

Competition Issues in ERCOT: Market Power, Market Manipulation, Detection and a Role for Antitrust



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Key Components of A Well-Functioning Market

- Establishing the Right Rules of the Game
 - Market rules should minimize manipulation
 - Market monitoring and frequent rules updating essential
- Antitrust law an important aspect of market monitoring

Risks of Getting It Wrong

- **California: Interruptions of service, bankruptcy of one utility, wealth transfers to generators with market power, ex-post regulatory moves to disgorge ill-gotten gains.**
- **Texas: Wild price fluctuations, retail bankruptcies, and more???**
- **"There's nothing to stop generators from bidding \$1,000 every day," --Mr. Kelly said (chief operating officer for retailer Texas Power LP).**

Why Market Monitoring is Competition's Ugly Stepsister

- Production of data needed to satisfy an extensive inquiry could be quite costly in terms of time and money.
- Monitors could also spend a great deal of time conducting an extensive investigation—time that might be spent examining other aspects of the electricity industry.
- Market monitors woefully understaffed or outsourced.

Bad Idea: Screens

- Market power screens may meet the criteria of minimizing enforcement costs, but are unable to detect many types of market power exercises that a generation company might undertake.
 - Typical add 'em up market shares miss the point of specialization of units
 - Vertical issues completely missed

Texas PUCT Rules Prohibit Certain Conduct

- **(1)** Schedule, operate, or dispatch its generating units in a way that creates artificial congestion.
- **(2)** Execute pre-arranged offsetting trades of the same product among the same parties, or through third party arrangements, which involve no economic risk and no material net change in beneficial ownership.
- **(3)** Offer reliability products to the market that cannot or will not be provided if selected.
- **(4)** Conduct trades that result in a misrepresentation of the financial condition of the organization.
- **(5)** Engage in fraudulent behavior related to its participation in the wholesale market.
- **(6)** Collude with other market participants to manipulate the price or supply of power, allocate territories, customers or products, or otherwise unlawfully restrain competition. This provision should be interpreted in accordance with federal and state antitrust statutes and judicially-developed standards under such statutes regarding collusion.
- **(7)** Engage in market power abuse. Withholding of production, whether economic withholding or physical withholding, by a market participant who has market power, constitutes an abuse of market power.
[\[1\]](#) 16 Tex. Admin. Code § 25.503 (g). § 25.503(g) is aimed to prevent “any act or practice of a market participant that materially and adversely affects the reliability of the regional electric network or the proper accounting for the production and delivery of electricity among market participants.”

Mitigation

- In addition ERCOT adopted numerous rules designed to mitigate any market power or manipulation detected on the grid.
- Public Flogging: Disclosure of any market participants who bid in excess of \$300 MWhr.
- Rules dealing with forced outage of a reliability must-run (RMR) unit
- Mitigation of hockey-stick bidding by alteration of the competitive solution method used to determine the clearing price in the market.
- Filing requirement: power generators and power marketers file confidential quarterly reports discussing the terms by which they have sold power in ERCOT wholesale markets.

What is Market Power?

- PUC: “market power” is defined as “[t]he ability to control prices or exclude competition in a relevant market.”
- “Market power abuse” is the practice by persons possessing market power that are unreasonably discriminatory or tend to unreasonably restrict, impair, or reduce the level of competition, including practices that tie unregulated products or services to regulated products or services or unreasonably discriminate in the provision of regulated services.
- Market power abuses include predatory pricing, withholding of production, precluding entry, and collusion.

The Screen

- Any single power generating entity that controls more than 5% of the installed generation capacity in ERCOT, excluding uncontrollable renewable resources, potentially possesses ERCOT-wide market power.
- Controlling 5% or more of the installed generation capacity in ERCOT does not, of itself, mean that a generating entity has market power.
- However, a generator with less than 5% of regional capacity is exempt from market power regulations.

Let's Recall

- In California, virtually EVERY generator had market power.
- In tight markets, it does not require much capacity to alter clearing prices.
- Fuel curve or hockey stick theories of harm are not easily identified by Screens. Vertical considerations such as those encountered in PE/Enova^[1] concerning pipeline transportation and issues concerning transmission manipulation are not addressable using market screens.
- A market power screen, if properly applied, may determine in some instances the boundaries of the market and market shares within that market. However, it will not capture certain types of conduct, particularly if the screen is slavishly applied such that facts indicating different market analysis ought to be undertaken are ignored.

[1] U.S. v. Enova Corp., Case No. 98-CV-583 (TFH) (D.D.C. 1998), available at <http://www.usdoj.gov/atr/cases/f1700/1790.htm> (Complaint) and <http://www.usdoj.gov/atr/cases/f1700/1789.htm> (Competitive Impact Statement).

Market Power: Withholding

- Prices offered by a generation entity with market power may be a factor in determining whether the entity has withheld production.
- A generation entity with market power that prices its services substantially above its marginal cost may be found to be withholding production;
- offering prices that are not substantially above marginal cost does not constitute withholding of production.

What's Wrong?

- Two screens in place that act to reduce the costs of Commission investigation.
- For example, the PUCT presumes that a generator with less than 5% of the generation capacity within ERCOT are exempt from market power regulations. However, there are conditions which might exist within subregions of ERCOT that could rise to market power conditions without any generator reaching the 5% goal.
- Bidding provisions might come into play, but only to the extent that the generator bids above \$300 MWhr. Thus, room still exists to exercise market power in the ERCOT environment.

Independent Market Monitor

- As of March 29, 2007, rules have been promulgated that establish an independent market monitor (IMM) for the ERCOT wholesale markets. The IMM shall monitor wholesale market activities so as to:
 - **(1)** Detect and prevent market manipulation strategies and market power abuses; and
 - **(2)** Evaluate the operations of the wholesale market and the current market rules and proposed changes to the market rules, and recommend measures to enhance market efficiency.
- ERCOT and the commission will contract with an entity selected by the commission to act as the commission's wholesale market monitor. The IMM shall be established as an office independent from ERCOT, and is not subject to the supervision of ERCOT with respect to its monitoring and investigative activities.
- A great job? Ask Dan Jones.

IMM Authority

- to conduct monitoring, analysis, reporting, and related activities but has no enforcement authority.
- to question a market participant about activities that may violate commission rules or ERCOT protocols or may be potential market manipulations.
- to require submission of any information and data it considers necessary to fulfill its monitoring and investigative responsibilities by ERCOT and by market participants.

IMM Report Writing

- The IMM shall provide periodic updates to market participants regarding the operation of the ERCOT wholesale market. In addition, the IMM will submit to the commission the following reports:
 - (1) Daily, monthly, and quarterly reports on prices and congestion;
 - (2) An annual report on the state of the market, which will include an assessment of the competitiveness of the market; an assessment of the efficiency of ERCOT's management of the balancing energy, ancillary services, and congestion rights markets; an evaluation of the effectiveness of congestion management by ERCOT; an evaluation of whether there are inappropriate incentives, flaws, inefficiencies, and opportunities for manipulation in the market design; and any recommendations for improving the market design; and
 - (3) Periodic or special reports on market conditions

What's Missing?

- Where's antitrust law?
 - State Action?
 - Filed Rate Doctrine?

Antitrust Fails to Cure Ills of Market Where Regulation Permits The Ills or Where Market Is Nascent

Curable Via Antitrust

- Price fixing
- Monopolization (but not always market power)
- Mergers to market power (after market commences)
- High Prices due to Plant withholding (but only if plants weren't offline for legitimate reason)

Not Curable

- Market power exercised after market commences that may not violate Section 2
- Manipulations of the market not arising from market power or concerted action
- Pre-competition acquisitions of generation that may create market power
- High Prices Due to High Bids

Proper Regulation is An Essential Complement to Antitrust in Deregulating Energy Markets

Curable via Regulation

- Market power exercises that are not violations of antitrust law (e.g., RMR units)
- Pre-competition acquisitions of plants that give rise to market power
- Actions that Give Rise to System Instability

Not Curable

- Any action allowed by the rules where incentives created by the rules are perverse to the intent of the drafters
- Market power where mitigation rules do not fully eliminate the ability or incentive

Antitrust Remedies And Problems

Problems With The Proposed Remedy

- Virtual divestiture vs. actual divestiture
- Divest, but why?
- Treble damages?

Problems With Antitrust Analysis

- The abuse and misuse of screens
- Whither Theory of Harm?
- Vertical Issues
- Identifying Markets and Information

Antitrust Limitations

Immunities and Exemptions

- **Express Immunity**
- **Implied Immunity**
- **State Action Doctrine**
- **Filed Rate Doctrine**

Conclusions

- Regulation and antitrust are not substitutes, but to some degree they are complements
- Regulation better at fixing, *ex ante*, problems associated with market power if the regulations are properly formatted.
- ERCOT getting better at detecting market power, but there is a lot more to do.
- Antitrust does decent job at fixing certain market abuses, if (and only if) regulations are properly formatted.
- If regulations are not properly formatted, but antitrust and regulation will fail to protect consumers.