

**R.97-04-011, I.97-04-012
D.97-12-088**

Commissioner P. Gregory Conlon, Dissenting:

Throughout the entire debate over electric restructuring my main concern has always been ensuring a competitive market place and preventing the abuse of market power. The potential for market power abuse is particularly a problem in the electric industry, where almost 100 years of regulation has resulted in the incumbent utilities controlling almost all of the existing generation, transmission, and distribution assets within their service territory. The incumbent utilities also start out with a captive customer base of 100% of the market. It is this captive market that Direct Access will now open up to full competition.

One of the major issues¹ in today's decision on affiliate transactions addresses our concern over a potential for market power abuse in the direct access market we are creating; that is the advantages that an affiliate of an incumbent utility has in marketing to customers in the new competitive marketplace. This includes the ability of the affiliate to use the name, logo, and goodwill of the utility. My goal has been to maximize the number of competitors in the new direct access market that we are creating. In my mind, it does not make sense to open up the electric market to competition if the newly created direct access market itself could be dominated by the affiliates of the incumbent utilities.

¹ Today's decision also addresses rules governing local natural gas distribution companies and electric utilities' relationships with affiliates covering a broad range of energy services, as more specifically defined in the rules. This dissent focuses solely on the potential advantages of utility affiliates in the direct access market.

Concern over the problem of market power has been an important factor throughout our electric restructuring process. To address the market power problem in generation, our Commission successfully encouraged the incumbent utilities to divest themselves of significant portions of their generation capacity. The creation of the Independent System Operator ensures that the incumbent utilities' monopoly transmission system will be made available – on an open non-discriminatory basis – to all market participants, while the creation of the Power Exchange similarly removes the incumbent utilities' control over the purchase of energy.

The decision we adopted today contains a large number of structural and procedural safeguards designed to prevent market power abuses that may be caused by an incumbent utility's relationship with its affiliates. These safeguards address potential abuses not only in the direct access market but also in numerous other energy related markets as defined by the decision. The decision contains numerous safeguards designed to eliminate the ability of an incumbent utility to either cross-subsidize or confer any undue advantage to its affiliates in these competitive markets.

I support the safeguards contained in the decision except I am strongly concerned that the adopted decision does not go far enough in recognizing the inherent advantages that an affiliate of a utility has in the direct access market. These advantages may come from the utility's control of essential bottleneck facilities such as the processing of Direct Access Service Requests (DASRs). Even more important, the utility affiliate can use the brand name, logo, and goodwill that is built up by the sister utility to market its unregulated services within the utility's service territory.

Results from other states which have allowed a utility affiliate to market within the utility's service territory show how powerful this advantage can be. In this proceeding, the Joint Petitioners Coalition submitted exhibits showing that in pilot direct access programs in a number of states the utility affiliate routinely gathered the lion's share of the marketplace. Their exhibit shows that it was not uncommon for the utility's affiliate to gain market shares as high as 80% of the direct access market. Even more interesting, in states which did not allow the utility's affiliate to use the name and logo of the utility, the affiliate's market share was significantly less.

The only reason I can see for the affiliate's better success than its competitors is the ability of the affiliate to piggy-back off of the brand name, logo, advertising and name recognition of the sister utility. As Commissioner Bilas noted, referring back to the textbook on microeconomics that he authored as a college professor in 1971, brand name identification is a barrier to entry and if significant could lead to market power abuse.

With approximately one month's worth of data on the number of direct access service requests (DASRs) to examine, it is clear that California has not yet seen an "Oklahoma land rush" of customers signing up for direct access. I believe this will change as restructuring begins and marketers advertise their products; the Power Exchange price becomes visible; and consumers evaluate their new options. Nonetheless, I am concerned that with the advantages of brand name recognition that the utility affiliate has in this marketplace, many marketers may be deterred from competing against the affiliate and withdraw from the market over time. This is not a result we want to encourage but should deal with up-front in a pro-active manner.

My proposed alternate decision in this proceeding recognized the advantages that a utility affiliate may have, and sought to prevent the utility from exploiting those advantages to obtain an undue market share. My proposal would have limited a utility from processing the direct access requests of its affiliates if the affiliates' market share exceeded 20% of the direct access market (by volume of kilowatt hours sold) within the utility's service territory. This 20% "competitive cap" would be applied separately for each class of customer--residential, commercial, agricultural, and industrial. This competitive cap would not have prohibited the affiliates from competing, but at the same time would have permitted entry of enough additional marketers to ensure a competitive market. The application of the competitive cap by market segment would have prevented the utility's affiliate from "cream-skimming" the more lucrative markets and ensure that customers in all markets enjoyed the benefits of competition.

My proposal would have allowed for two exemptions from this 20% cap. First, it would not have applied to the sale of renewable energy to residential customers. It appears to date that only a few marketers will be offering this service and this segment of the marketplace should be encouraged. Second, it would have "grandfathered" contracts entered into prior to the adoption of this decision. This provision recognized that some affiliates may have relied on our pre-existing affiliate rules in developing their market strategy, even though we clearly stated that those rules were interim in nature.

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A number of parties to this proceeding – consumer groups, end users, and the new competitors that we hope to bring into the marketplace-- supported a complete ban on the use of the utility's name and logo by its affiliate, as well as a complete prohibition against an affiliate offering service within the territory of its sister utility. The utilities and their affiliates, by contrast, wanted no limitations for their affiliates. I believe my proposal struck a fair balance. It would have allowed a utility's affiliates to compete in the marketplace, thus promoting competition, but it would have prevented the affiliates from unfairly controlling the market through the advantages that they may have as utility affiliates. My proposed rules would have been in effect for 2-years, at which time the Commission could have revisited the rules to see if they should have been extended until the end of the transition period.

The order adopted by the majority provides for monthly reporting of the volumes of energy sold by the utilities' affiliates. Our office will monitor and study these results and encourage further action by the Commission if it is clear that the utilities' affiliates are gaining a disproportionate share of the market.

/s/ P. Gregory Conlon

P. Gregory Conlon

San Francisco, California

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