UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New York Independent System Operator, Inc.	**)**	**Docket No. RM00-7-000**
	)	**(Bill Number M2E20248)**

REQUEST FOR REHEARING

OF NEW YORK INDEPENDENT SYSTEM OPERATOR, INC.

On July 15, 2002, the Federal Energy Regulatory Commission (the "Commission") issued an invoice to the New York Independent System Operator, Inc. ("NYISO") for $6,234,908, representing the NYISO's share of the Commission's annual electric program charges. This amount, coupled with contemporaneous billings to individual New York utilities, represents a remarkable increase of over 400% versus the prior year's assessment to New York utilities. The July 15 bill is erroneous in both its specific allocation to the NYISO and in the legal and policy assumptions on which it is based. The new methods the Commission employed to compute the 2002 bill, as demonstrated by the bills that have been issued, do not, therefore, meet the "fair and equitable" standard required by statute. Accordingly, the NYISO seeks rehearing of the bill pursuant to the instructions stated on the bill and Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713.[1]

I. INTRODUCTION

The Omnibus Budget Reconciliation Act of 1986[2] ("Budget Act") requires the Commission to assess annual charges under a method that it determines to be "fair and equitable." The Budget Act also requires the Commission to establish its allocation procedure through a rulemaking, to ensure transparency to the public of the "fair and equitable" determination.[3]

The July 2002 assessments represent the first cycle of bills under new regulations adopted by the Commission in 2000 in response to this mandate. As documented by the 2002 assessments themselves, the Commission has significantly revised the basis for apportioning its electric program costs among public utilities.[4] The revisions adopted in Order No. 641 reflect an entirely new approach to the Commission's apportionment of electric program costs. Prior to 2002, the Commission used a formula that took into account *both* major categories of jurisdictional transactions: interstate wholesale sales *and* transmission services. In Order No. 641, however, the Commission declared that regulating the wholesale power market was becoming an insignificant part of its workload; the discipline of the marketplace was essentially supplanting the need to exercise wholesale regulation under the Federal Power Act ("FPA"). The Commission instead allocated electric program costs entirely on the basis of reported transmission service volumes.[5]

With respect to Independent System Operators ("ISOs"), the Commission made three additional, critical rulings. First, it determined that it would look to the ISO -- rather than transmission owners whose assets the ISO operates -- as the "public utility" that would report transmission volumes provided under an ISO tariff. Second, it stated that virtually all *retail sales* within ISO-served regions would be reflected in the unbundled transmission volumes reported.[6] And finally, the Commission held that ISOs would have to report transmission service physically performed by systems that had been exempt from reporting (and therefore previously exempt from Commission charges) under the prior regulations (*i.e.*, state and municipal entities and cooperatives).

A number of commenters on the Proposed Regulation protested that the changes envisioned by the Commission would unfairly and perversely shift a disproportionate share of

Commission electric program costs toward the very regions that had responded to the Commission's call for the formation of ISOs or Regional Transmission Organizations ("RTOs"). The Commission's response, discussed in more detail below, essentially was that such a shift was (a) driven by trends sweeping the industry; (b) a proper alignment of regulatory costs with benefits; and (c) not significant in absolute dollar terms. With the first set of bills now in hand, it is clear that two years ago the Commission was too optimistic in predicting minor cost shifting and premature in concluding that the new charges would be a fair and equitable representation of an evolving national electric system.

The bills resulting from the actual implementation of Order No. 641 demonstrate that the new methodology in fact produces results that are neither fair nor equitable.

Moreover, the Commission's justification for this new methodology is tainted by erroneously projected industry trends and legal precedents. Accordingly, the NYISO requests: (i) a thorough review of the inputs from the jurisdictional utilities; (ii) a reexamination of the underlying premises of the July billings and an associated reallocation of electric program costs to achieve meaningful fairness and equity in the current (and future) allocations of the Commission's program costs and (iii) a rebilling to jurisdictional utilities consistent with that analysis and reallocation.

II. SPECIFICATION OF ERRORS

1. The Commission has erred in basing the July 15, 2002 billings on data that is, in material respects, not in conformity with the Commission's Regulations, resulting in severe inequities in amounts entities such as the NYISO must pay to the Commission and charge to their customers.

2. The Commission has erred in basing the new allocation method for 2002 bills on

projections about the scope of its regulatory activities and on industry trends that have proven invalid over time, with the result that certain public utilities, such as the NYISO, have received enormous and unjustified increases in the current year's allocation of program costs. In the same time frame, jurisdictional public utilities (*i.e.*, sellers of power at wholesale) that formerly bore their fair share of Commission costs -- and continue to cause the Commission to incur substantial regulatory costs -- are allowed to avoid payment responsibility entirely.

III. REQUEST FOR REHEARING

A. The Specific Commission Cost Allocations to Public Utilities for 2002 Indicate Unacceptably Erratic Results and Significant Overcharges to the NYISO

Even a cursory review of the allocations of Commission charges to public utilities indicates significant gaps and inconsistencies in the data reported and costs assigned, to the disadvantage of the NYISO. While a comprehensive compliance audit obviously is beyond the scope of this pleading, several serious anomalies stand out.

1. Omissions. The NYISO observes that Duke Power Company (and other Duke entities), reported zero "sales"[7] for 2002. This cannot be possible. Duke Power Company must have had *some* bundled wholesale transactions with on-system or off-system wholesale customers, *some* use of its transmission system by customers seeking through-or-out wheeling, and *some* purchases and power exchanges with neighboring utilities, all of which, it would appear, would require unbundled wholesale transmission service. Under Order No. 888 principles and Order No. 641 guidelines, all such transactions would be reportable for Commission annual charge allocation purposes.[8]

2. The absence of consistency among ISOs in reported transactions. The Commission's Electric Assessment Table for Fiscal Year 2002 ("Assessment Table") distributed with the bills reveals anomalies or errors so serious as to require a complete recompilation. This

is most obvious in the case of the four jurisdictional ISOs actually operating in 2001, the year on which this July's billing is based. The Assessment Table shows allocations to the California Independent System Operator ("Cal ISO") and the NYISO of approximately $9.1 and $6.2 million, respectively. In percentage terms, the Cal ISO is bearing 13.9% of the Commission's electric program costs while the NYISO is paying 9.5% -- a total of 23.4%. To provide a yardstick for comparison, sales in 2000 to end use customers (bundled and unbundled) in New York were 142,027 GWh out of a nationwide total of 3,421,414 GWh -- or 4.2%, less than half of what the Commission's allocation of electric system costs to the NYISO would seem to indicate. The equivalent calculation for California is 7.1% of the national total.[9]

These numbers become even more incongruous when compared to those applicable to PJM Interconnection ("PJM"), which realized 262,846 GWh in sales or 7.6% of all sales nationally. PJM's 2002 Commission assessment was only about $1.7 million -- about 2.7% of the total billed. No entry at all is shown for ISO-New England (or for NEPOOL).

Adding to the ISO invoice the bills of individual public utilities in each ISO region provides a more complete comparison.[10] In New York, the billings for the state increase to about $7.0 million or 10.6% of the total charged when the separate direct bills for New York's utilities are included. Similarly, inclusion of California's individual reporting utilities increases the total for that state to $10.4 (15.9%). Thus using its current methodology and implementation plan, the Commission has assigned New York and California consumers 26.5% of its total electric program costs. Adding the bills of individual utilities in PJM's region to PJM's bills raises the total for that region to about $2.5 million, or only about 3.9% of the total program costs. The Commission billed the individual utilities in New England about $3.8 million, or 5.8% of the total.

The following chart illustrates these comparisons more completely.

Region	**Annual Charges Billing for FY 2002 (2002)**	**Share of Total Billings (%)**	**Demand (2001) (MW)**	**Regional Energy Sales (2000) (GWh)**	**Share of National Energy Sales (%)**
California	$10,442,038	15.9	41,155[11]	244,057[12]	7.1
New York	$6,959,865	10.6	30,983	142,027[13]	4.2
New England	$3,813,000	5.8	23,882	116,987[14]	3.4
PJM	$2,545,239	1.7	54,014	262,084[15]	7.7

These billings bear no rational relationship to the relative demands or energy usage in the regions or to the level of transmission service necessarily related to the level of demand or energy usage.

Such statistical discrepancies suggest profound differences in the way similarly situated entities are interpreting reporting requirements under Order No. 641. The Commission declared that virtually all energy *sold at retail* within an ISO/RTO would effectively count in the allocation formula as unbundled transmission volumes -- regardless of whether the load-serving entity was using purchased power or its own resources. While only *unbundled* retail transmission would count in the formula for loads outside ISOs/RTOs, “in the ISO or RTO context, . . . all retail transactions involve an unbundled retail transmission component."[16]

The Commission acknowledged that its new approach would result in differential treatment, depending on whether the retail loads were or were not part of an ISO/RTO. The Commission went on to explain the practical effect of this distinction:

> For example, when PEPCO takes service under the PJM tariff to serve its native load, it makes use of the entire PJM system and, as such, obtains unbundled retail transmission service from other transmission-providing members of PJM. Those transmission volumes, essentially the entire intra-ISO or RTO load, will need to be reported to the Commission…(along with the other transmission provided by the ISO or RTO, *i.e.,* essentially so-called through or export transactions) and annual charges will be assessed accordingly.[17]

Furthermore, the Commission made it clear that ISOs or RTOs would assume the transmission owners' responsibility[18] for reporting transmission transaction volumes for Commission cost allocation purposes:

> If any ISO or RTO public utility has taken over from individual public utilities the function of providing transmission service, . . . then it is the ISO or RTO public utility that will be responsible for paying annual charges, and it will be assessed annual charges based on all transmission that it provides pursuant to its tariff or rate schedule.[19]

Accordingly, the NYISO can only explain the discrepancies demonstrated in the table above as a reflection of significant industry misconception over how to implement the new regulations. While minor deviations could be tolerated and corrected in subsequent year billing adjustments, a discrepancy of this magnitude simply does not satisfy the statutory "fair and equitable" standard regardless of its source. As it now stands, New York ratepayers would be seeing a 400% increase in their responsibility for Commission costs, although the Commission's program costs increased a mere 9% from $59,716,995 in FY 2000 to $65,613,000 in FY 2001.[20] The Commission must rectify these inequities promptly.

B. The Bill to the NYISO and the Electric Assessment Table for Fiscal Year 2002 Demonstrate that the Approach Utilized in Order No. 641 Does Not Result in a Fair and Equitable Allocation.

The stated rationale for Order No. 641 may have been plausible in early 2000, when the Commission proposed the revisions and received public comment. But the forecasted industry changes that the Commission relied upon to justify the shift in its cost allocation principles have not been borne out. The Commission's predictions of the issues that would be commanding its attention have been overtaken by real events.

The Commission explained its intent in the NOPR in terms of a rapidly diminishing need to regulate the wholesale power segment of its jurisdiction, in the wake of unbundling and competition. It noted:

> With open-access transmission, functional unbundling and the rapid movement to market-based power sales rates…the time and effort of our electric regulatory program that had been devoted to reviewing cost-based power sales rates has been decreasing, and with open access transmission, power sales rates are now increasingly being disciplined by competitive market forces and less by the Commission directly. As a consequence, we believe it appropriate to assess our electric regulatory program costs solely on the MWh of electric energy transmitted…rather than, as in the past, on both jurisdictional power sales and transmission volumes.[21]

A number of commenters, including the New York transmission owners and the Cal ISO, pointed out that the Commission's approach would shift costs to the regions that had responded favorably to the Commission's restructuring and competition initiatives, especially the adoption of ISOs or RTOs. But the Commission rejected these protests, basing its conclusions on industry trends and jurisdictional constraints it perceived at the time.

In Order No. 641, the Commission repeated its observation in the NOPR about market forces disciplining wholesale prices. Then it elaborated: "As stated earlier, the Commission has been reducing its regulation of the power sale business and that trend is continuing and even accelerating. We thus believe that it is appropriate that the annual charges be borne by the entities and services on which we are now increasingly focusing."[22]

Whatever their merits then, the reasons the Commission gave for rejecting the protests are simply unsustainable today. The NYISO briefly examines each of the Commission's principal justifications below:

1. Diminished need to regulate wholesale power transactions. As noted above, the foundation of the Commission's reallocation of costs was its belief that the discipline of competitive market forces was rapidly supplanting the need for regulation. But since 2000, the trend has reversed. The Commission is now placing tremendous emphasis and resources on investigating (and curbing) electric trading and market power abuses; establishing independent market monitors for ISOs and RTOs; developing new tools for flagging market power, such as the Supplier Margin Assessment; and proposing a Standard Market Design for national application.

The Commission's responsibilities and heavy workload today are every bit as attributable to regulating wholesale power sales, markets and sellers as to ensuring open access to transmission. The perception at the heart of Order No. 641 -- that "wholesale power sales rates are now increasingly being disciplined by competitive market forces"[23] so that the Commission could devote itself mainly to transmission issues -- has proven unduly optimistic. The Commission's reallocation of 2002 program costs exclusively to transmission service remains as a flawed legacy of an erroneous prediction. Power markets and dealers are again occupying a major part of the Commission's regulatory attention but are not paying a fair share of its costs.[24]

2. Rapidly spreading retail restructuring and ISO/RTO formation. The Commission also assumed that retail restructuring -- and, consequently, retail unbundling -- would continue to develop quickly throughout the country. This was the basis for the reallocation policy adopted in Order No. 641. Such an assumption, if true, might have distributed the annual charges more

uniformly. In response to the comment that its proposal "could be unfairly prejudicial to public utilities that have unbundled their retail transmission service," the Commission stated, "The Commission notes, however, that more than half of the states are already moving, or have moved to, unbundle transmission." However, in the wake of California's difficulties in implementing retail competition, many of those states reversed direction or slowed the process.

Furthermore, the Commission is obviously expending significant time and resources addressing the prolonged and complex RTO formation processes in the many regions where ISOs or RTOs are not operational. The unfortunate and unlawful result of Order No. 641 is that the regions with operating ISO or RTOs (or that have opened up retail service to competition) are bearing a disproportionate share of the Commission's costs. Thus, ratepayers in these states are paying their own increased Commission costs *and* subsidizing regions where RTOs are at best works in progress.

3. <u>Jurisdictional constraints.</u> Several commenters urged the Commission to achieve a more balanced allocation by either *excluding* unbundled retail transmission or *including* the bundled transmission component where states had not yet offered retail access.[25] As to the latter approach, the Commission claimed that its hands were tied by its holding in Order No. 888 that "bundled retail service is not subject to Commission regulation."[26] However, the Supreme Court recently observed in an opinion affirming Order No. 888 this year that the Commission *could* regulate even the transmission component embedded in bundled retail service if it made the appropriate Section 206 discriminatory practice findings.[27] The Commission has done precisely that in explaining its recently proposed Standard Market Design program. There, it stated that the Commission "proposes to exercise jurisdiction over the transmission component of bundled retail transactions" in order to remedy undue discrimination.[28]

Clearly, the Supreme Court and now the Commission itself have rejected the very legal reason the Commission gave in Order No. 641 for rebuffing the suggestion of commenters that its electric program costs should be spread over bundled as well as unbundled retail transmission service. The Commission now intends to regulate bundled retail transmission; its extension of regulation will presumably benefit that segment of ratepayers; and an allocation of Commission regulatory costs to utilities serving them is entirely appropriate.

4. Lack of real cost impact. The Commission also deflected criticism of its reallocation and attendant cost shifting by stating that the dollars involved were not a "large sum." The Commission also explicitly assumed that any higher costs diverted to states that had ISO or unbundled retail transmission service should be offset by savings resulting from the state's reduced burden of regulating transmission. "In short," said the Commission, "what is occurring is more a shifting of costs and assessments, rather than an absolute increase."[29]

As noted earlier, the Commission annual charge billings to New York public utilities in fiscal year 2001 -- the last year the prior regulations governed -- was $1.7 million. The aggregate charges for 2002 are roughly $7 million, of which $6.2 million was billed to the NYISO. That four-fold increase, representing more than $5 million -- at the same time that the Commission's overall budget was increasing by less than 10% -- is a large sum. Moreover, the Commission's optimistic forecast of offsetting reductions in state charges for regulating transmission has not materialized. Indeed, the budget for the New York Department of Public Service, including that of the Public Service Commission, has remained relatively flat in the last four years.

IV. REMEDIES SOUGHT

The NYISO requests that the Commission undertake:

1. A thorough review of the inputs from the jurisdictional utilities that went into the compilation of the July billings, to achieve full and uniform compliance by similarly situated entities with the Commission's Order No. 641 requirements;

2. A reexamination of the underlying premises and allocation methodology that the Commission employed in developing the July billings, to achieve fairness and equity in the current (and future) allocations of the Commission's program costs;

3. A rebilling to jurisdictional utilities consistent with that analysis and reexamination.

V. COPIES OF CORRESPONDENCE

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VI. CONCLUSION

Wherefore, for the reasons provided herein, the Commission should grant rehearing with respect to the bill issued to the NYISO and should implement the remedies requested by the NYISO. Only by pursuing that approach will the bill to the NYISO be fair and equitable.

Respectfully submitted,
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August 14, 2002

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each party 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. 385.2010 (2001).

Dated at Washington, D.C. this 14th day of August 2002.

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[1] The bills state that "for the Commission to consider an argument of law or policy," the recipient of the bill must file a request for rehearing.

[2] Omnibus Budget Reconciliation Act of 1986, Section 3401, 42 U.S.C. § 7178(c).

[3] *Revision of Annual Charges Assessed to Public Utilities*, Notice of Proposed Rulemaking, 65 Fed. Reg. 5289 (February 3, 2000), FERC Statutes and Regulations, Proposed Regulation Preambles ¶ 32, 550 (2000) at 33,916 ("Proposed Regulation").

[4] *Revision of Annual Charges Assessed to Public Utilities,* Order No. 641, 65 Fed. Reg. 65757 (October 26, 2000); [1996-2000 Transfer Binder] FERC Statutes and Regulations, Regulation Preambles, ¶ 31,109 (2000). 18 CFR Part 382 ("Order No. 641").

[5] The Commission retained *bundled* wholesale sales in the reporting formula because those transactions by definition included a transmission service component. 18 CFR § 382.201. The Commission rejected arguments to also include the bundled transmission component of retail rates claiming it was jurisdictionally precluded from doing so. The NYISO questions this conclusion based on recent Supreme Court rulings (see discussion in text at footnote 28) and notes that the absence of such an allocation, in practical terms, means retail transmission volume in states that have not yet offered retail access escape any reflection in the transmission volumes on which the revised allocation is based.

[6] The Commission's explanation for this position was that all load-serving entities -- whether they are purchasing or self-supplying energy -- must take unbundled transmission under the ISO's tariff to deliver that energy.

[7] The Commission annual charges billing and tables showing company-by-company assessments use the term "sales" to denote billing units, although transmission service has superseded the combination of wholesales sales and transmission service that formerly comprised the billings.

[8] *See* Order No. 641 at 31,850.

[9] *Electric Sales and Revenue 2000,* Energy Information Administration, Table 1b. Elimination of Texas, Alaska and Hawaii from the U.S. Total would increase the New York share to 4.6%. The total without the adjustment for Texas, Alaska and Hawaii is referred to herein as the "unadjusted total." Such figures translate directly to transmission-related volumes since, as the Commission stated, virtually all energy *sold at retail* within an ISO/RTO would effectively count in the allocation formula as unbundled transmission volumes. Order No. 641 at 31,855 n. 69.

[10] The inclusion in the billing calculation of sales by marketers in prior years makes the comparison difficult since the publicly available data do not attribute the sales of a marketer to a particular region.

[11] ISO area. In 2000, the ISO area was 43,784 MW, compared to a statewide peak of 51,547 MW.

[12] *Electric Sales and Revenue 2000,* Energy Information Administration, Table 1b.

[13] *Id.*

[14] *Id.*

[15] Source: PJM Annual Report on Operations 2000 at 8.

[16] Order No. 641 at 31,855 n.69.

[17] *Id.*

[18] For some transactions, both an ISO/RTO and an individual public utility will report transmission volumes subject to an annual charge, if both provided tariff-based services. But the Commission left no room for the ISO/RTO to delegate the responsibility for reporting transmission usage and receiving assessments to individual transmission owners. Order No. 641 at 31,855.

[19] *Id.*

[20] The FY 2001 Electric Assessment Table discloses that the New York State utilities received an adjusted allocation of approximately $1.7. The comparable number for FY 2001, prior to any adjustments, is approximately $7.0 million, as noted above.

[21] Proposed Regulation at 33,920.

[22] Order 641 at 31,851.

[23] *Id.* at 31,849.

[24] Another defense for reallocation the Commission offered in Order No. 641 was that the sellers of power would end up paying the Commission annual charge *indirectly* as transmission customers. It observed: "…the Commission believes that power sellers will continue to contribute to the Commission's recovery of its electric regulatory program costs, albeit indirectly, through the cost-based transmission rates" [which would include recovery of annual Commission charges]. Order No. 641 at 31,850. However, in many regions such as New York, the load-serving entity, not the power seller, is the transmission system customer and pays the bills. In that frequent situation, the wholesaler would be insulated from Commission annual charges.

[25] Order No. 641 at 31,850.

[26] *Id.*

[27] *New York, et al. v. Federal Energy Regulatory Commission, et al.*, 122 S.Ct. 1012, 1028 (2002).

[28] *Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design*, Notice of Proposed Rulemaking, 100 FERC ¶ 61,138 (July

31, 2002) at ¶ 6 (2002).

[29] Order No. 641 at 31,851.