

UNFAIR UTILITY COMPETITION and CROSS-SUBSIDIZATION

The Tilted Playing Field

Public utilities and their affiliates inhabit a mixed world of both regulated and unregulated markets where it is all-too possible to shift the costs of the unregulated, competitive venture back to the regulated utility operation with its guaranteed coverage of costs and protected rate of return. Utilities and their affiliates are using their special status as a government-sanctioned utility monopoly in their generation, transmission and distribution operations to unfairly compete against non-affiliated companies.

Because captive customers must deal with the local utility for generation and distribution of power, utilities are able to use their customer contacts to steer business away from competitors and towards their own unregulated businesses. This inherent discrimination against non-affiliated competitors, combined with anti-competitive cost-shifting and cross-subsidization, produces a distorted market in which utility monopolies and their unregulated affiliates have an artificial and unfair competitive advantage over non-affiliated private sector companies. This produces an enormously unfair competitive edge for the utility's affiliated businesses; one with which smaller, private sector businesses, lacking a base of captive ratepayers to whom they can pass the costs of operation, cannot hope to overcome. It also harms consumers who have to pay higher rates to cover the costs of the unregulated operations.

An Old Problem Made Worse

This is not a new problem, but one which has existed for some time and which has been exacerbated by the partial deregulation of electric power during the late 1990's. It has been well documented. The Small Business Administration noted the problems encountered by small businesses from unfair utility competition in two

published studies.¹ The SBA concluded that existing legal and regulatory frameworks are inadequate to protect small firms engaged in competition with utilities, saying:

"... utility supply and installation programs cannot be effectively regulated to eliminate improper subsidies and other competition problems. Such unregulated activity by the utility does not provide significant public benefits which outweigh the hazard to competition and the cost or regulatory oversight."

The Federal Trade Commission has recognized the need for policies aimed at protecting America's small businesses. In September, 2001, the FTC concluded:

"Policies are needed to prohibit vertically integrated utilities from anti-competitively (1) shifting costs from unregulated... operations to their distribution and default service operation, and (2) exercising discrimination in the provision to retail suppliers of inputs over which the utility has a monopoly."

The Department of Energy issued a report in 1993 which noted some of the problems associated with cross-subsidization and small business competitors:²

"A regulated firm's advantage in

¹ See: Utility Competition with Small Businesses: Recommendations for States on Utility Energy-Related Programs and the Commercial and Apartment Conservation Service Program, 1984; and, Final Report: Utility Competition with Small Business, June 10, 1986, prepared for the Office of Advocacy, SBA.

² Report To The President and Congress of the United States On the Current Status and Likely Impacts of Integrated Resource Planning, U.S. Dept. of Energy (1995). To be precise, the Report is a DOE study in which the FTC provided certain information in response to the framework devised by DOE. This framework did not include "a broad investigation into the general issue of utility competition with small business".

unregulated markets might arise, not from economies of scale or scope, but from evading regulation. By evading regulation, utilities could compete with independent firms by cross-subsidizing their unregulated service. Two means of evading regulation (and disadvantaging ratepayers) are self-dealing and cost shifting. A utility could use self-dealing and cost shifting strategies if:

- 1) its rates are based on costs, and*
- 2) its expenditures cannot be monitored adequately.”³*

The Report then concludes that “*eliminating unfair competition may require preventing cost shifting and self-dealing.*”

The Public Utility Commission of Texas has noted that:

“[T]here is a strong likelihood that a utility will favor its affiliates where these affiliates are providing services in competition with other, non-affiliated entities. . . [In addition,] there is a strong incentive for regulated utilities or their holding companies to subsidize their competitive activity with revenues or intangible benefits derived from their regulated monopoly businesses. . . Finally, . . . current regulations . . . are not adequate to prevent or discourage [this] anticompetitive behavior. . .”⁴

There is abundant evidence to indicate this is a problem which needs to be addressed.

To make the situation worse, those small businesses impacted by unfair competition have few, if any remedies to address the situation. Present energy legislation will repeal the Public Utility Holding Company Act which is the only federal statute providing potential restraints keeping regulated utilities from rolling rough-shod

over unregulated markets.

Related Problems

There are other problems as well:

State utility regulatory authorities lack enforcement powers to address competition issues (as opposed to ratepayer issues) and have no direct jurisdiction over the operations of unregulated utility affiliates.

Operation of unregulated utility affiliates increasingly is multi-state in nature and scope.

The nation’s anti-trust laws do not apply to the situations which give rise to unfair competition in this area. Even if impermissible and unfair competitive conduct is found to exist, state utility commissions lack powers to permit recovery for economic harm sustained.

It does not appear that competitors harmed by cost shifting schemes would be able to sustain a predatory pricing complaint under the antitrust laws. There may be no incentive for a utility affiliate to raise prices in a mixed-market environment since, taken together, the utility and its unregulated affiliates are already reaping substantial profits by shifting some portion of the unregulated operation’s costs back to the regulated rate base. Thus, the last element of a traditional predatory pricing scheme is lacking and the anti-trust complaint will fail.

Remedies for cross-subsidization are available only after-the-fact and cannot prevent harm before it occurs.

There is both a lack of law and regulations in most states and a lack of uniformity among those states which have developed regulations; and

There is a split in federal enforcement between the Federal Trade Commission (FTC) and the Department of Justice (DOJ) which effectively precludes oversight of affiliate transactions by either agency.

Such a division of jurisdiction may appear reasonable since it reduces duplication, confusion, splits of decisions, and appears to produce a degree of efficiency.

³ Id.

⁴ Promulgation of New Rules Governing Activities Between Affiliates, Public Utility Commission of Texas, Project No. 17459, 23 Tex. Reg. 5294 (May 22, 1998).

However, it also produces a gap in enforcement. While the FTC might - arguably - possess statutory authority to address anticompetitive conduct resulting from abusive transactions between a public utility and its unregulated affiliates, it has not done so. This is because such acts arise in the context of electricity matters relegated to DOJ.

For its part, DOJ exercises its jurisdiction in electricity matters primarily in terms of mergers within the utility industry and does not generally enforce the Federal Trade Commission Act regarding unfair competitive practices. The end result is that neither agency acts to enforce competitiveness problems associated with abusive and anticompetitive affiliate transactions.

Incentives for Abuse

Competition thrives in an environment where numerous entrants compete on choice, price and quality of service for consumers. Yet, there are strong incentives for regulated utilities or their holding companies to subsidize their competitive affiliates with revenues or intangible benefits derived from monopoly businesses. These benefits

allow the affiliates to drive lower-cost providers from the market and to deter new entrants into the market. This results in less competition and less choice for consumers.

Action Is Needed

In the present energy legislation, Congress is engaged in the process of removing old restrictions, such as PUHCA, and creating a framework in which competition can flourish. Due to the interstate nature of electric power sales and transportation and the fact that unregulated affiliates will be offering their services across state lines, Congress should also take action designed to preserve and foster fair and open competition in impacted markets as part of any reform to address the many inextricably linked issues respecting open markets and fair competition.

Air Conditioning Contractors Association
American Subcontractors Association
Associated Builders and Contractors
Mechanical Contractors Association of America
National Electrical Contractors Association
Plumbing, Heating Cooling Contractors National Association
Sheet Metal and Air Conditioning Contractors National Association

National Alliance for Fair Competition