STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

REPLY COMMENTS OF ENRON ENERGY SERVICES, INC.

Case No. EX-99-442 -- Electric Utilities Affiliate Transactions
Case No. GX-99-444 – Natural Gas Affiliate Transactions
Case No. GX-99-445 – Natural Gas Marketing Affiliate Transactions

August 2, 1999

36

BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

In the Matter of Proposed Rules to Govern Affiliate Transactions	)))	**Case Nos. EX-99-442, 444 & 445**

These are the Reply Comments of Enron Energy Services, Inc., ("Enron") in the above-referenced proceeding. Enron would like to thank the Missouri Public Service Commission ("Commission") for the opportunity to offer these comments regarding marketing affiliate relationships.

I. Introduction

As a general matter, Enron agrees with the Office of the Public Counsel ("OPC") as duly noted in their Initial Comments, that the proposed electric and gas affiliate transaction rules in Case Nos. EX-99-442 and GX-99-444 are nearly identical and therefore should be consolidated into one rule. *See* Comments of the OPC, at p.4. Further, Enron concurs with Mountain Energy that "[t]hese rules should apply equally to both natural gas and electric utility companies in operation of their Marketing Affiliates . . . ." *See* Comments of Mountain Energy, 1 (June 30,1999).

In state after state, both electric and gas utilities have begun to diversify their operations by expanding into competitive, energy-related businesses including, but not limited to, demand side management services, energy audits, and appliance sales and repairs. Utilities have begun this diversification process regardless of whether retail competition has been implemented in a particular state or not. As a result, incumbent utility affiliates providing such services are in a position to benefit from the sharing of confidential information and preferential access to utility goods and services throughout both the transition period to, as well as during, retail electric and gas competition. It is no great surprise then that incumbent utilities can and currently do use their control and knowledge of essential facilities and the relationships developed by virtue of their monopoly franchises to the advantage of their own unregulated operations. Without proper affiliate rules in place, the incumbent utilities can significantly subsidize their affiliates' competitive activities. For these reasons, it is critical that strong utility-affiliate transaction rules be in effect to protect both the competitive market as well as the captive ratepayer. Enron commends the Commission and its Staff for recognizing the danger of anti-competitive behavior and market power problems that clearly would result without the necessary affiliate rules in place.

II. "Economies of Scope and Scale"

In their initial comments, several parties made reference to the Federal Trade Commission's alleged bias towards promoting the utilities' use of economies of scope and scale with regard to their forays into competitive businesses. *See* Initial Comments of The Empire District Electric Company, at p.2; Comments of Kansas City Power & Light Company, at p.10 ("Officials at both the Federal Trade Commission and the Department of Justice have rejected competitive handicapping of incumbent utilities as detrimental to competition and consumer welfare."). Enron does not believe that Staff's intent in drafting its proposed rules was to "handicap" the incumbent utilities. In fact, Enron believes that the objective of this rulemaking is to create a level playing field for all competitors in competitive retail energy and energy-related markets.

Further, Enron submits that the position of the Federal Trade Commission ("FTC") with regard to incumbent utilities and their use of economies of scope and scale was taken somewhat out of context. A clearer representation of the FTC's position on standards of conduct as filed in numerous state proceedings is stated below:

> In weighing the trade-offs between preventing discrimination and fostering economies of vertical integration, it is important to keep in mind that these questions arise in a broader context of introducing competition into a very large industry with widespread effects on local economies as well as the national economy. For competition to take hold quickly and effectively in these formerly regulated markets, it may be particularly important to dispel potential entrants' perceptions that the incumbent distribution firms will manipulate rules and mislead regulators to the disadvantage of new competitors. . . . Accordingly, the need to address (and reduce) the perception of potential discrimination and cross-subsidization may be greatest when competition is just getting underway.

See Comment of the Staff of the Bureau of Economics of the FTC Before the Commonwealth of Massachusetts Department of Telecommunications and Energy, p.3 (October 8, 1998); *see also* Comment of the Staff of the Bureau of Competition of the FTC Before the Public Utilities Commission of Nevada, p.3 (September 22, 1998).

For example, when determining whether an affiliate should be permitted to use its parent company's name and logo, the FTC acknowledges that "[o]ne benefit of such use may be to reduce prices in the competitive markets served by affiliates." FTC Comments Before the Nevada PUC, at 5. However, the FTC also emphasizes its concern that use of the name and logo by affiliates leads to "deception of consumers and cross-subsidization." *Id.* As a result, the FTC recommends that "[i]f this deception results in harm to consumers or competition, [states] may wish to restrict the affiliate from using the parent's logo." *Id.* at 6. The name/logo issue is simply one example of the incumbent utilities' wrongful attempt to use their economies of scope and scale.[1] In their numerous comments before state regulatory agencies, however, the FTC has made it abundantly clear that there are significant and substantial issues that warrant consideration by regulators with regard to any decision-making involving the use of economies of scope and scale.[2] Clearly, the utilities in this case have mischaracterized the FTC's position regarding such use. The FTC certainly acknowledges the distinct probability that when an incumbent utility exploits its preferred access to economies of scope and scale, this activity builds on an entry barrier and renders competition less effective. *See also* Initial Comments of the OPC, pp.8-9 (aptly refuting the utilities' allegations that it is anti-consumer to prevent use of their economies of scope and scale).

III. Cross-Subsidization

Certain incumbent utilities improperly believe that current regulation adequately addresses cross-subsidization. *See, e.g.*, Comments of Ameren Corporation and Union Electric Company (collectively referred to as "Ameren"), pp. 13-14, 23. If current regulation were adequate to address cross-subsidization, Enron doubts that regulators would find it necessary to adopt resolutions concerning cost-allocation guidelines[3], or enforcers would be referencing the deficiencies in state and federal antitrust law regarding remedies for anti-competitive concerns related to cross-subsidization.[4]

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[1] Enron supports the OPC's primary position regarding a prohibition on affiliate use of the parent company's name and logo. *See* Initial Comments of the OPC, pp.12-13.

[2] *See, e.g.,* Comments of the Bureau of Competition of the FTC Before the Public Utilities Commission of Texas, p.2 (June 19, 1998) ("We agree with the PUCT's assessment that 'there is a strong likelihood that a utility will favor its affiliates where those affiliates are providing services in competition with other, non-affiliated entities . . . Further . . . 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 business . . . Finally, . . . current regulations . . . are not adequate to prevent or discourage [this] anticompetitive behavior. . . .'").

[3] *See* NARUC Resolution Regarding Cost Allocation Guidelines For The Energy Industry, Spring 1999 (San Francisco).

[4] As Principal Deputy Assistant Attorney General A. Douglas Melamed stated:

> The antitrust laws do not outlaw the mere possession of monopoly power. The exercise of market power can be addressed only if an entity is attempting to monopolize, or if two or more entities are acting in concert in restraint of trade, or are proposing to merge. With an industry emerging from decades of government-sanctioned monopoly, we

Moreover, incumbent utilities that qualify as holding companies such as Ameren seem to believe that the Securities and Exchange Commission's ("SEC") approval of its general services agreement ("GSA") might preempt the Commission from establishing and applying new rules regarding cost allocation guidelines and pricing mechanisms to Ameren's transactions with unregulated affiliates. *Id.* at pp.15-16. However, the SEC may find the Commission's approach an improvement over current SEC regulations. For example, with respect to instances where goods and services flow from the utility to the unregulated affiliate, the SEC has stated that: "A new standard of review for transactions between utility and non-utility associate companies may also be appropriate where the utility is the seller of goods or the service provider."[5]

IV. Beyond "Essential Facilities"

The incumbent utilities improperly allege that there are no benefits to be derived from sharing information unrelated to "essential services." *See, e.g.,* Comments of Ameren, p.6. In fact, Ameren states that "[a] utility cannot harm consumer welfare by preferentially sharing information about non-essential services such as corporate support, human resources, internal policies of the utility and marketing of the utility's competitive services." *Id.* Enron finds this difficult to believe when sharing market information with a utility-affiliate encourages potential cross-subsidization to the detriment of consumers.

For example, an incumbent utility might commission a market study paid for by its ratepayers and then share that information with only its affiliate. In this scenario, why

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> anticipate that there may well be market power problems that do not fit neatly into these categories but are nonetheless serious impediments to competition . . . .

"Antitrust Aspects of Electricity Deregulation," before the Committee on the Judiciary, 105th Congress (1997), should the utility be permitted to share that study with only its affiliate and not with all marketers when a marketer's customer (who is also the utility's customer) may have paid for that same study? In fact, it is difficult and inappropriate to make such a blanket statement as Ameren has done when there are numerous ways in which incumbent utilities may discriminate against competitors by improperly sharing customer and marketing information with its affiliate. Of course, Ameren is therefore correct in concluding that "preferential treatment with respect to non-essential services and information promises tremendous benefits" -- however, without an affective code of conduct, those benefits will simply accrue to Ameren's shareholders to the detriment of ratepayers and competitive markets.

The incumbent utilities encourage the Commission to establish a "light-handed" regulatory framework for utility-affiliate transactions. *See, e.g.*, Comments of Ameren, p.8. However, the wholesale electricity market is an example of why it is important to establish detailed and stringent rules *now* for competitive retail electricity, gas and energy-related markets. Initially, The Federal Energy Regulatory Commission ("FERC") believed that it had implemented sufficient utility-affiliate rules when it issued Orders No. 888 and 889 to govern the wholesale electricity market when, in fact, they were not. As a result of the anti-competitive behavior that has continued to permeate the wholesale electricity market for the past few years, the FERC is currently attempting to rectify problems that might have been cured had it issued more detailed rules in the first instance. Enron submits that it is imperative that the Commission implement proper

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[5] The Regulation of Public-, Division of Investment Management, Securities and Exchange Commission (June 1995).

affiliate rules *now* that address nondiscrimination, information sharing, structural separation, and regulatory oversight for utility-affiliate transactions.

While the Commission, Staff, and the OPC are to be commended for understanding and acknowledging the significant need for the proposed rules to address cross-subsidization as well as such critical areas as nondiscrimination and improper information sharing, Enron submits that the proposed rules must also establish the appropriate regulatory oversight (*i.e.,* complaint procedures, compliance plans, compliance audits, penalties, etc.) in order to be effective in a competitive marketplace. Enron encourages the Commission to review the redlined versions of the proposed rules that it submitted as part of its Initial Comments for a detailed description of the necessary enforcement mechanisms.

Enron strongly supports the Initial Comments of the OPC with very few modifications and encourages the Commission to consider the OPC's positions and rationale when determining the appropriate affiliate transaction rules. The Commission has an opportunity to establish and grow competitive energy-related markets in Missouri at this time. Without the appropriate affiliate rules in place, however, these markets simply will not flourish.

Respectfully submitted,

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