) service reductions tend to disproportionately adversely affect low-income consumers.

Consider one example in particular: the service reductions recently announced by Public Service Company of Colorado (PSCO). In an effort to cut costs and thus "become more competitive," PSCO centralized its customer service operations and closed its regional customer service centers. The belief of local low-income advocates in Colorado is that this reduction in the number of customer service centers has made it more difficult for low-income customers to make in-person contact with the company. If one assumes that low-income households make a disproportionate number of contacts with the company --an assumption that has an empirical basis-- this reduction will have a disproportionately adverse impact on low-income customers. These personal contacts may be to ask for short-term bill payment extensions, to seek deferred payment arrangements, to discuss medical certificates underlying service termination postponements, to make bill inquiries, to seek information on fuel assistance, or a host of other reasons. It can be empirically established that low-income households have less access to transportation and a greater inability to travel longer distances to make personal contact with the Company.

Even if entire customer service centers are not closed, a reduction in the number of customer service representatives makes it more difficult for low-income customers to contact the company by telephone. The lack of telephone service is directly related to the level of household income. Low-income households who do have a telephone in the home, therefore, must use alternatives such as pay phones, or phones at friends and relatives homes. A reduction of service for these no-telephone

households would involve not simply the inability to contact a company representative by telephone, but an inability to contact a representative within a reasonable holding time. "Call back" procedures, also, frequently do not assist these no-phone customers. Elimination or reductions in the staff of special services sections of merged companies would also disproportionately and directly affect low-income households. In particular, elimination of (or reductions in) offices such as PSCO's PAR Unit, which provides personalized attention to low-income payment-troubled accounts, would represent a reduction in service.

Other "efficiency improvements" that, in fact, represent a reduction in service involve proposals to shorten deferred payment arrangements, to shorten the collection cycle, to eliminate winter shutoff protections, to decrease the availability of energy efficiency programs, and the like.

Part B: The "Service" Provided by an Electric Company Involves More than the Provision of Electricity

Having concluded that the cost reductions advanced in support of a merger proposal should represent true efficiencies, and not merely reductions in service, it is important to develop a decision rule as to what represents a part of the "service" provided by a local electric company. It might be easiest to begin by saying that the "service" provided by an electric company is the service of providing power through wires to the consumer. This approach has some merit. This approach standing alone, however, is too narrow. Rather than developing a definition of "service" by laundry list, it is necessary to *define* what constitutes the "service" provided by an electric company. There are two tests to FERC to consider: (1) the inextricable relationship test; and (2) the product acquisition cycle test.

A simple "but for" analysis delineates the inextricable relationship test. If an electric company

would not be engaging in the activity "but for" the provision of electric service, there constitutes an "inextricable relationship." The term "inextricable relationship" connotes an inability to divide or an "inseparability." If a utility activity bears an inextricable relationship to the provision of electric service, it is included as part of the "service" offered by that company. Included as one example of activities that have an "inextricable relationship" to the provision of electric service is the process of billing and collection (*i.e.*, it means nothing for an electric company to provide electric service if it cannot bill and collect for such provision). Second, the "product acquisition cycle" test encompasses the entire process of providing electric service to residential ratepayers from beginning to end. The relationship begins with a customer inquiry about obtaining electric service (or with a company solicitation), continues with the provision of the basic electric service, and ends with a final bill or subsequent collection activity. To use the product acquisition cycle is not uncommon at all in commercial law. Indeed, from a consumer protection perspective, such an analysis is what lies as the foundation of the Equal Credit Opportunity Act. In sum, therefore, if an electric utility activity is part of the product acquisition cycle associated with the provision of electric service to a residential customer, it is part of the "service" being rendered to the customer.

Part C: Recommended Merger Criteria

Given the discussion above, the Consolidated Low-Income Representatives recommend that FERC adopt the following Rule regarding the impacts of proposed mergers on consumers. The Rule would state:

Proposed Rule 6: Claimed cost savings resulting from a merger will not be

considered by FERC if those savings are accompanied by reductions in service provided to customers or any specifically identifiable group of customers. Claimed benefits accruing in the form of enhancements to service will not be considered by FERC if those claimed enhancements are accompanied by increased rates to customers or to any specifically identifiable group of customers.

PART VII:
SUMMARY AND CONCLUSIONS

For all of the reasons stated in the Comments of the Consolidated Low-Income Representatives above, the Federal Energy Regulatory Commission should adopt the proposed Rules which are set forth to protect the interests of small user and low-income customers in any consideration of proposed mergers of electric companies.

Submitted on Behalf of
Consolidated Low-Income Representatives

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Summary of Recommended Rules

<u>Proposed Rule 1</u>: Electricity is an essential product which must be available to all customers. Any claim by applicants that a merger will produce probable efficiencies, including benefits and savings, shall be supported by an assurance that: (a) existing special rates, payment programs, and protections regarding customer service and shutoffs for customers will be maintained; and (b) further developments of such rates, programs, and protections to address the goals of universal service will continue.

<u>Proposed Rule 2</u>: No merger shall result in an adverse impact on attaining or maintaining universal service in the territory served by the applicant. Each application shall contain an explicit assurance that in the event an adverse impact on universal service occurs subsequent to a merger approval, the applicant will develop and implement an Action Plan reasonably directed toward reversing the adverse impact.

<u>Proposed Rule 3</u>: In determining whether workable competition exists in any product or geographic market in which electric energy or capacity is offered for sale to

wholesale or retail customers, applicants shall provide documentation of such competition for each discrete customer class that is identifiable by characteristics of the customers in that class. This documentation shall identify the customer characteristics that might interfere with the operation of a competitive market and contain an evaluation of the impacts of those customer characteristics on competition.

Proposed Rule 4: Each application must contain an assessment of the competitive protections provided to small user customers. Whether competitive protections exist will depend upon whether small user consumers have both the choice of alternative suppliers and the ability to exercise that choice.

Proposed Rule 5: A determination that a merger will not have anti-competitive impacts must be made for each discrete market served by the applicant(s).

Proposed Rule 6: Claimed cost savings resulting from a merger will not be considered by FERC if those savings are accompanied by reductions in service provided to customers or any specifically identifiable group of customers. Claimed benefits accruing in the form of enhancements to service will not be considered by FERC if those claimed enhancements are accompanied by increased rates to customers or to any specifically identifiable group of customers.