Market Power and Antitrust Issues in the Restructuring of the Electric Industry

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I. Key Points

A. Who is Dynegy?

B. Behavioral vs. Structural Remedies

C. Various questions about the application of antitrust law

D. Market power problems encountered by Dynegy

II. Dynegy, Inc.

A. Dynegy is one of the country's leading energy merchants - formerly NGC Corporation and Natural Gas Clearinghouse.

B. Dynegy owns an interest in power plants with more than 14,000 MW of domestic generating capacity.

C. Dynegy is currently developing power generation projects in seven states (Arizona, Florida, Georgia, Illinois, Kentucky, Louisiana, North Carolina)
D. Average worldwide natural gas sales of more than 10 Bcf/d.

E. Recently completed merger with Illinova/Illinois Power

F. Headquartered in Houston: approximately 5,000 employees

III. Core Issue: Vertically Integrated Electric Utilities - common control of generation, transmission, and distribution

A. The electric utility industry produces many distinct, sequential, and interrelated products and services, including the processes of generation, transmission, and distribution.

B. Prior to the technological advances in the generation and delivery of electricity, and the introduction of competition into wholesale and retail markets, vertical integration of these processes made sense.

C. When successive stages of production are not vertically integrated, prices tend to be set by competitive forces, provided that one or more stages are not being used as a bottleneck.

D. Transmission and distribution are "natural monopolies" and will continue to be regulated, while generation and value-added products and services are subject to competition.

E. Management is accountable to shareholders to maximize profits and create value from its investments.

F. For vertically integrated electric utilities, generation investment generally far exceeds transmission investment.

G. FERC regulations require comparability, prohibit discrimination and prohibit preferential treatment of affiliates.

H. Management dilemma: how to reconcile accountability to shareholders and to regulators?

IV. Structural v. Behavioral Remedies

A. Behavioral Remedies

1. Focus is on behavior, not underlying motivations.

2. Monitoring is costly and complex - violations are difficult to detect and document.

3. Possible misidentification of appropriate, competitive behavior.

4. Codes of conduct - may not adequately address opportunity and incentive.

B. Structural Remedies

1. Reduces opportunity and incentive to use regulated assets to favor "at risk" assets.

2. Reduces need for regulatory oversight.

3. Example: divestiture of generation or transmission.
V. Behavioral Remedies Alone Are Not Sufficient

A. FERC Order 497 - standards of conduct for interstate gas pipelines.

B. FERC Orders 888 and 889: OATTs and OASIS.

C. FERC Order 2000: Discrimination in transmission services can still occur when operation of the transmission system remains in the control of a vertically integrated utility.

D. FERC is beginning to take structural remedies more seriously.

E. Divestiture of generation or transmission is an effective remedy.

VI. State Action Immunity

A. Application of the state action immunity doctrine is a question of law:

B. Immunizes a private party from antitrust liability if private party acts pursuant to a "clearly articulated" and "affirmatively expressed" state policy to allow the anti-competitive conduct, and the regulatory policy is "actively supervised" by the state itself.

C. Behavioral rules do not evidence a clear intent by the state to displace competition with a regulatory structure, nor do they ensure adequate state supervision.

VII. Constitutional Limits: The Dormant Commerce Clause & Burdens on Interstate Commerce

A. The negative or dormant Commerce Clause prohibits state regulation that discriminates against, or unduly burdens, interstate commerce.

B. State moratoriums on merchant power plants.

C. Will they survive scrutiny under the dormant Commerce Clause?

D. Are they examples of simple economic protectionism, or do they protect legitimate local concerns, with only incidental effects on interstate commerce?

VIII. Private Antitrust Enforcement

A. Expensive and time consuming to pursue.

B. Difficult issues of proof.

C. Relief not timely - justice delayed is justice denied.

D. State action immunity could shield inappropriate conduct.

E. Private interests may depend on DOJ to pursue.

IX. When Is Antitrust Enforcement Needed?

A. Little need when industry was totally regulated.
B. Antitrust oversight will gradually replace regulatory oversight as the industry is restructured and structural separation has been implemented.

C. Special attention to regulatory gaps during transition to competition.

D. State and federal regulators face challenges to identify and address gaps.

Want More Information?

For more information on Dynegy, visit Dynegy's web site at:

www.dynegy.com

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Mr. Cruthirds earned his MBA from Houston Baptist University in 1986 and his law degree from South Texas College of Law in Houston where he graduated with honors (cum laude). He was a member of the South Texas Law Review and had one of his papers published in the South Texas Law Review. Mr. Cruthirds managed Chevron's state regulatory affairs from 1993 to 1996 when Chevron spun off its natural gas marketing business to NGC Corporation, now known as "Dynegy." He is now Senior Director and Regulatory Counsel for Dynegy and is responsible for all aspects of Dynegy's state regulatory affairs including natural gas marketing as well as Dynegy's power marketing and power plant development activities.