IN THE
UNITED STATES COURT OF APPEALS
FOR THE
DISTRICT OF COLUMBIA CIRCUIT

No. 03-1228

EDISON MISSION ENERGY, INC.
AND
EDISON MISSION MARKETING & TRADING, INC.,
Petitioners,
v.
FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR PANEL REHEARING OF NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

INTRODUCTION

Intervenor, New York Independent System Operator, Inc. ("NYISO"), petitions the Court for rehearing and clarification of the scope and nature of the relief granted by the Court in its January 14, 2005, opinion.[1]

The sole issue preserved and argued on appeal by the Petitioners, Edison Mission Energy, Inc. and Edison Mission Marketing & Trading, Inc. ("Edison Mission"), was the application of the NYISO's Day-Ahead Market ("DAM") Automated Mitigation Procedures ("AMP") in the area outside of New York City (the "rest-of-state" area). Accordingly, the NYISO requests that the Court clarify, or grant rehearing to clarify, that the relief ordered in its January 14 Opinion applies only to approval by the Federal

[1] *Edison Mission Energy, Inc. v. FERC*, 394 F.3d 964 (2005) ("January 14 Opinion") (see Addendum for copy).

Energy Regulatory Commission ("FERC" or the "Commission") of the rest-of-state DAM AMP, and not to the Commission's orders in their entirety.[2]

In addition, the NYISO respectfully submits that the Court should not reverse or vacate in addition to remanding, because the Court misapprehended critical record evidence assertedly supporting the arguments of the Petitioner, Edison Mission. Properly understood, the record does not show that the orders under review[3] meet the standards for reversal or vacatur, and vacatur would have potentially unfair and disruptive consequences.

In seeking rehearing and clarification, the NYISO does not request the Court to alter its conclusion that the Commission's orders should offer a more detailed explanation of its reasons for accepting the NYISO's AMP. The NYISO does respectfully submit, however, that the January 14 Opinion misapprehended the record in three critical respects, and that properly understood, the record does not warrant vacatur or reversal as well as remand. Because this Court has "commonly remanded without vacating an agency's rule or order where the failure lay in lack of reasoned decisionmaking . . . but also where the order was otherwise arbitrary and capricious . . .,"[4] for the reasons set

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[2] The NYISO supports the arguments in the Petition for Panel Rehearing of Consolidated Edison Company of New York, Inc., *et al.*, ("Consolidated Edison Petition") showing that the rehearing request of Edison Mission to the Commission and the issues Edison Mission requested this Court to review were limited to the rest-of-state DAM AMP. As stated in the Consolidated Edison Petition, there is no basis for the Court's relief to reach any other aspects of the Commission's orders.

[3] *New York Independent System Operator, Inc.* 99 FERC ¶ 61,246 (2002) ("Initial Order"), JA 443-62; *New York Independent System Operator, Inc.*, 103 FERC ¶ 61,291 (2003) ("Rehearing Order"), JA 490-96.

[4] *Int'l Union, United Mine Workers of America v. Fed. Mine Safety & Health Admin.*, 920 F.2d 960, 966-67 (D.C. Cir. 1990) (citations omitted); *Massachusetts v. NRC*, 924 F.2d 311, 336 (D.C. Cir.), *cert. denied*, 502 U.S. 899 (1991) (Court will "remand without vacating an agency's order where the reason for the remand is a lack of reasoned decisionmaking."); *Engine Mfrs. Ass'n v. EPA*, 20 F.3d 1177, 1184 (D.C. Cir. 1994) (remanding without vacatur where "the agency's error

forth below the Court should exercise its discretion to remand the orders under review, with clarification as to the scope of the remand, for further consideration in accordance with the Court's opinion.

ARGUMENT

A. The Court Should Clarify that the Scope of the January 14 Opinion is Limited to the Rest-of-State DAM AMP, the Only Issue Raised on Appeal

The Commission orders giving rise to the January 14 Opinion approved "a comprehensive market mitigation plan, which included the AMP."[5] In addition to continuing the rest-of-state DAM AMP, the NYISO's comprehensive filing made a number of additional changes and improvements in the NYISO's measures for mitigating market power, including in particular, extensive changes to the market power mitigation measures used in New York City that the NYISO had inherited from the Consolidated Edison Co. of New York.[6] On appeal to this Court, however, Edison Mission's objections to the comprehensive plan were limited to rest-of-state AMP, which under the compliance filing[7] applied only to the DAM.[8] No other issues were briefed or argued.[9]

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was one of form and not of substance, *i.e.*, that it will be able to provide the information necessary to explain its cost allocation decisions").

[5] January 14 Order at 967.

[6] Initial Order at 62,039-40 (2002), JA 447-48.

[7] *New York Independent System Operator, Inc.*, Compliance Filing of the New York Independent System Operator, Inc. Regarding Comprehensive Market Mitigation Measures and Request for Interim Extension of Existing Automated Mitigation Procedure, Docket Nos. ER01-3155-000, ER01-1385-001, EL01-45-001 (Mar. 20, 2002) ("NYISO Compliance Filing"), JA 37-261.

[8] Edison Mission Initial Brief at 2; *New York Independent System Operator, Inc.*, Request for Rehearing by Edison Mission Energy, Inc. and Edison Mission Marketing & Trading, Inc., Docket Nos. ER01-3155-002, *et al.*, at 20, 21 (July 1, 2002), JA 482, 483.

[9] *Time Warner Entm't Co., L.P. v. FCC*, 93 F.3d 957, 964 (D.C. Cir. 1996) (stating that "the court generally does not consider issues that are not raised in the parties' briefs . . ."); 16A Charles Alan Wright, Arthur R. Miller & Edward H. Cooper, Federal Practice and Procedure: Jurisdiction § 3974.1 (3d ed. 1999).

Consequently, under the Federal Power Act and the decisions of this Court, the Court did not have jurisdiction under the Federal Power Act to consider issues for which rehearing was not sought.[10]

The remedial statements in the January 14 Opinion, however, do not by their terms distinguish between the rest-of-state DAM AMP and the other dimensions of the Commission's orders that were not preserved for, nor briefed nor argued, on appeal. Accordingly, the NYISO respectfully requests that the Court clarify, or grant rehearing to clarify, that any relief granted in the January 14 Opinion is limited to the Commission's conclusions with respect to the portions of the comprehensive filing relating to the rest-of-state DAM AMP.

B. The Court Should Remand Without Vacatur or Reversal

1. The Orders Under Review Do Not Meet the "Deficiency" Standard for Vacatur

This Court has held that: "The decision whether to vacate depends on 'the seriousness of the order's deficiencies (and thus the extent of doubt whether the agency chose correctly) and the disruptive consequences of an interim change that may itself be changed.'"[11] The NYISO respectfully submits that, for the reasons set forth below, the January 14 Opinion significantly misapprehends and overstates the nature and extent of any deficiencies in the Commission's orders. Furthermore, the January 14 Opinion did not find, nor have any basis for finding, that the Commission lacked legal authority to

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[10] 16 U.S.C. § 8251(b) (2000) (stating that "[n]o objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do"); *see also Canadian Ass'n of Petroleum Producers v. FERC,* 308 F.3d 11, 15 (D.C. Cir. 2002) (finding that the Court did not have jurisdiction to consider issues not raised on rehearing); *Kelley ex rel. Mich. Dep't Natural Res. v. FERC,* 96 F.3d 1482, 1489 (D.C. Cir. 1996) (same).

[11] *Allied-Signal, Inc. v. NRC,* 988 F.2d 146, 150-51 (D.C. Cir. 1993) (quoting *Int'l Union, UMA v. FMSHA,* 920 F.2d 960, 967 (D.C. Cir. 1990)).

approve market power mitigation measures like the AMP, such that no set of facts would render an AMP appropriate.[12] While the Commission's orders may warrant further explanation or other action consistent with the January 14 Opinion, properly understood they are not so deficient as to warrant reversal or vacatur. The Court should therefore exercise its discretion to remand these issues to the Commission for further consideration and an opportunity to remedy any defects in its orders, without imposing a flawed predetermination of the validity of the rest-of-state AMP.

2. The Penalty Provisions of § 4.3 of Attachment H Do Not Apply to the AMP and Thus Could Not Cause the AMP to Inhibit Legitimate Scarcity Price Increases

In the January 14 Opinion, the Court stated: "Even though the AMP was not triggered, Klein plausibly—and without contradiction—attributed that to generators' awareness of the AMP and anxiety to avoid the effect of its rather serious penalty provisions."[13] The Court cites § 4.3 of Attachment H of the NYISO's Market Administration and Control Area Services Tariff ("Services Tariff") for "details of the penalty provisions."[14] This is not correct. The provisions of § 4.3 do not apply to the AMP. The AMP applies only to *economic* withholding, while § 4.3 sets forth the penalties for *physical* withholding, that is, not submitting a bid at all, or misrepresenting the physical characteristics of a unit:

> The NYISO shall impose financial penalties as provided in this section 4.3, if the NYISO determines in accordance with the thresholds and other standards specified in this Addendum A that; (i) a Market Party has engaged in physical withholding, including providing the NYISO false information regarding the derating or outage of an Electric Facility; or (ii) a Market Party has failed to operate a generating unit in conformance with NYISO dispatch instructions, and such conduct has caused a material

[12] *Compare Atlantic City Elec. Co. v. FERC,* 329 F.3d 856 (D.C. Cir. 2003).

[13] January 14 Opinion at 968.

[14] *Id.*

> increase in one or more prices or guarantee payments in a New York Electric Market administered by the NYISO; or (iii) Load Serving Entity has been subjected to a Penalty Level payment in accordance with section 4.4 below.[15]

The AMP by its terms can only be triggered by changes in bids that cross the thresholds specified in the "conduct" test. The AMP accordingly only applies to *economic* withholding, defined in Attachment H, § 2.4(a)(2), as "submitting bids for an Electric Facility that are unjustifiably high so that (i) the Electric Facility is not or will not be dispatched or scheduled, or (ii) the bids will set a market clearing price."[16] There is no basis in Attachment H for applying the penalties in § 4.3 to economic withholding, and no suggestion in the record that a § 4.3 penalty has ever been found applicable to economic withholding. Indeed, neither Mr. Klein nor EME cite § 4.3. To the contrary, the only consequence of mitigation under the AMP is that a bid increase indicative of market power would be replaced by a default bid at the level of a unit's bids under competitive conditions.[17] The Court erred in applying § 4.3 to the AMP. As a result, the Court erred in adopting Mr. Klein's hypothesis that generators' anxiety over the serious penalties under § 4.3 cause them to underbid in order to avoid triggering the AMP, so that the AMP inhibited prices from rising to legitimate scarcity levels. By the same token, the Commission's reasoned decision not to accord the weight to the Klein affidavit that the Court apparently did does not render the Commission's orders so deficient as to warrant vacatur.

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[15] NYISO's Compliance Filing, JA 156.

[16] NYISO Compliance Filing, JA 145; *see also* NYISO Compliance Filing, Services Tariff, Attachment H, § 3.2.2(b), JA 153 (specifying that the automated mitigation procedures apply to bids).

[17] NYISO Compliance Filing, Services Tariff, Attachment H, §§ 4.2.1 and 4.2.2(d), JA 154-55.

3. The Commission Did Conclude, with Record Support, that the AMP Differentiates Between Bids Due to Scarcity and Bids Due to Market Power

The Court erred in finding that the Commission did not claim that "conduct-impact tests somehow differentiated between bid increments due to scarcity and ones due to market power."[18] In the Initial Order, the Commission expressly reiterated its finding in its November 27, 2001[19] order that "the AMP appropriately attempts to distinguish between market power and scarcity."[20] In its November 27 Order, the Commission plainly found that: "Our review of the AMP indicates that it appropriately attempts to distinguish between market power and scarcity."[21] The record also shows that the Commission was presented with evidence showing that the AMP distinguished between scarcity prices and exercises of market power. Specifically, in his affidavit, Dr. Patton testified that:

> Importantly, during the highest load periods when prices were close to $1000 due to legitimate shortages of supply, the AMP did not result in any mitigation. This is a direct result of using the conduct-impact framework, which generally precludes mitigation when the system is in shortage. . . . [T]he mitigation measures are designed to address cases when withholding causes the energy market to produce shortage prices when the system is not in shortage.[22]

Dr. Patton also testified that, with appropriate reference levels, the conduct test underlying the AMP "is a key for differentiating between scarcity and market power for purposes of mitigation . . . ."[23] Moreover, as shown above, the Court's conclusion that

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[18] January 14 Opinion at 968.

[19] *New York Independent System Operator, Inc.*, 97 FERC ¶ 61,242 (2001) ("November 27 Order"), JA 628-33.

[20] Initial Order at 62,037, JA 445.

[21] November 27 Order at 62,098, JA 633.

[22] Patton Affidavit ¶ 101, JA 244.

[23] Patton Affidavit ¶ 14, JA 220.

the AMP inhibits prices from rising to legitimate scarcity levels was based on a faulty reading of § 4.3 of Attachment H to the NYISO's Services Tariff. In short, the record shows that the ability to distinguish between scarcity and market power was a key factor in the Commission's approval of the AMP. Because the Commission addressed the issue of whether the AMP differentiated between scarcity and market power prices, and had before it record evidence squarely on point, a remand for such further explanations as may be warranted, rather than vacatur, is the appropriate remedy.

4. The Court Erroneously Relied Upon EME's Citation to a Document that was Not an Affidavit, Was Not Before the Commission or the Court, and Does not Address Structural Market Power Conditions in New York Electricity Markets

The Court states that FERC does not "take issue with Edison Mission's contention that the New York power market outside New York City is 'workably competitive.'"[24] In support of this finding, the Court states: "Before the Commission, Edison Mission pointed out that an affidavit of the NYISO's own expert, Dr. David B. Patton, acknowledged such competition."[25] The document cited in Edison Mission's Protest, however, is not an affidavit.[26] Rather, it is a PowerPoint presentation by Dr. Patton to the NYISO Management Committee ("Presentation"),[27] summarizing Dr. Patton's 2001 Annual Report on the New York Electricity Markets ("2001 Annual Report") dated June 2002.[28] Moreover, this document was not submitted to the Commission with the Protest of Edison Mission,[29] and it was not filed by any other party in the docket that is the

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[24] January 14 Opinion at 968.

[25] *Id.*

[26] Edison Mission Protest at 26, 26 n.83, JA 287.

[27] Copy available at: http://www.potomaceconomics.com/serv02.htm

[28] Copy available at: http://www.potomaceconomics.com/serv02.htm

[29] *See* Edison Mission Protest, JA 262.

subject of this appeal. It was thus not before the Commission in the dockets for the orders under review, nor does it appear in the Joint Appendix in this appeal.[30]

If the PowerPoint presentation and the full report on which it is based had been made available for examination by the Commission and Court as part of the record, it would have been clear that they would not support a conclusion that the structure of the New York electricity markets obviates the need for the AMP, as suggested by EME. While both the Presentation and the full report provide graphs and other summaries of price and other New York market statistics for 2001, and analyze the *conduct* of market participants in 2001, neither provides any analysis of *structural* market conditions in the New York electricity markets. Neither assesses market shares, concentration levels, or other factors bearing on a structural market power analysis.[31] Neither provides any basis for concluding that the market structure is sufficient to provide assurance against any future market power abuse, particularly in a non-switched network industry with no inventory such as electricity, where market conditions can change very rapidly. To the contrary, as the January 14 Opinion notes, "the Commission can obviously use a definition of workably competitive that allows for occasional exercises of market power," and Dr. Patton's conclusion in his full 2001 Annual Report confirms that this is precisely the sense in which he used the term: "The markets remained workably competitive, *with limited instances of significant withholding or other strategic conduct.* The New York

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[30] Dr. Patton's Presentation was filed with the Commission in Docket No. AD02-19-000, on June 26, 2002. The Commission's Order on Compliance Filings in the dockets under review was issued on May 31, 2002. *See* Initial Order, JA 443.

[31] *See generally* 1992 Dept. of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, http://www.ftc.gov/bc/docs/horizmer.htm.

ISO's ('NYISO') market power mitigation measures were sufficient to address these instances."[32]

As pointed out in the brief of the Intervenors in support of the Commission, any submission on structural market conditions would have been beyond the scope of the Commission's November 27 Order giving rise to the NYISO's Compliance Filing that was the subject of the orders now under review.[33] Examination of the November 27 Order makes clear that: "FERC did not direct the NYISO or any party with market-based rates to submit new versions of the structural market power studies that were submitted in support of the original request for market-based rates."[34] Issues as to structural market power in New York were decided in the Commission's orders authorizing the use of market-based rates, and conditioning the use of those rates on effective measures to deal with the potential for exercises of market power notwithstanding a sufficient degree of market competitiveness under most conditions to justify market-based rates.[35] Accordingly, neither EME nor any other party submitted, nor should have submitted, any analysis of structural market power conditions in New York electricity markets, let alone evidence supporting a conclusion that structural market conditions were sufficient to deter strategic conduct and thus preclude any need for market mitigation measures such as the AMP. Neither Dr. Patton's Presentation nor his 2001 Annual Report can be cited for this purpose. As a result, the document cited by EME and relied on by the Court

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[32] 2001 Annual Report, at (i) (emphasis added).

[33] November 27 Order, JA 628-33.

[34] Brief of Intervenors at 6-7.

[35] *Central Hudson Gas & Elec. Corp.*, 86 FERC ¶ 61,062 at 61,237-40 (1999).

provides no evidence of FERC's "apparent acceptance of the workably competitive character of New York power markets outside New York City."[36]

5. Vacatur Could have Significant Disruptive Consequences

The second prong of *Allied-Signal* is the potential for "disruptive consequences" from a vacatur.[37] Here, the Commission has determined that the use of market-based rates in New York must be conditioned on effective measures for dealing with the potential to exercise market power in orders that were not before the Court,[38] and as the January 14 Opinion noted, the AMP addresses the fact that market power "mitigation is not retroactive . . . ."[39] At the same time, FERC has held that sellers are entitled to receive their "full bid" if they are subjected to erroneous AMP mitigation.[40] In these asymmetrical circumstances, the Court should err on the side of not vacating the orders under review, since vacatur may leave New York ratepayers vulnerable to market power with no effective remedy, even though sellers can be made whole for faulty mitigation.[41]

In addition, relevant features of the New York electricity markets are significantly different today than they were two and a half years ago. The Court should take notice of

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[36] January 14 Opinion at 969.

[37] 988 F.2d at 150-51.

[38] *Central Hudson Gas & Elec. Corp.*, 86 FERC ¶ 61,062 at 61,237-40 (1999) (conditioning the use of market-based rates on an effective market monitoring and mitigation plan).

[39] January 14 Opinion at 966; *see also Consolidated Edison Co. v. FERC*, 347 F.3d 964 (D.C. Cir. 2003) (holding that FERC cannot act retroactively under § 205 of the Federal Power Act to remedy abuses of market power).

[40] *New York Independent System Operator, Inc.*, 95 FERC ¶ 61,471 at 62,690 n.9 (2001) (finding that "if NYISO subsequently determines that the bid was not an attempt to exercise market power, the generator will be paid its full bid").

[41] *See, e.g., Burlington Northern Inc. v. United States*, 459 U.S. 131, 141-42 (1982) (finding that "the equities favor allowing the carrier's rate to control pending a decision by the Commission, since under the Act the shipper may receive reparations for overpayment while the carrier can never be made whole after underpayment").

the fact that since the issuance of the orders under review, the Commission has approved the use of so-called "reserves demand curves"[42] and "regulation demand curves"[43] in New York, the purpose of which is to assure that in scarcity conditions that result in operating reserves or regulating capacity being used for energy, electricity prices will reflect the value of the foregone operating reserves or regulation. Thus, in addition to assurance that mitigation will only be imposed if both the conduct and the impact tests are met and remedies for erroneous mitigation, sellers now have substantial additional assurances of receiving scarcity prices that were not available at the time of the orders under review. Given the continuing evolution of the New York electricity markets, the Court should remand the orders so that the Commission can have an opportunity to deal with the Court's concerns in the context of the current market conditions, while not leaving consumers exposed to "cases when withholding causes the energy market to produce shortage prices when the system is not in shortage."[44]

CONCLUSION

Wherefore, for the foregoing reasons, this Court should reconsider the relief granted in this case. The Court should clarify that the scope of its remedy is limited to

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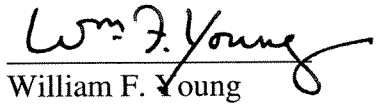
[42] *New York Independent System Operator, Inc.*, 106 FERC ¶ 61,111 at P 41-45 (2004) (stating, at P 41, that "the demand curves will ensure that the value of foregone ancillary services is appropriately reflected in energy prices during shortage periods"). "Operating reserves" refers to generating capacity held on standby "to allow utilities to produce electricity on short notice to meet load (the total demand for service on a utility system)." *Consolidated Edison*, 347 F.3d at 966.

[43] *New York Independent System Operator,* 106 FERC ¶ 61,111 at P 41-45 (approving the Regulation Service Demand Curve). Regulation Service is the "continuous balance of resources (generation and interchange) with Load . . . [and] is accomplished by committing on-line Generators whose output is raised or lowered . . . as necessary to follow the moment-by-moment changes in Load." *See* NYISO Open Access Transmission Tariff, Rate Schedule 3, Second Revised Sheet No. 251 (effective Feb. 1, 2005), *available at* http://www.nyiso.com/services/documents/filings/pdf/oatt/oatt_schedules.pdf.

[44] Patton Affidavit ¶ 101, JA 244.

the rest-of-state DAM AMP. In addition, the Court should modify its decision by deleting the direction that the Commission's orders are either reversed or vacated and remanded, and instead should remand for further consideration in accordance with the Court's directions.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that I have this 28th day of February, 2005, served the foregoing petition by first class U.S. mail to the counsel listed below.

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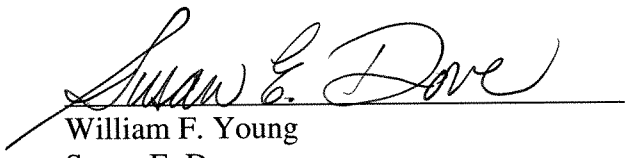

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ADDENDUM

Westlaw.

394 F.3d 964
394 F.3d 964, Util. L. Rep. P 14,541
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Briefs and Other Related Documents

United States Court of Appeals,
District of Columbia Circuit.
EDISON MISSION ENERGY, INC. and Edison Mission Marketing & Trading, Inc.,
Petitioners
v.
FEDERAL ENERGY REGULATORY COMMISSION, Respondent
Consolidated Edison Company of New York, Inc., et al., Intervenors
No. 03-1228.

Argued Oct. 18, 2004.
Decided Jan. 14, 2005.

Background: Independent power producer petitioned for review of orders of Federal Energy Regulatory Commission (FERC) permitting operator of state's bulk power transmission system to unilaterally reduce bid prices that generators and marketers submitted to sell power.

Holdings: The Court of Appeals, Stephen F. Williams, Senior Circuit Judge, held that:
(1) producer was not barred from challenging orders, and
(2) FERC did not articulate satisfactory explanation for its orders.
Reversed and remanded.

West Headnotes

[1] Electricity 11(4)
145k11(4) Most Cited Cases
Independent power producer was not barred from challenging orders of Federal Energy Regulatory Commission permitting operator of state's bulk power transmission system to unilaterally reduce bid prices that generators and marketers submitted to sell power, even though orders represented modification of prior orders that producer had failed to challenge, where new orders obviously increased likely harm to producer, as did establishment of reformed program on permanent basis.

[2] Electricity 11(4)
145k11(4) Most Cited Cases
Federal Energy Regulatory Commission (FERC) did not articulate satisfactory explanation for its orders permitting operator of state's bulk power transmission system to unilaterally reduce bid prices that generators and marketers submitted to sell power, regardless of whether price increments that were due to scarcity rather than to any exercise of market power, where producer demonstrated that conduct-impact tests under reformed program could not differentiate between bid increments due to scarcity and ones due to market power and that program would have effect of deterring suppliers from entering competitive markets, but FERC failed to attempt to refute analysis of producer's experts.
***964** On Petition for Review of Orders of the Federal Energy Regulatory Commission.

***965** Peter W. Brown argued the cause for petitioners. With him on the briefs were Richard C. Mooney and Pamela G. Van Horn.

Robert H. Solomon, Deputy Solicitor, Federal Energy Regulatory Commission, argued the cause for respondent. With him on the brief were Cynthia A. Marlette, General Counsel, and Dennis Lane, Solicitor.

William F. Young argued the cause for intervenors in support of respondent. With him on the brief were Susan E. Dove, Elias G. Farrah, Rebecca J. Michael, Neil H. Butterklee, and Edgar K. Byham. David E. Blabey, Donald K. Dankner and David P. Yaffe entered appearances.

Diane T. Dean argued the cause and filed the brief for intervenor-appellee Public Service Commission of New York.

Before: EDWARDS and RANDOLPH, Circuit Judges, and WILLIAMS, Senior Circuit Judge.

STEPHEN F. WILLIAMS, Senior Circuit Judge.

Edison Mission, an independent power producer (which we treat as one with its fellow petitioner, a wholly owned subsidiary engaged in power marketing), challenges two rulings of the Federal Energy Regulatory Commission. It says that the rulings allow the New York Independent System Operator ("NYISO") to "mitigate," i.e., unilaterally reduce, the bid prices that generators and marketers submit to sell power in New York State under conditions where, in the judgment of the Commission itself, there should be no such mitigation. Specifically, Edison Mission says that the rulings will cut back price increments that are due to scarcity rather than to any exercise of market power, and as a result will impair the growth of needed power supply. Because of the seeming inconsistency in FERC's positions, we reverse and remand the orders.

* * * * * *

The NYISO is a non-profit corporation that operates the bulk power transmission system in New York. It sells its services under tariffs filed with FERC, and administers two sets of bid-based energy markets. First is the "Day-Ahead Market," in which the NYISO derives a market-clearing price from the sellers' and buyers' price and quantity indications for the next day; sales are then made at the market-clearing price. Second is the "Real-Time Market," designed to ensure system reliability by calculating hourly clearing prices and allowing sellers to offer supplies to meet additional demand and even to revise day-ahead bids. See *Cent. Hudson Gas & Elec. Corp.*, 1999 WL 34331, 86 FERC ¶ 61,062, 61,222-23 (1999).

Under Market Mitigation Measures ("MMM") approved by FERC as part of the NYISO's Market Monitoring Plan, the NYISO has monitored the electricity markets for circumstances in which (the NYISO contends) exercises of market power, as opposed to true scarcity, drive up prices. See *New York Indep. Sys. Operator, Inc. & Consolidated Edison Co., Inc.*, 2002 WL 32035487, 99 FERC ¶ 61,246, 62,038, 62,041 (2002) ("Initial Order"). Under the MMM the NYISO has applied so-called "conduct" and "impact" screens to bids in the Day-Ahead Market. The conduct screen sifts out prices that by some amount or percentage exceed a "reference price." The latter may be based on prior bids from a unit, or some direct calculation of the unit's production costs. New York Independent System Operator, Inc., FERC Electric Tariff (Services Tariff), Attachment H, "NYISO Market Monitoring Plan" ("Attachment H") at § 3.1.4. The impact screen tests whether that price increment actually would cause market-***966** clearing prices to rise a certain amount or percentage over the price that would prevail in the event of mitigation.

Under the MMM, if the conduct and impact tests were met, the NYISO would consult with the supplier to request an explanation of any legitimate basis for the unusually high bid price. If dissatisfied with the explanation, the NYISO would mitigate the bid price to a default bid equal to the supplier's reference price. The program would then calculate the market-clearing price, using the supplier's default bid in lieu of its actual bid. But the supplier would, like all other suppliers, be paid the market-clearing price for that period. See Initial Order, 99 FERC ¶ 61,246 at 62,038, 61,041; see also Attachment H at §§ 3, 4.2.

These procedures, as promulgated in 1999 and revised in 2000, see *New York Indep. Sys. Operator, Inc.*, 1999 WL 1063780, 89 FERC ¶ 61,196 (1999); *New York Indep. Sys. Operator, Inc.*, 2000 WL 330447, 90 FERC ¶ 61,317 (2000), are dubbed "manual" because of built-in lags. (They would be more accurately labeled "less automated," as the process is not done by hand.) Under them, the NYISO has been unable to complete application of the conduct and impact tests until after the end of a given day's Day-Ahead Market. As mitigation is not retroactive, the NYISO had no remedy for high prices charged before the analysis was complete. See *New York Indep. Sys. Operator, Inc.*, 2001 WL 726735, 95 FERC ¶ 61,471 at 62,688 (2001) ("June 2001 Order"); see also *New York Indep. Sys. Operator, Inc.*, 2001 WL 1386418, 97 FERC ¶ 61,155 at 61,682 (2001) (rejecting claim for retroactive calculation of prices to compensate for high cost to consumers). In practice the NYISO evidently enforced mitigation under the "manual" scheme by cutting a supplier's price the following day, "if the bidding conduct continues and market conditions [were] expected to be similar." See May 17, 2001 letter to FERC from William F. Young, counsel for NYISO.

In 2001 the NYISO sought to amend its services tariff, pursuant to § 205 of the Federal Power Act, 16 U.S.C. § 824d, proposing to "automate" its mitigation procedures and thus be able to mitigate bids in real time rather than the following day. See *Mirant Americas Energy Marketing, L.P. v. New York Indep. Sys. Operator, Inc.*, 2001 WL 537577, 95 FERC ¶ 61,189 at 61,670 (2001). The Automated Mitigation Procedure ("AMP") differs from the manual MMM in four important respects. First, it doesn't run the conduct and impact tests at all unless the software determines that prices will exceed $150/MWh without mitigation. See Initial Order, 99 FERC ¶ 61,246 at 62,036-37. Second, when those tests are run, mitigation will occur automatically and immediately, substituting the supplier's reference prices for the bids actually made. See June 2001 Order, 95 FERC ¶ 61,471 at 62,688. Third, bid mitigation occurs if the bids of all suppliers running afoul of the conduct test would in the aggregate trigger an impact on market-clearing price, as opposed to the bidder-by-bidder analysis under the manual system. See Initial Order, 99 FERC ¶ 61,246 at 62,041. Finally, any consultation with a supplier over mitigation occurs only at the supplier's request, and most likely after mitigation has occurred.

In 2001 FERC twice approved the use of the AMP, but limited its time span because of doubts about its suitability. In approving the AMP for the peak demand of the summer season, the Commission expressed concern "that the proposed AMP may mitigate bids in situations where market power is not the cause for high or volatile bids," June 2001 Order, ***967**95 FERC ¶ 61,471 at 62,690, and "that the proposal may not provide for sufficient consultation with generators to reasonably establish that particular bids were attempts to exercise market power," *id.* It observed that "automatic market power mitigation may be most appropriate where it is tied to structural market power problems ... where generators would otherwise be in a position to name their price." *Id.* FERC later approved the NYISO's AMP plan for an additional year, while instructing the NYISO to respond to FERC's concerns that the AMP would result in "unnecessary mitigation." *New York Indep. Sys. Operator, Inc.*, 2001 WL 1497805, 97 FERC ¶ 61,242 at 62,098 (2001).

In March 2002 the NYISO filed a comprehensive market mitigation plan, which included the AMP. Edison Mission objected, arguing that outside New York City the AMP would mitigate when temporary shortages, rather than market power, caused the price hikes. This would deprive suppliers of scarcity rents and would deter new suppliers from entering the market. FERC nonetheless approved the AMP, for the first time imposing no time limit. See Initial Order, 99 FERC ¶ 61,246 at 62,052.

On Edison Mission's application for rehearing, the Commission adhered to its position, saying that Edison Mission "submit[ted] no evidence that NYISO's mitigation plan keeps prices from rising to competitive levels." *New York Indep. Sys. Operator, Inc. & Consolidated Edison Co., Inc.*, 2003 WL 21293995, 103 FERC ¶ 61,291 at 62,136 (2003) ("Rehearing Order"). The Commission also offered the theory that if the markets outside New York City were competitive, "the AMP should not be triggered and should have virtually no impact on the markets," and said that Edison Mission had "not made its case" that "the AMP will trigger during competitive conditions." *Id.* at 62,139.

* * * * * *

We first address a jurisdictional challenge by the NYISO and other intervenors on behalf of FERC. Pointing out that suppliers such as Edison Mission had for some time been subject to the MMM, and had twice been subject to temporary AMPs, they argue that the orders now before us neither impose nor threaten Edison Mission with any new harm. Alternatively, they argue that Edison Mission's claims here are simply a collateral attack on the prior MMM and temporary AMP orders, for which the time to seek review has expired. See also FERC Br. at 8; compare *New York Indep. Sys. Operator, Inc.*, 108 FERC ¶ 61,188, 2004 WL 1784385 at *4 (2004) ("August 2004 Order").

[1] These arguments are plainly inconsistent with the NYISO's reasoning in seeking the AMP--that it would tend to cure the MMM's deficiencies as a means of securing what the NYISO regarded as adequate mitigation. By enforcing mitigation far more rapidly, shifting the burden of initiating consultation from the NYISO to suppliers, and making the AMP permanent, the orders ramp up mitigation's potential effects on Edison Mission.

Granted, both the manual MMM and the two prior temporary AMPs pose the same conceptual problem as the current permanent AMP--the failure to distinguish between price increments due to scarcity (which are completely consistent with perfect competition) and ones due to exercises of market power (which are by definition inconsistent with perfect competition). But the shift to what FERC and the NYISO claimed was a more effective mitigation program obviously increased the likely harm to Edison Mission, as did establishment of the reformed program on a permanent basis. See ***968** *Competitive Telecommunications Ass'n v. FCC,* 309 F.3d 8, 11-12 (D.C.Cir.2002); *Public Citizen v. Nuclear Regulatory Comm'n,* 901 F.2d 147, 151 (D.C.Cir.1990).

[2] We thus turn to the merits, reviewing whether under standard principles the Commission's decisions were arbitrary and capricious. See 5 U.S.C. § 706(2)(A). We find that FERC did not "articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.' " *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43, 103 S.Ct. 2856, 2866-67, 77 L.Ed.2d 443 (1983) (citation omitted).

Contrary to FERC's statement in the Rehearing Order, Edison Mission offered support for its claims. In the first place, FERC appears not even to take issue with Edison Mission's contention that the New York power market outside New York City is "workably competitive." Before the Commission, Edison Mission pointed out that an affidavit of the NYISO's own expert, Dr. David B. Patton, acknowledged such competition. See Protest of Aquila Merchant Services, Inc., Edison Mission Energy Inc., and Edison Mission Marketing & Trading, Inc. of the Compliance Filing of the New York Independent System Operator, Inc. Regarding Comprehensive Market Mitigation Measures and Request for Interim Extension of Existing Automated Mitigation Procedure ("Edison Mission Protest") at 26 (citing affidavit of Dr. Patton).

The Commission's brief responds by noting that Dr. Patton plainly did not regard his statement as inconsistent with occasional exercises of market power, and a need to protect against them, as shown by his advocacy of the AMP. See FERC Br. at 28-29. This isn't much of an answer. While the Commission can obviously use a definition of workably competitive that allows for occasional exercises of market power, the presence of workable competition would suggest that many, perhaps most, possibly all, of the bids triggering mitigation will be due not to market power but to temporary scarcity. At least this would be so unless the conduct-impact tests somehow differentiated between bid increments due to scarcity and ones due to market power--which the Commission doesn't claim. This inability to distinguish presumably explains the Commission's earlier acknowledgment that "automatic market power mitigation may be most appropriate where it is tied to structural market power problems ... where generators would otherwise be in a position to name their price." June 2001 Order, 95 FERC ¶ 61,471 at 62,690.

In addition to the natural inference that in conditions of workable competition the application of a "conduct" test based on production cost would catch scarcity-based bid hikes, Edison Mission offered a plausible example. Attached to the Edison Mission Protest is the Affidavit of Abram Klein ("Klein Affidavit"), pointing out that Day-Ahead Market prices for the highest-priced six hours of August 9, 2001, a day of extreme scarcity, averaged $762/MWh, well below New York's price cap of $1,000/MWh. Klein Affidavit at 2, 7. (The price cap is an additional limit on prices, applying even if price increments are scarcity-based but where (the Commission assumes) demand is completely inelastic. See *New York Indep. Sys. Operator, Inc.,* 2001 WL 34075777, 97 FERC ¶ 61,095, 61,496 (2001)). Even though the AMP was not triggered, Klein plausibly--and without contradiction--attributed that to generators' awareness of the AMP and anxiety to avoid the effect of its rather serious penalty provisions. Klein Affidavit at 7; for details of penalty provisions, see Attachment H at § 4.3.

***969** If prices are suppressed in a competitive market, a natural inference is that suppliers who could otherwise profitably enter will be deterred from entry. Certainly FERC offered nothing to contradict the analyses to that effect offered by Klein and by Dr. Larry E. Ruff. See Affidavit of Larry E. Ruff ("Ruff Affidavit") at 7; Klein

Affidavit at 3; see also Edison Mission Protest at 27-31. [FN1] In addition, Edison Mission pointed to statements by the NYISO's chief executive officer warning that "New York remains headed towards a very serious power shortage." *Id.* at 34.

> FN1. We note with dismay that Edison Mission's briefs, though often referring to the specific points made in the Klein and Ruff affidavits, virtually never do us the courtesy of citing the relevant pages. Such a violation of Rule 28(a)(9)(A) of the Federal Rules of Appellate Procedure is sanctionable under Rule 46(c).

FERC responded to Edison Mission's concerns with vague generalities. It summarized the arguments of both parties and then perfunctorily concluded that the NYISO had the better argument--with little or no further explanation. See, e.g., Initial Order, 99 FERC ¶ 61,246 at 62,041-42 ("We accept NYISO's contention that review of bids individually in the AMP is impractical if not impossible to implement and therefore will not require the changes requested by intervenors."). Nowhere did it seriously attempt to refute the analysis of Edison Mission's experts. And nowhere did FERC try to reconcile its embrace of the AMP here with its apparent acceptance of the workably competitive character of New York power markets outside New York City, or with its earlier apparent view that the AMP was too strong medicine for markets without material structural defects. Finally, one of its arguments for denying relief--the suggestion that if the markets outside New York City were competitive, "the AMP should not be triggered and should have virtually no impact on the markets," Rehearing Order, 103 FERC ¶ 61,291 at 62,139--appears simply to deny that scarcity can have an impact on competitive market prices.

The AMP may well do some good by protecting consumers and utilities against price increments caused by the exercise of market power. But the Commission gave no reason to suppose that it does not also wreak substantial harm--in curtailing price increments attributable to genuine scarcity that could be cured only by attracting new sources of supply. "[T]he crucial question--one the Commission left unaddressed--is whether the program FERC approved will do more good than harm." *Maryland People's Counsel v. FERC,* 761 F.2d 780, 788- 89 (D.C.Cir.1985) (internal citation and quotation marks omitted). And the Commission's contradiction of its prior rulings acknowledging the potential ill effects of forcing down prices absent structural market distortions is the epitome of agency capriciousness. See *Motor Vehicle Mfrs. Ass'n,* 463 U.S. at 57, 103 S.Ct. at 2873-74.

FERC finally defends the orders by arguing that they only "allow[ed] the AMP to remain in effect for a limited period" while the Commission gathered additional real-world data about how the AMP operates, evidently through a report that FERC required the NYISO to file by December 2, 2004. FERC Br. at 35; see also Rehearing Order, 103 FERC ¶ 61,291 at 62,139 ("The Commission did not accept AMP as a permanent measure."). This claim of limited duration appears based on FERC's promise to reconsider the AMP in the future; but that leaves the AMP to operate with as unlimited a time span as any rule that an agency may reconsider at ***970** a later date--i.e., all agency rules except for ones that really are temporary.

The Commission's orders are vacated and the case remanded.

So ordered.

394 F.3d 964, Util. L. Rep. P 14,541

Briefs and Other Related Documents (Back to top)

. 2004 WL 1588385 (Appellate Brief) Joint Brief of Intervenors on Behalf of Respondent (Jul. 14, 2004)Original Image of this Document (PDF)

. 2004 WL 1696724 (Appellate Brief) Final Brief Of Intervenor-Appellee Public Service Commission Of The State Of New York (Jul. 14, 2004)Original Image of this Document with Appendix (PDF)

. 03-1228 (Docket)
(Aug. 04, 2003)

END OF DOCUMENT

CERTIFICATE AS TO PARTIES

The parties before the Federal Energy Regulatory Commission are those listed below.

AES Eastern Energy, L.P.
Aquila Merchant Services, Inc.
Arthur Kill Power LLC
Astoria Gas Turbine Power LLC
Central Hudson Gas & Electric Corporation
City of New York
Consolidated Edison Company of New York, Inc.
Constellation Power Source, Inc.
Duke Energy North America, LLC
Dynegy Power Marketing, Inc.
Edison Mission Energy, Inc.
Edison Mission Marketing & Trading, Inc.
Electric Power Supply Association
HQ Energy Services
Independent Power Producers of New York, Inc.
KeySpan-Ravenswood, Inc.
LIPA
Member Systems of the New York Power Pool
Mirant Americas Energy Marketing, LP
Mirant Bowline, LLC
Mirant Lovett, LLC
Mirant New York, Inc.
Mirant NY-GEN, LLC
Morgan Stanley Capital Group, Inc.
Multiple Intervenors
National Grid - USA
New York State Attorney General's Office
New York State Consumer Protection Board
New York State Electric & Gas Corporation
New York Sate Public Service Commission
NRG Power Marketing, Inc.
Power Authority of the State of New York
PP&L EnergyPlus, LLC
PSEG Energy Resources and Trade LLC
Reliant Energy Power Generation, Inc.
Rochester Gas and Electric Corporation

The Petitioners in this Court are listed below:

Edison Mission Energy, Inc.
Edison Mission Marketing & Trading, Inc.

The Respondent is the Federal Energy Regulatory Commission ("FERC").

The parties who have moved to intervene in this proceeding are:

Central Hudson Gas & Electric Corporation
Consolidated Edison Company of New York, Inc.
LIPA
Morgan Stanley Capital Group, Inc.
New York Independent System Operator, Inc.
New York State Public Service Commission
Orange & Rockland Utilities, Inc.
Power Authority of the State of New York

Respectfully submitted,

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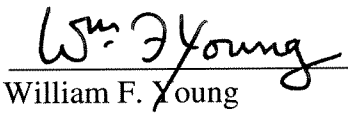
Dated: February 28, 2005

CORPORATE DISCLOSURE STATEMENT

The New York Independent System Operator ("NYISO") is a New York not-for-profit corporation formed under New York law. Although it does not own or control any electric power generation facilities, it possesses operational control over the transmission facilities in New York. The NYISO is the independent body responsible for providing open access transmission service, maintaining reliability, and administering competitive wholesale electricity markets in New York. The NYISO is not a publicly-held company. No parent company or publicly held company has a 10% or greater ownership in it.

Respectfully submitted,

By: 

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