

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Terms and Conditions)
of Public Utility Market-Based Rate) **Docket No. EL01-118-000**
Authorizations)

COMMENTS OF THE
NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

In accordance with the schedule established by the Commission in the above docket, the New York Independent System Operator, Inc. (“NYISO”) hereby respectfully submits the following comments on the Commission’s Order Establishing Refund Effective Date and Proposing to Revise Market-Based Rate Tariffs and Authorizations, Docket EL01-118-000 (November 20, 2001) (hereafter, “the Order”). The NYISO strongly supports the Commission’s efforts to redress anti-competitive conduct and abuses of market power by sellers authorized to sell energy at market-based rates, including the proposed provisions to allow the ordering of refunds in appropriate cases.

I. Copies of Correspondence

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II. Discussion

It is both necessary and appropriate for the Commission to implement standards and procedures to redress effects on rates of anticompetitive behavior or an exercise of market power by sellers authorized to sell at market-based rates. The tariff requirement proposed by the Commission will be an important and proper feature of the tariff provisions that should be applicable to all sellers with market-based rates.¹

As discussed further below, and as the Order correctly asserts, the Commission has a duty to ensure that rates for wholesale power sales are just and reasonable. The NYISO concurs in the Commission's determination that, despite careful design and monitoring of wholesale electric markets, market conditions can arise in which a seller can engage in anticompetitive behavior or exercise market power. Given that bulk electric power cannot be stored, and is sold over interconnected, unswitched transmission networks that make the conduct of all market participants interrelated and potentially subject to congestion that can create load pockets, electricity markets are inherently dynamic and fast changing. Moreover, the ability of loads to respond to high prices is generally limited, even in the NYISO-administered markets, which, as various commenters have observed, have more robust demand response mechanisms than any other regional market. In consequence, sellers may from time to time be able to abuse non-competitive market conditions to charge rates that are unjust and unreasonable.

These facts necessitate the protection afforded by the Commission's proposed tariff change, which will make clear that authorization to sell at market-based rates is conditioned

¹ The Commission should clarify that the proposed tariff requirement would apply to new sellers that propose to sell only in ISO-administered markets.

upon a seller's refraining from anti-competitive behavior or exercises of market power. The proposal for refunds will provide a meaningful mechanism for enforcing that condition. In addition, the proposal will allow time for adequate investigation of questionable market conditions or conduct, without hasty action being required to protect customers from a continuation of unjust and unreasonable rates that would otherwise be immune from scrutiny. Thus, the proposed tariff changes are both necessary and appropriate to conditions in the developing wholesale markets.

The NYISO also notes that the proposed tariff provision will also reinforce existing market monitoring and mitigation measures that already apply to many sellers. As the NYISO has pointed out in a recent filing with the Commission, retroactive refunds can be authorized by the Commission in the markets administered by the NYISO pursuant to the NYISO's market mitigation authority under Section 205 of the Federal Power Act ("FPA"). *See* Request of New York Independent System Operator, Inc. for Suspension of Market-Based Pricing for 10-Minute Reserves and to Shorten Notice Period, ER00-1969-000 (March 27, 2000) and New York Independent System Operator, Inc. Request for Rehearing of Order on Rehearing, ER00-1969-002, et al. (December 10, 2001). The NYISO thus supports the Commission's proposed tariff changes because they are consistent with and complement the approach the Commission has already taken in New York's markets by conditioning the use of market-based rates in New York on the implementation of the NYISO Market Monitoring Plan under Section 205.

Some commenters have argued that the Commission’s proposed tariff requirement would violate the filed rate doctrine and undermine the principles of regulatory certainty and finality.² The Commission’s proposed tariff requirement would not violate the filed rate doctrine because the potential refunds under the Commission’s proposed provisions would be part of each filed market-based rate. Thus, sellers would be on notice that their sales would be subject to refund in cases of anticompetitive behavior or abuse of market power. Furthermore, while the facts may vary from case to case, the standards for identifying anticompetitive behavior or an abuse of market power have been developed through many years of antitrust and competition law jurisprudence and enforcement across the full range of the U.S. economy, and are sufficiently well-known that the Commission’s proposed provision will not undermine the principles of regulatory certainty and finality. In addition, in New York standards for abuse of market power are spelled out in the NYISO’s Commission-approved market mitigation measures. Any remaining uncertainty must give way to the Commission’s obligation under the FPA to ensure that jurisdictional rates are just and reasonable.

The Commission’s proposed tariff amendment does not violate the rule against retroactive ratemaking because it will not be retroactive. As the United States Court of Appeals for the District of Columbia Circuit has held, “[t]he rule against retroactive ratemaking . . . does not extend to cases in which [customers] are on adequate notice that resolution of some specific

² See, e.g., Motion to Intervene and Request for Rehearing of Mirant Americas, Inc. Mirant Americas Energy Marketing L.P., and Transalta Energy Marketing (US), Inc., Docket No. EL01-118-001, (Dec. 20, 2001).

issue may cause a later adjustment to the rate being collected at the time of service.”³ All market participants will be on notice that raising prices through anticompetitive behavior or abuses of market power is not encompassed by market-based pricing authority, and that prices resulting from these activities will be subject to revision, since that condition will be included in each seller’s market-based rates tariff. Moreover, any rate set at a level that would warrant a refund as a result of anticompetitive behavior or an abuse of market power would be inherently unjust and unreasonable under the standards of the FPA. No seller can have a reasonable expectation of a right to recover unjust and unreasonable rates.⁴

The FPA imposes an affirmative obligation on the Commission to ensure that customers do not pay unjust and unreasonable charges when they purchase jurisdictional services from public utilities. As several courts have recognized, market-based pricing can be a just and reasonable alternative to traditional cost-of-service regulation, provided that the interplay of competitive forces ensures that markets are at least workably competitive, or that regulatory mechanisms are in place to mitigate any market power that might arise in markets that are not workably competitive.⁵ Each departure from cost-based rates must, however, be “found not to

³ *Exxon Co., U.S.A. v. FERC*, 182 F.3d 30, 49 (D.C. Cir. 1999), quoting *OXY USA, Inc. v. FERC*, 64 F.3d 679 (D.C. Cir. 1995) and *Natural Gas Clearinghouse v. FERC*, 965 F.2d 1066, 1075 (D.C. Cir. 1992).

⁴ The Commission should, however, set a reasonable limit on the timeframe during which action can be taken pursuant to the proposed tariff amendment.

⁵ See, e.g., *Elizabethtown Gas Co. v. FERC*, 10 F. 3d 866, 870 (D.C. Cir. 1993) (“when there is a competitive market the FERC may rely upon market-based prices . . . to ensure a ‘just and reasonable’ result.”) (emphasis added).

be unreasonable and consistent with the Commission's [statutory] responsibility."⁶ In cases where this standard has not been met, courts have held that market-based charges are unjust and unreasonable and required the Commission to find a just and reasonable means of establishing prices.⁷

The Commission has acknowledged that market-based pricing is only permissible when competitive market forces or adequate regulatory back-stops are in place.⁸ For example, in Order No. 2000, the Commission noted that it has "a responsibility under FPA Sections 205 and 206 to ensure that rates for wholesale power sales are just and reasonable and has found that market-based rates can be just and reasonable where the seller has no market power."⁹ Similarly, in Order No. 637-A, the Commission argued that it was not required to conduct a detailed market power analysis prior to relaxing cost-based regulation in the secondary gas capacity release market but recognized that rate regulation could only be relaxed "if the

⁶ *Farmers Union Central Exchange, Inc. v. FERC* ("Farmers Union"), 734 F.2d 1486, 1502 (D.C. Cir. 1984); *cert. denied*, 469 U.S. (1984); *citing Mobil Oil*, 417 U.S. 283, 308 (1974).

⁷ *Farmers Union* at 1508-10 (rejecting Commission approval of market based rates for oil pipelines on the basis that the Commission had not supported its claim that market forces would restrain rates to just and reasonable levels.); *Farmers Union* was decided pursuant to the Interstate Commerce Act which, like the FPA, employed a justness and reasonableness standard.

⁸ *See. e.g., LG&E-Westmoreland Southampton*, 83 FERC ¶ 61,182 (1998) ("The Court of Appeals has stated that where there is a competitive market, the Commission 'may rely upon market-based prices in lieu of cost-of-service regulation to assure a 'just and reasonable result.'")

⁹ *Regional Transmission Organizations, Order No. 2000, FERC Stats. & Regs. (CCH) at ¶ 31,089 at 31,044.*

regulatory scheme itself acts as a monitor to maintain rates in the zone of reasonableness or to act as a check on rates if they are not.”¹⁰

Accordingly, in order for the Commission to fulfill its obligation to ensure that jurisdictional charges are just and reasonable, it must be able to conclude that market-based rates are driven by competitive market forces or that appropriate regulatory safeguards are in place. The Commission may properly find, upon an appropriate factual record, that rates that result from anticompetitive behavior should be subject to revision to levels that are just and reasonable.

III. Conclusion

WHEREFORE, the New York Independent System Operator, Inc. respectfully requests that the Commission consider these comments in this proceeding, and require that the proposed refund provision be included in all market-based rates tariffs.

Respectfully submitted,

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¹⁰ Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services, Order No. 637-A, FERC Stats. & Regs. (CCH) ¶ 31,099 (May 19, 2000), *slip op*, at 28.

January 7, 2002

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure 18 C.F.R. § 2010 (2001).

Dated at Washington, D.C. this 7th day of January, 2002.

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